



RED DIAMOND
— HOME LOANS —

*Quality Control
Policy*

2018

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**INCLUDES
HMDA**

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Section 1

1.1 Introduction:

The purpose of our quality control plan is to ensure that Red Diamond Home Loans is compliant with the Texas Savings and Loan Department, along with the CFPB and any applicable federal guidelines. We also must comply with the requirements of FHA/HUD, Fannie Mae, Ginnie Mae and Freddie Mac, and our internal policies and procedures. Lastly, our QC policy is not only a teaching tool for new employees, but also a valuable review for those with experience. We will accomplish this by integrating quality control procedures into our day-to-day operations, and making sure that each employee receives annual comprehensive compliance training and testing. There will be periodic audits of a comprehensive sampling of loans post-closing, and anyone found engaged in activities that violate this quality control plan will face termination. It is every employee's responsibility to learn and understand the contents of the Red Diamond Home Loans quality control plan.

1.2 Quality Control Personnel

A. QC Officer/ BSA Officer

The Quality Control/Bank Secrecy Act Officer for Red Diamond Home Loans is Mike Rogers. The QC/BSA officer is ultimately responsible for the company's adherence to the policies and procedures set forth within form HUD-11701, this quality control plan and oversight of the day-to-day operations of this lender. On a quarterly basis, the Quality Control Officer shall submit a written report to all managers and company officers regarding the status of compliance activities and any deficiencies discovered. The QC/BSA officer will work with Senior Management to promptly correct any and all deficiencies.

i) Additional Responsibilities

It will be the responsibility of the QC/BSA Officer to ensure that:

- All employees receive and acknowledge a copy of this quality control plan;
- All in-house staff performing QC functions are properly trained and have access to current guidelines relating to operations;
- The policies and procedures outlined in this QC policy are revised as needed to reflect federal, state and investor requirements. It shall be the responsibility of the QC/BSA officer to furnish any revisions to all employees.

B. Red Diamond Home Loans Employees

It is the responsibility of every employee to act in an ethical manner, and act in the best interests of Red Diamond Home Loans. All employees are required to read the company's quality control policy and follow the guidelines therein. Employees should be proactive in their approach to compliance.

1.2 Quality Control Personnel (continued)

C. Independent Third Party:

Any independent third-party compliance/quality control company must be in accordance with HUD 4060.1, Rev-2, 7-3, B-2. It will be the responsibility of the Kelly Stephens QC/BSA officer to ensure that any third-party handling of quality control meets or exceeds CFPB and HUD requirements. Any agreement shall be in writing, and state the roles and responsibilities of each party.

D. Executive Board

The company's managers and officers are responsible for ensuring the overall effectiveness of the plan, and providing assistance to the Compliance Officer. Listed are the key responsibilities of the managers and officers:

- (1) Reviewing and approving the company's Red Flag Identity Theft Program and recommending updates or changes
- (2) Monitor changes to federal laws and mandates to ensure the company has the tools and resources to remain compliant
- (3) Providing guidance and assistance to the Compliance Officer charged with administering the program
- (4) Review audit reports and results of regulatory examinations
- (5) Review the company's response to incidents
- (6) Assess overall effectiveness on a periodic basis
- (7) Audit company QC Policies for effectiveness including: AML, Red Flags, GLBA, and SAFE Act

Red Diamond Home Loans requires management to ensure that the internal controls and procedures established under the Red Flags Identity Theft plan to be tested at least annually by internal or external auditors. Reports of these audits should be reported to the managers and officers with recommendations for corrective action.

Section 2

2.1 Loan Originators:

Loan originators must be licensed under the National Mortgage Licensing System (NMLS), and may not take an application or close a transaction until they are within the registrant's system. In addition to the annual continuing education requirements, loan originators must complete any federally required training by the CFPB. Loan originators are required to read, understand and acknowledge receipt of this quality control policy. If an originator has a question regarding any section of this policy, the QC/BSA Officer should be consulted. Lastly, loan originators are required to conduct themselves in an ethical manner that reflects the values of Red Diamond Home Loans.

2.2 Loan Applications:

Loan applications must be fully completed and signed by all borrowers and the loan originator prior to submission. Under RESPA regulations (Section 4.8), an application has been taken and a Loan Estimate (LE) must be given when the following six pieces of information have been given:

- (1) The borrower's name;
- (2) The borrower's gross monthly income;
- (3) The borrower's Social Security number (to obtain a credit report);
- (4) The property address;
- (5) An estimate of the value of the property; and
- (6) The mortgage loan amount sought.

Once an application has been taken, the loan originator may require additional information deemed necessary. However, when the six items listed above have been collected, an application has officially been taken and an LE must be issued.

A loan originator will be presumed to have relied on such information prior to issuing a LE, and cannot submit a revision unless the information changes or is later found to be inaccurate.

The loan originator cannot require the submission of supplemental documentation to verify information provided by the borrower on the application in order to issue an LE. However, a loan originator is not prohibited from using his/her own sources to verify the information provided by the borrower prior to issuing the LE.

For **table-funded transactions** (brokered loans), the [lender/investor must provide the LE](#) within three business days of receiving an application or information sufficient to complete an application. We do not provide nor create an LE on table-funded transactions. LO's may provide the borrower with a fee sheet out of our LOS to give a breakdown of fees. The lender is responsible for ascertaining whether the LE has been provided.

For **warehouse transactions** (mini-correspondent loans), Red Diamond Home Loans is considered the lender, therefore [we are responsible for issuing the LE](#) to the borrower within three business days of taking an application. Loan officers' responsibilities in regards to LE compliance include the following:

- (1) LO's are responsible to create and send the initial LE's to the borrower with 3 days of the application being taken.
- (2) LO's must ensure that "Change in Circumstance" documentation is completed and submitted to the investor,
- (3) LO's are responsible to create and send revised LE's to the borrowers.

A loan originator is prohibited from charging a borrower any fee to obtain an LE, unless the fee is limited to the cost of a credit report. For additional regulations regarding the LE, please see section 4.8 Real Estate Procedures Act – RESPA.

Lastly, an originator must be aware that whenever an application as defined under RESPA and HMDA is completed, it must be logged into your internal system so that it may be reported to HMDA. Consult your QC/BSA officer on the specifics of your system, or see section 4.13 Home Mortgage Disclosure Act – HMDA.

2.3 Loan Processing

Although processors are not required to be licensed, it's very important that they understand the loan process, lenders' requirements and Kelly Stephens' internal policies. Under new federal regulations, all employees of a lender (mortgage brokers are also included in this definition) are required to complete specified training. Processors will be required to complete this training via classroom or electronically.

Loan processors are required to read, understand and acknowledge receipt of this quality control policy. If a processor has a question regarding any section of this policy, the QC/BSA Officer should be consulted. Lastly, loan processors are required to conduct themselves in an ethical manner that reflects the values of Red Diamond Home Loans. Processors' responsibilities regarding compliance include the following:

- (1) Processors will ensure that borrowers have waived their 3-day right to wait for an appraisal to be ordered, or ensure that it is not ordered if the borrower has not waived their right to wait.
- (2) Processors need to follow all lenders' instructions on submitting loans.
- (3) Processors will ensure that all required disclosures are sent promptly, signed, dated and on file.
- (4) Processors must verify the borrower's identity.
- (5) Processors must confirm all parties to the transaction are not on the General Services Administration (GSA) list or the HUD Limited Denial of Participation (LDP) list.

While it's important to define specific duties of each employee, processors tend to be the "catch-all" for a broker/correspondent/lender; this needs to change, and should be addressed in your office as well. Compliance is a team effort, involving a number of people to review completed work and documents. The processors should be the second line of quality control checks, with the loan originator as the first, and management as the final.

2.4 Loan Closing

Although closers are not required to be licensed, it's very important that they understand the loan process, lenders' requirements and Kelly Stephens' internal policies. Under new federal regulations, all employees of a lender (mortgage brokers included) are required to complete specified training. Closers will be required to complete this training either via classroom or electronically.

Loan closers are required to read, understand and acknowledge receipt of this quality control policy. If an originator has a question regarding any section of this policy, the QC/BSA Officer should be consulted. Lastly, loan closers are required to conduct themselves in an ethical manner that reflects the values of Red Diamond Home Loans. Loan closers' responsibilities regarding compliance include the following:

- (1) Closers will ensure that all LE's are in the file, along with any change-in-circumstance documentation. Closers will ensure that the QM/ATR figures have been run on the loan, making certain that they match the final approved CD, and finalized in the *system prior to closing*.

2.4 Loan Closing (continued)

- (2) Closers need to follow all lenders' instructions on closing loans.
- (3) Closers will ensure that all required disclosures are signed, dated and on file.
- (4) Closers need to verify the borrower's identity.

The compliance responsibilities for closers and processors are very similar, because in many shops they tend to be the same people. Remember that the key items to look for are:

- Signatures are on all required documents.
- Signatures match borrowers' printed name(s).
- Documents are all dated for the same day.
- Review the borrower's ID and make sure the borrower's identity has been confirmed.
- The QM documentation/calculations have been run through Loan Origination System (LOS). This is very important, as these are date and time-stamped.

Section 3

3.1 Audits and Oversight

The QC/BSA officer is ultimately responsible for ensuring that the company adheres to the policies and procedures set forth within form HUD-11701, all applicable federal/state requirements, this quality control plan and the day-to-day operations of this lender. In conjunction with this, the company will need to conduct regular audits to insure company's compliance with this plan. Audits will be conducted according to the following guidelines, as well as guidelines set forth in other sections of this QC plan.

3.2 Audits

The purpose of this function is to select loans for detailed quality control analysis utilizing prescribed random selection procedures. The objective is to achieve the required percentage of loan reviews encompassed by the scope of the quality control program. These procedures are designed to provide an evaluation of overall loan compliance quality, based on review of a representative cross section of loans originated and purchased.

3.3 Selection

On a monthly basis, using the Closed Loan Report for the preceding month, the closed loan statistical data will be completed. This determines the required percentage of loans to be reviewed, in order to assure compliance with program objectives. A representative loan sample should be chosen from the monthly closed loan register by a third-party compliance vendor. Selection will include 10% FHA files and 10% conventional files, and will be done on a rotation basis of loan product, branch, loans officer, broker and state in which loans were originated. File selection will be done within 30 days of month end, with the review completed within 60 days of selection. Reports to management are due within 30 days of completion and no later than 90 days from the end of the month in which the loan was closed. This process should provide a sampling of all types of FHA and conventional loans originated or purchased by the company. In making the selection, high LTV loans and credit scores indicating a higher probability of default shall be the top priority. All loans that have first payment defaults or early payment defaults (first 12 months) will be audited.

3.3 Selection (continued)

The QC officer will review all audit reports after completion, and areas that contain deficiencies will be addressed by giving a copy of the report to the individual or department in which the deficiency was discovered to have occurred. The individual or department will then have 72 hours to give a written response in regards to the deficiency, and how they plan to address it so it doesn't occur again. Once the QC officer has received all written responses from either the individual or department, they will give them to senior management for review. The final reports shall include the audit report, written responses, documents reviewed, re-verifications performed, and expectations found. Final reports must be maintained for a minimum of 3 years from closing/funding date.

The quality control staff shall analyze the *Neighborhood Watch - Early Warning System* data, and identify patterns of early defaults by location, program, loan characteristics or loan originator. Commonalities among participants in the mortgage origination process must be identified to learn the extent of their involvement in problem cases. Loans involving appraisers, loan officers, processors, underwriters, etc. who have been associated with problems in the past must be included in the review sample, (HUD 4060.1, Rev-2, 7-5, C).

Loan selection for detailed quality control review is done on a random basis to include a sample of each type of loan originated. At least 10% of all loans originated or purchased must be reviewed within 90 days of funding, (HUD 4060.1, Rev- 2, 7-6, A). These guidelines must be followed for the randomly selected loan files and their quality control audit:

- A. The company will participate in all FHA loan programs including, but not limited to 203(b), 203(k), 234, and HECM programs. If the company originates/purchases between 1 and 9 of any category of FHA mortgage loans during the audit period, then at least one loan file shall be randomly selected for detailed quality control review. If the company originates/purchases 10 or more FHA mortgage loans of any category of loan, then a sampling of 10% shall be selected for detailed quality control review, (HUD 4060.1, Rev-2, 7-6, C).
- B. Alternative document loans shall be included in the sample of loan files selected for detailed quality control review.
- C. The status of all FHA loans originated/purchased by the company shall be checked on the first working day of each month via HUD's *Neighborhood Watch - Early Warning System*. All loans that go into default (i.e. become 60 days past due) within the first 6 months shall be selected for detailed review, (HUD 4060.1, Rev-2, 7- 6, D).
- D. The number of loans selected for detailed quality control review shall be increased, if appropriate, for the purpose of checking new operation procedures, increasing audits of correspondent-originated loans, and/or tracking a marked increase in exceptions received from one source.
- E. If the detailed quality control review of sample loan files reveals that fraud or the suspicion of fraud and/or patterns of deficiencies exists, and/or that a pattern of early defaults are from a specific source, the scope of quality control sampling shall be increased to 20%. This must include samples of all categories of loans for which such fraud and/or pattern(s) has

3.3 Selection (continued)

been revealed. The detailed quality control reviews of selected loan files shall be more in-depth to the extent necessary to identify the source of the problem, (HUD 4060.1, Rev-2, 7-3, F). The scope of sampling can return to normal levels when detailed quality control reviews indicate that such fraud or suspicion of fraud and/or pattern(s) have been eradicated.

- F.** A minimum of 10% of applications filed that have been rejected shall be reviewed to determine if reasons given for rejection were valid, supporting documentation is present and that ECOA requirements were met. Verify that denial letters were sent to all borrowers (see Compliance Audit section for review guidelines), (HUD 4060.1, Rev-2, 7-8, A-1).
- G.** A minimum of 10% of all conventional loans will be selected each month for a quality control audit.

3.4 Primary Quality Control Review Procedures: (contains Conventional and Government)

- A.** Verify that the loan application along with initial signed-and-dated 1003, initial disclosures, final signed-and-dated 1003 and final disclosures are in the file.
 - i)** FHA - Determine whether a face-to-face interview with the applicant was conducted prior to signing the HUD form 92900 (unless otherwise exempt, i.e. refinances).
 - ii)** Conventional – Determine whether a face-to-face interview, phone, mail or internet interview with the applicant was conducted. Face-to-face interviews must have the *Borrower Ethnicity* section completed by a loan officer – even if borrowers don't wish to furnish the information. If so, the loan officer is required to make an educated guess to the ethnicity of the borrower on face-to-face interviews.
- B.** Verify that information in the preliminary loan application, final application and all credit documents is consistent or reconciled, (HUD 4060.1, Rev-2, 7-7, A).
- C.** Verify that all areas of the application are complete. Verify that loan documents requiring signature (other than blanket verification releases) were signed by the mortgagor or employee(s) of the mortgagee only after completion; and that all corrections were initialed by the mortgagor or employee(s) of the mortgagee, (HUD 4060.1, Rev-2, 7-7, C).
 - i)** Compare the information on the handwritten application to the final typed application to determine any significant discrepancies or omissions that have not been resolved.
 - ii)** If signatures of borrowers on any part of the file do not match, send documents with discrepant signatures to applicant(s) to verify that information is accurate as shown and that signatures are authentic.
- D.** Compare name and address of the mortgagor's ID to borrowers' identification search, and employment records against loan application. Verify Social Security numbers are consistent throughout the file and have been verified by the IRS. Also verify length of employment and income data on the application to the verifications of employment or other sources. If the borrower is self-employed, receives VA benefits, retired or receives public assistance, compare the application to the supporting data obtained on the borrower's credit tax returns, or to data used by the underwriter.

3.4 Primary Quality Control Review Procedures: (continued)

- E.** Review all parties involved in the transaction are not on the LDP or GSA list.
- F.** Review the credit report for any conflicting or derogatory information, and for FHA loans verify that all debts are on the 92900 and satisfactory explanations on derogatory credit items are included. In addition, check to make sure borrowers S.S. and D.O.B. are the same as the loan application. Check report for aliases.
- G.** Determine whether outstanding judgments shown on the credit report were shown on the Form HUD-92900 (Mortgage Credit Analysis Worksheet {MCAW}) and acceptably explained in accompanying documentation, (HUD 4060.1, Rev-2, 7-7, G).
- H.** Determine that the credit report is no more than 120 days old (existing) and 180 days old (new construction) at closing.
- I.** If more than one credit report was ordered, verify that all copies of the credit report are included in the file and were also submitted with the loan package sent to HUD or the Direct Endorsement Underwriter, (HUD 4060.1, Rev-2, 7-7, F).
- J.** Review the verification of employment & deposit for completeness and conflicting or derogatory information. Determine that the resolution has been fully documented. Verify that all corrections were initialed by the mortgagor/employee. Determine whether verifications of employment, deposit or credit reports are suspect due to handling by any interested third party or the mortgagor (HUD 4060.1, Rev-2, 7-7, D).
- K.** Review that a 4506-T has been executed on the loan.
- L.** Compare mortgagor's cash assets shown on the application to the verification of deposit, and that no undocumented assets are listed in the application. Verify that any large deposits (25% or more of annual income) are documented. Verify all bank statements are no more than 30 days old from the date of closing.
- M.** Compare mortgagor's liabilities shown on the application to the credit reports and other sources, and verify that each outstanding debt listed is included on the application.
- N.** Compare cash deposits on purchase transactions (earnest money) shown on the application to the amount shown on the sales contract and the loan settlement statement. If a gift represents a significant portion of the borrower's down payment or closing costs, verify its source and documentation.
- O.** Ensure that there are sets of *both* interim and final findings in the file. Verify that a copy of the *final approval* is in the file, along with any closing conditions requested by the underwriter.
- P.** Verify that copies of the Good-Faith-Estimate and all (if applicable) Change-in-Circumstance documentation are in the file.
- Q.** Confirm borrower discount on FHA 92900.
- R.** Confirm that correct UFMIP and MIP terms were utilized. (FHA Loans) Verify that the correct M.I. coefficient was used and is correct the dollar amount. Verify the MI cert or guaranty cert is correct and in the file.

3.4 Primary Quality Control Review Procedures: (continued)

- S. Verify that the loan was processed by an employee or authorized agent of the company (loans may be processed by independent-contractor processing companies, but may not be processed by individual independent-contractor processors), (HUD 4060.1, Rev-2, 7-3, G-1).
- T. Determine whether all conflicting information or discrepancies in the application file were resolved and properly documented in writing, prior to submission of the loan for underwriting. Verify that the loan originator has included all pertinent notes, emails and supporting documentation in the file. (HUD 4060.1, Rev-2, 7-7, 1).
- U. Determine whether there are sufficient and documented compensating factors if the debt ratios exceed FHA limits on manual underwrites, (HUD 4060.1, Rev-2, 7-7, J).
- V. Re-verifications will be performed on the following items:
- Verification of Employment
 - Verification of Deposit
- W. Determine whether all conditions were cleared prior to closing, (HUD 4060.1, Rev-2, 7-7, L).
- X. Review the following for validity, proper signatures, data and agreement with other information in file:
- Gift letter signed by all parties
 - Tax returns
 - W2's/paystubs
 - Bank statements
 - VOM, VOE, VOD, VOR
 - Sale of Home documentation
- Y. Ensure that copies of the appraisal and any completion certifications are on file. Verify that the address matches the subject property and a copy of the survey is on file. Verify that the appraiser's license has not expired prior to completion of appraisal. If appraisal was transferred, be sure to include transfer request and approval.
- i) Desk reviews of the appraisal is required on all loans selected for QC audit.
 - ii) Field reviews must be performed on 10% of the loans selected for QC audit.
- Z. Determine whether the Closing Disclosure Settlement Statement (CD) was accurately prepared and properly certified.
- FHA Loans** - Assure that only FHA-allowable fees and charges were paid by the mortgagor. The CD should be compared with other relevant loan documents to determine whether the mortgagor made the required minimum investment, and whether any credits resulted in an over-insured mortgage (HUD 4060.1, Rev-2, 7-7, M).
- AA. Determine whether the loan file contains all required loan processing, underwriting and legal documents, (HUD 4060.1, Rev-2, 7-7, N).
- BB. Determine whether the seller acquired the property at the time of or soon before closing, indicating a possible property "flip" (HUD 4060.1, Rev-2, 7-7, P).

3.4 Primary Quality Control Review Procedures: (continued)

CC. Determine whether all items requiring documentation have been properly evidenced and retained in the file, (HUD 4060.1, Rev-2, 7-7, R).

DD. Verify that none of the participants in the mortgage transaction (excluding the seller of a principal residence) was debarred, suspended or under an LDP for the program and jurisdiction. Verify that the applicant was not ineligible due to a delinquent federal debt (eligibility is influenced by repayment arrangements, extenuating circumstances and the age of the debt), (HUD 4060.1, Rev-2, 7-8, C).

EE. Review all Qualified Mortgage (QM) documentation sent by the underwriter, and compare with QM and Ability-To-Repay (ATR) documentation in your LOS (Calyx). Be sure the ATR figures in your LOS are less than or equal to the figures provided by the underwriter. Lastly, be sure the QM and ATR figures in your LOS were run and match the CD *prior to closing*.

FF. Additional Documents to be audited: (if applicable)

- (1) Certificate of eligibility/ request for certificate of eligibility.
- (2) VA-related indebtedness
- (3) Bankruptcy discharge papers
- (4) Loan analysis
- (5) Notice to Veteran
- (6) Certificate of Commitment (if applicable) G. 1008
- (7) FHA prepayment notice
- (8) Homeowner's Fact Sheet
- (9) Notice to Homeowner
- (10) Interest Rate Disclosure
- (11) List parties
- (12) LDP
- (13) CAIVR's
- (14) Contingent Liability
- (15) Lead Paint Notice
- (16) 92900-WS (Attachment A)
- (17) Child Care statements
- (18) Borrower cert. and authorization
- (19) State-specific documents (i.e. 12-Day Letter on Texas Home Equity)
- (20) Notes & all Riders
- (21) Mortgage or Deed of Trust & all riders
- (22) Assignment of mortgage or MERS numbers
- (23) Survey
- (24) Initial and final Truth-In-Lending disclosures
- (25) Ensure all closing documents are signed, witnessed and notarized where applicable

3.5 HECM Audits:

A minimum of 10% of all HECMs originated and submitted to an authorized agent for underwriting/funding shall be selected for detailed quality control review. Files selected for review must be reviewed as follows:

- A.** Counseling and Referral Fees
- (i)** Verify that the homeowners received the appropriate counseling.
(HUD 4060.1, Rev-2, 7-9, C-2).
 - (ii)** Verify that any referral fees paid are reasonable for the service provided and Disclosed in the loan file, (HUD 4060.1, Rev-2, 7-9, C-2).

3.5 HECM Audits: (continued)

- B.** For each HECM file selected, verify that the following items are included in the Mortgage Credit Analysis (MCA) side of the file:
- (1)** Loan Submission Checklist/Stacking Order [FFSFC Form 248-3W]
 - (2)** Loan Officer Certification [FFSFC Form 488-3W]
 - (3)** Application Information Form [FFSFC Form 251-3W]
 - (4)** Scratch 1009 or 1003
 - (5)** Power of Attorney & Conservator documents (if applicable)
 - (6)** Counseling Certificate
 - (7)** Borrower ID
 - (8)** Customer Identification Certification [FFSFC Form 225-3W]
 - (9)** Proof of Age (birth certificate of equivalent)
 - (10)** Social Security Card (verification)
 - (11)** Alternative Contact Person(s) Form [FFSFC Form 293-3W]
 - (12)** Credit Report (tri-merge)
 - (13)** OFAC/Factual Data (Tru-Alert) (Financial Freedom supplied)
 - (14)** LDP/GSA printout
 - (15)** CAIVRS
 - (16)** Title Commitment
 - (17)** Trust Agreement (if applicable)
 - (18)** Loan Payoff letters (if applicable)
 - (19)** Death Certificate (if applicable)
 - (20)** Comparison Summary Printout of RM Option (RMA Printout)
 - (21)** Amortization Schedule (RMA print out)
 - (22)** Total Annual Loan Cost (RMA print out)
 - (23)** LE (RMA print out)
 - (24)** Required Service Provider Notice [FFSFC Form 490-3W]
 - (25)** Important Terms Disclosure (State-specific)
 - (26)** Notice of Availability of Real Estate Appraisal [FFSFC Form 527-3W]
 - (27)** The Housing Financial Discrimination Act of 1977 - Fair Lending Notice [FFSFC Form 489-3W]
 - (28)** Lead Based Paint Certification [FFSFC Form 433-3W]
 - (29)** Expected Principal Limit Disclosure HECM [FFSFC Form 601-3W] DD. Other Notification [FFSFC Form 528-3W]
 - (30)** Excessive Fee Disclosure [FFSFC Form 296-3W]
 - (31)** Tax and Insurance Disclosure [FFSFC Form 297-3W] (except Texas) GG. State Specific Disclosures (as applicable)
 - (32)** General Authorization/Bankruptcy Statement [FFSFC Form 526-3W]
 - (33)** Reverse Mortgage Advisor Disclosure [FFSFC Form 321-3W]
- C.** Property Analysis - For each HECM file selected, verify that each of the following items are included in the Property Analysis side of the file:
- (1)** Loan Submission Checklist/Stacking Order [FFSFC Form 248-3W]
 - (2)** USPS Address Verification

3.5 HECM Audits: (continued)

- (3)** CHUMS (FHA Case Number Assignment printout)
- (4)** Condo Approval (FHA Connection) (if applicable)
- (5)** Spot Condo Affidavit (if applicable)
- (6)** Copy of Legal from Title Report
- (7)** Appraisal - including:
 - First page and Grid pages of URAR
 - Addendum/Comment pages
 - Sketch
 - Subject photos
 - Comp photos
 - Location map
 - Plat map (if provided)
 - VC sheets (pages 1-5) (or Home Inspection)
 - Notice to Homebuyer
 - Limited Conditions (pages 1-2)
 - Remaining miscellaneous pages of appraisal
- (8)** Survey (if applicable)
- (9)** Flood Certification
- (10)** Hazard Insurance Policy
- (11)** Termite/Pest Report
- (12)** Contractor/Repair Bids (if applicable)
- (13)** Compliance Inspection Report (if applicable)
- (14)** Structural Engineer's Report (if applicable)
- (15)** Well/Water Test (if applicable)
- (16)** Septic Inspection (if applicable)
- (17)** Oil Tank Inspection (if applicable)
- (18)** Roof Inspection (if applicable)
- (19)** Excessive Land Certificate (if applicable)
- (20)** Hotel Transient Use Certification (if applicable)

Section 4

Section 4.10 Federal Compliance

The following sections are the heart of Kelly Stephens' compliance program. If there is ONE section you take away from this QC policy, it should be the content contained within Section 4. While the CFPB has given clear guidance on what is - and is not - considered compliance for loan officers and lenders, there continue to be areas that are not very well defined. Over time these areas will improve, but in the interim we must interpret certain rules and what they are attempting to define. If you have any questions on anything contained within the following sections, please ask your QC/BSA officer.

[Section 4.20 Fair Lending](#)

The purpose of this section is to familiarize you with the importance of Fair Lending and our company-wide commitment to support this effort. Red Diamond Home Loans has incorporated Fair Lending principles into our policies and practices. It is imperative that our employees understand Fair Lending, and demonstrate to our investors and customers our support for the fair and equal treatment to all customers. Kelly Stephens' commitment to the principles of Fair Lending extends to all aspects of our business. This includes advertising, pre-application inquiries, application processing, loan offerings, credit evaluations and customer service.

Kelly Stephens' focus on Fair Lending practices reflects its ongoing commitment to provide all clients and potential customers with equal access to credit. It is a focus that requires all of us to be aware that Fair Lending is not just the law; fair and consistent treatment of all our customers is the right thing to do, and makes good business sense.

[Section 4.21 Lending Discrimination Statutes and Regulations](#)

Fair Lending was adapted from the Interagency Policy Statement on Fair Lending issued in 1994. Fair Lending is actually a collection of regulations; each will be defined in later sections. The first section is the Equal Credit Opportunity Act (ECOA). ECOA prohibits discrimination against the protected classes listed below. This includes the checking of credit, pre-application, loan offering, rate, terms, processing and closing of any loan. As a licensed loan officer, you have a legal - and moral - responsibility to treat all clients equally. This means you must conduct your business without regard to the following:

- Race or color
- Age
- Sex
- Marital status
- Religion
- National origin
- Applicants who receive public assistance
- Any additional rights under the Consumer Credit Protection Act

It is only through our efforts that we can make certain that every applicant, potential customer and client receives fair and equal treatment.

ECOA regulations outline that the abovementioned factors may not be considered when an applicant is applying for a loan. Red Diamond Home Loans wants to take this one step further (considering the law was written 20 years ago). The company will conduct business without regard to the following:

- Race
- Age
- Creed
- Sex
- Sexual orientation
- Gender identity
- Marital status

Section 4.21 Lending Discrimination Statutes and Regulations (continued)

- Pregnancy
- Religion
- National origin
- Ancestry
- Disability
- Genetic information
- Applicants who receive public assistance
- Handicap of the clientele.

The next section, The Fair Housing Act (FHAct), was originally adopted by the Federal Reserve and then the CFPB, and is sometimes referred to as Section B of Fair Lending. Regulation B describes lending acts and practices that are specifically prohibited, permitted or required.

The Fair Housing Act (FHAct) prohibits discrimination in all aspects of "residential real-estate-related transactions," including but not limited to:

- Making loans to buy, build, repair or improve a dwelling
- Purchasing real estate loans
- Selling, brokering or appraising residential real estate
- Selling or renting a dwelling.

The FHAct also prohibits discrimination on mortgages based on the same list as ECOA. Under the ECOA, it is unlawful for a lender to discriminate on a prohibited basis in any aspect of a credit transaction, and under both the ECOA and the FHAct, it is unlawful for a lender to discriminate on a prohibited basis in a residential real-estate-related transaction. Under one or both of these laws, a lender may not, because of a prohibited factor:

- Fail to provide information or services, or provide different information or services, regarding any aspect of the lending process, including credit availability, application procedures or lending standards;
- Discourage or selectively encourage applicants with respect to inquiries about or applications for credit;
- Refuse to extend credit or use different standards in determining whether to extend credit
- Vary the terms of credit offered, including the amount, interest rate, duration or type of loan;
- Use different standards to evaluate collateral;
- Treat a borrower differently in servicing a loan or invoking default remedies;
- Use different standards for pooling or packaging a loan in the secondary market.

A lender may not express, orally or in writing, a preference based on prohibited factors, or indicate that it will treat applicants differently on a prohibited basis. A violation may still exist even if a lender treated applicants equally. A lender may not discriminate on a prohibited basis because of the characteristics of:

- An applicant, prospective applicant, or borrower;
- A person associated with an applicant, prospective applicant, or borrower (for example, a co-applicant, spouse, business partner, or live-in aide);

Section 4.21 Lending Discrimination Statutes and Regulations (continued)

- The present or prospective occupants of either the property to be financed or the characteristics of the neighborhood or other area where property to be financed is located.

Finally, the FHAct requires lenders to make reasonable accommodations for a person with disabilities when such accommodations are necessary, to afford the person an equal opportunity to apply for credit. This means that you must make a reasonable effort to assist the person in taking the application, through the loan process and closing the loan. An example might be providing an elderly couple with poor vision the application in a larger bold font.

Section 4.22 Types of Lending Discrimination

The courts have recognized three methods of proof of lending discrimination under the ECOA and the FHAct:

- Overt evidence of disparate treatment;
- Comparative evidence of disparate treatment;
- Evidence of disparate impact.

To determine if disparate treatment has been committed, an examiner must establish that the lender explicitly considered prohibited factors (overt evidence), or by differences in treatment that are not fully explained by legitimate nondiscriminatory factors (comparative evidence).

Overt Evidence of Disparate Treatment: This is overt evidence of discrimination when a lender openly discriminates and considers factors other than just creditworthiness. The easy way to remember “overt” is exactly what it sounds like; it’s obvious.

Example: A lender would only offer a 20-year-old man a mortgage up to \$75,000.00, because of his age. The lender felt he was too young, and would not meet his obligation to make payments in a timely manner.

There is overt evidence of discrimination even when a lender expresses - but does not act on – a discriminatory preference:

Example: A loan officer told a customer, “We do not like to make home mortgages to Muslims, but the law says we cannot discriminate and we have to comply with the law.”

This statement violates the FHAct’s prohibition on making statements that expressing a discriminatory preference, as well as Section 202.4(b) of Regulation B, which prohibits discouraging applicants to apply for a loan.

Comparative Evidence of Disparate Treatment: Disparate treatment occurs when a lender treats applicants differently based on one of the prohibited items listed in ECOA or FHAct. **IMPORTANT** – An examiner is not required to find proof that the discrimination was motivated by a prejudice of the loan officer/loan originator/lender, OR even that the discrimination was a conscious intention. They only need to find the difference in treatment between two borrowers. The easy way to remember “comparative” is that it’s not obvious discrimination.

Section 4.22 Types of Lending Discrimination: (continued)

Example: A heterosexual couple applied for a mortgage loan. The loan officer found derogatory information in the couple's credit report. The loan officer discussed the credit report with them and discovered the derogatory information, a judgment, was incorrect because the judgment had been dismissed. The heterosexual couple was granted their loan. A homosexual couple applied for a similar loan with the same lender. Upon discovering derogatory information in the gay couple's credit report, the lender denied the loan application without giving the couple an opportunity to discuss the report.

The last example is considered disparate treatment simply because the same assistance was not provided to both couples.

If a loan officer/loan originator/lender has treated applicants differently on similar loan transactions, the LO must provide an explanation for the difference in treatment. As we will discuss several times throughout this policy, it is imperative that the loan officer and processor take notes throughout the transaction, and save those notes within the file. If an examiner finds the explanation lacking, a decision could be made that the loan officer had discriminated.

Redlining: is another form of disparate treatment in which a lender provides unequal access to credit, or unequal terms of credit, because of the race, color, national origin or other prohibited characteristic(s) of the residents of the area in which the subject property is located.

Example: A loan originator decides the area located south of Dallas is of higher risk due to its residents being minorities. As such, any loans closed in this area will be given a higher rate than loans closed in North Dallas.

Redlining can also work in the other direction. For example, a loan officer/loan originator/lender targets a specific demographic (e.g. residents who live in North Dallas) and gives them reduced fees. This is considered disparate treatment, because one specific group enjoyed a special offer not available to all borrowers.

Lender-Paid Compensation vs. Borrower-Paid Compensation

Another form of disparate treatment could be having our lender-paid compensation set differently for each of our investors. All compensation must be the same with all our investors. In addition, if you decide to do a loan with borrower-paid compensation, you should attempt to keep the compensation similar to what the lender-paid compensation would have been. The CFPB does not give a clear definition of "similar" compensation between lender-paid and borrower-paid. If your compensation is going to differ, you must document the reason. Did the borrower show you a LE from a competitor and you had to match the deal? Did they threaten to go elsewhere? Whatever the reason, you need to document everything. Documentation doesn't necessarily guarantee protection, but it will certainly strengthen your case with an auditor.

4.23 Fair Lending - Advertising

As an equal-housing lender, Red Diamond Home Loans is required to display the Equal Housing Lender symbol in all advertisements relating to credit per ECOA. We also have to pay attention to the words, symbols and models we use in advertising our products, to represent our entire customer base. To ensure compliance, all advertising must be approved by your AML/BSA compliance officer. This includes both electronic and print media. You can view all the requirements for advertising in section 6.1.

4.24 Fair Lending – Conclusions

Meeting ECOA's requirements means applying fair and consistent treatment throughout the loan process, from the point of customer inquiry to timely notification to the customer of the credit decision - and if declined, the reason for the declination. For example, we may not discourage anyone from applying for a loan. We may not tell customers that they do not qualify at the inquiry stage, or that they should wait for a change in circumstances before they apply for a loan. We must give everyone the opportunity to apply for a loan.

ECOA does allow us, in certain situations, to request information about marital status, spousal information, child support etc., but only if it is relevant to the applicant's creditworthiness (as determined through an evaluation of his/her income, expenses, debts and credit history), and relevant to the type of credit requested.

Remember, you cannot:

- discount or disregard income of a co-applicant;
- require more or different information from similarly situated applicants;
- require an applicant to disclose receipt of alimony or child support;
- refuse to include alimony or child support as income if the applicant wishes to have such income considered (must include if regular payments have been made and will continue for at least 3 years); and
- require a co-signer if the applicant qualifies on his/her own.

You can only ask about gender, race or national origin if this information is required by the regulation for government monitoring purposes. The part you play in correctly completing loan information is critical. ECOA requirements include maintaining records of all loan applications for up to 25 months. So, what is the takeaway from all this? Exactly what the title suggested...Fair Lending. Treating all your clients the same is not just a federal regulation, it's the right thing to do.

Section 4.30 Anti-Money Laundering/Bank Secrecy Act (AML/BSA)

In years prior this topic was reserved for banking institutions, and not a topic covered by mini-correspondents. Under the CFPB's definition of loan or finance companies, brokers and mini-correspondents are considered to be lenders, and as such, must complete the same training. With that being said, suspicious activity is something all Red Diamond Home Loans employees should look for and report. The AML/BSA compliance program is intended to mitigate fraud activity when implemented, and identify activities that constitute fraud. Employees of the company are required to do one thing – report

Section 4.30 Anti-Money Laundering/Bank Secrecy Act (AML/BSA) (continued)

suspicious activity to the AML/BSA officer. If he or she agrees the activity is suspicious, then they will complete and submit a Suspicious Activity Report or SAR.

The primary objective of this program is to detect and report any suspicious transactions to the Financial Crimes Enforcement Network (FinCEN). In order to do this, the company has created a Customer Identification Program or CIP. Every single borrower that we do business with must be identified. Prior to a loan application being taken, we must collect the following requirements for our Customer Identification Program:

- Full legal name of all individuals on the loan
- Date of birth for all individuals
- Current address
- Social Security numbers or visas

If any of the items listed above do not match information provided by your applicant, then you cannot take a loan application. Explain to the applicant that until their identity can be verified, you cannot proceed with submitting the loan. For common surnames you may want to attempt to get additional information, such as a middle name or driver's license and attempt to re-verify.

If after repeating the process you still cannot verify the applicant's identity, **or** their name appears on a government list including the General Services Administration's (GSA's) or Limited Denial of Participation (LDP), confer with your AML/BSA officer (Compliance Officer) to discuss whether or not a Suspicious Activity Report should be filled.

Anti-Money Laundering

The Department of The Treasury defines money laundering as the concealment of the source of illegally obtained funds. The process of money laundering involves the filtering of funds received through illegal activities or "dirty" money through a maze or series of transactions, in an effort to "clean" these funds and make them appear to be proceeds from legitimate transactions.

This is pertinent to loan officers and originators, because FinCEN adopted the anti-terrorism rules from the Patriot Act which criminalized the financing of terrorism. These rules also augmented the existing BSA framework to strengthen customer identification procedures. Large sums of money can be laundered all at one time with a single mortgage transaction, and FinCEN wants to make sure this doesn't happen.

The following are the three primary money laundering techniques:

- **Placement:** The physical placing of cash or illegal proceeds into legitimate commerce, such as a down payment on a home or mortgage payments.
- **Layering:** The concealment of the source cash from its criminal origins by passing it through several financial transactions. An example would be the cash purchase of a home, an immediate cash-out refinance, and have the money placed into other investment vehicles.
- **Integration:** The consolidation of illegal funds with legitimately obtained funds, and providing a seemingly legitimate explanation for their ownership.

[Section 4.30 Anti-Money Laundering/Bank Secrecy Act \(AML/BSA\) \(continued\)](#)

Filing a Suspicious Activity Reports (SAR)

You are required to report suspicious activity that may involve money laundering, BSA violations or terrorist financing. In order for your AML/BSA officer to effectively complete the SAR, they will need the following information from you:

- The parties involved in the suspicious activity
- The type of transaction
- When the transaction began
- The suspicious activity you witnessed
- Why you feel the activity was suspicious
- Where and when the suspicious activity occurred
- Finally, how the suspicious activity was uncovered

Your AML/BSA officer will submit the SAR online in the event one is required. The web address for FinCEN is http://www.fincen.gov/financial_institutions/msb/. (1) You need to document any SAR decisions, including the specific reason for filing or not filing the SAR. (2) Suspicious Activity Reports must be filed within 30 days of the initial detection, and are required to be filed electronically. Information contained within the SAR must be kept strictly confidential, and should only be discussed with your AML/BSA officer and your general counsel. It's important to note that the law affords you and your company protection when filing an SAR from the applicant in question. The applicant cannot come back to sue Red Diamond Home Loans for filing an SAR. (3) If a situation seems to require immediate attention, contact the appropriate law enforcement authority right away; then file a SAR. If you have questions on filing a SAR you may also visit: http://www.fincen.gov/financial_institutions/msb/materials/en/report_reference.html

AML Red Flags

In this section we are going to give you some "Red Flags" to watch for while the application or loan is in process. The largest type of fraud affecting the mortgage industry today is identity theft. As loan officers and processors, you truly are the front line in defending against this type of fraud. The latest numbers from the Federal Trade Commission estimate that identity theft cost Americans and businesses \$2 billion in 2013. Here are indicators to watch for:

Identity Theft Red Flags

- Documents provided for identification appear to be altered or forged
- Photograph on ID is inconsistent with appearance of applicant
- Information on ID is inconsistent with information provided by applicant
- Information on ID does not match any address in the consumer report
- SSN has not been issued, or appears on the SS Administration's Death Master File
- The date of birth provided by the applicant does not match the SS number range
- Customer is unable to supply identifying information in response to notification that the application is incomplete
- Notice of a credit freeze in a consumer report

Section 4.30 Anti-Money Laundering/Bank Secrecy Act (AML/BSA) (continued)

Additional AML Red Flags

- An applicant uses unusual or suspicious identification documents that cannot be readily verified.
- An applicant provides an individual tax identification number after having previously used a Social Security number.
- An applicant uses different tax identification numbers with variations of his or her name.
- An applicant's home or business telephone has been disconnected.
- An applicant's background differs from that which would be expected on the basis of his or her business activities.
- An applicant makes frequent or large transactions.
- An applicant has no record of past or present employment experience.
- An applicant or group tries to persuade an employee not to file required reports or maintain required records.
- An applicant or company asks to be exempted from reporting or recordkeeping requirements.
- An applicant deposits funds into several different accounts, typically in amounts of less than \$3,000, which are subsequently consolidated into a single master account and transferred outside of the country. These funds are then sent to countries of specific concern (e.g., countries designated by the United States and the Financial Action Task Force on Money Laundering as non-cooperative countries and territories).

Trying to recognize and identify all the possible ways to defraud mortgage lenders would be an impossible task. What you need to take away from this – if something seems “off” with an applicant, then you need to take another look at the transaction. Here are a few examples of activities that would result in the filing of a SAR:

- **Occupancy Fraud:** Applicants attest the subject property will be their primary residence to obtain better interest rates and lower down payment requirements. In reality, the subject is actually an investment property.
- **Income Fraud:** The applicant understates their income to qualify for hardship concessions and/or loan modifications.
- **Employment Fraud:** The applicant misrepresents where and for how long they have been employed; whether they are independent contractors or business owners; whether they are actually employed or collecting unemployment.
- **Identity Theft:** The use of a SSN/TIN that belongs to someone other than themselves.

AML Testing

We will conduct annual testing of our AML program, to be performed by either an independent 3rd party who is primarily focused on PATRIOT Act compliance matters or other qualified independent 3rd party. The annual testing will include an audit of our compliance with our AML and Red Flags programs.

Section 4.40 Equal Credit Opportunity Act (ECOA) Regulation B

As discussed in Fair Lending, section 4.21, ECOA prohibits discrimination of any kind, and in any part of a transaction. This includes the checking of credit, pre-application, loan offering, rate, terms, processing

Section 4.40 Equal Credit Opportunity Act (ECOA) Regulation B (continued)

and closing of any loan. As a company, we have a legal - and moral - responsibility to treat all our clients equally. This means we must conduct our business without regard to the following:

- Race or color
- Age
- Sex
- Marital status
- Religion
- National origin
- Applicants who receive public assistance
- Any additional rights under the Consumer Credit Protection Act

In order to comply with Regulation B, Red Diamond Home Loans shall:

- Collect information about applicant's gender, marital status, age, race and ethnicity for government monitoring purposes. *** This information must be collected if the application is face-to-face or over the phone.
- Collect the applicant's current dwelling information and residency status.
- Notify applicants of any actions taken on their applications.
- Report credit histories of all applicants.
- Provide applicants with a copy of the appraisal.

A loan officer may not request information about an applicant's spouse or former spouse except under the following circumstances:

- The non-applicant spouse will be contractually liable on the account.
- The applicant is relying on the spouse's income, at least in part, as a source of repayment.
- The applicant resides in a community-property state, or the subject property is located in a community-property state. Texas is a community-property state.
- The applicant is relying on alimony and/or child support as income to obtain credit.

Adverse Action Notice - Denials

Red Diamond Home Loans must issue a written notice of denial to applicants within 30 days of the credit decision being made, and state the reason for the denial. It's important to remember that a notification of denial *must* be sent to applicants who fail to complete their application or send their required items.

Denials, also referred to as Adverse Action Notices, must include:

- Name and address of creditor (Red Diamond Home Loans)
- Action taken and date
- Reasons for action taken
- If the denial was due to credit score, the credit score information must be included regardless of any other reasons.

A credit denial must include the applicant's score, the full range of possible scores, any key factors that adversely affected the credit score, the date the report was pulled and the credit provider that issued the

Section 4.40 Equal Credit Opportunity Act (ECOA) Regulation B (continued)

score. In the case of joint applicants where the credit score of one borrower is the reason for the denial, the credit score notice may be provided only to that borrower. The co-borrower must receive a separate denial which does not include the other borrower's credit score.

Prohibited Practices

Regulation B contains two basic and comprehensive prohibitions against discriminatory lending practices:

- A creditor shall not discriminate against an applicant on a prohibited basis regarding any aspect of a credit transaction.
- A creditor shall not make any oral or written statement, in advertising or otherwise, to applicants or prospective applicants that would discourage, on a prohibited basis, a reasonable person from making or pursuing an application.

Fair Housing Act

The CFPB includes the Fair Housing Act (FHAct) in Regulation B. A civil rights law, the FHAct prohibits discrimination in the sale, rental or advertising of any residential property on the basis of race, color, religion, handicap, sex, familial status or national origin. Anyone who is in the business of selling, brokering, appraising or lending money on real property must comply with FHAct.

Red Diamond Home Loans shall not use different policies or practices in evaluating an application or loan offering to applicants based on race, color, religion, handicap, sex, familial status or national origin. The company shall not offer different interest rates, terms or loan types based on the same parameters.

Section 4.41 ECOA Disclosures

Red Diamond Home Loans will provide a statement notifying the applicant that ECOA prohibits discrimination based on race, color, religion, handicap, sex, marital status, sex, public assistance, familial status or national origin under the Consumer Protection Act. The ECOA disclosure should be given to applicants at the time of application. It should be noted that any statement or suggestion to the applicant that they should not bother to apply is a violation of ECOA. This adverse action does not even require a completed application. Management will not tolerate any form of discrimination, written or verbal; therefore loan officers found to have engaged in any discriminatory conduct will be terminated immediately.

At the time of application, Red Diamond Home Loans shall notify the applicant in writing of the right to receive a copy of any and all appraisals no later than 3 days prior to closing. The purpose of the appraisal must also be disclosed in writing. The applicant is permitted to waive the 3-day requirement. The company cannot charge a fee for providing copies of the appraisal.

Record Retention – Applications

A creditor must keep all written or recorded information connected with an application for 25 months after the date on which the creditor informed the applicant of action taken on an application or of information lacking on an application.

Section 4.50 Fair Credit Reporting Act (FCRA)

The Federal Fair Credit Reporting Act (FCRA) promotes the accuracy, fairness and privacy of information in the files of consumer reporting agencies. In 2011, the CFPB restated the FCRA regulations under its authority and was granted rule-making authority. There are a few key definitions in regard to FCRA:

Consumer Report. A consumer report is any written or oral communication of any information by a consumer reporting agency that bears on a consumer's creditworthiness, credit standing, credit capacity, character, general reputation, personal characteristics or mode of living that is used or expected to be used or collected, in whole or in part, for the purpose of serving as a factor in establishing the consumer's eligibility for any of the following:

Adverse Action. Regarding credit transactions, the term "adverse action" has the same meaning as used in the Equal Credit Opportunity Act (ECOA), and Regulation B. Under the ECOA, it means a denial or revocation of credit, a change in the terms of an existing credit arrangement, or a refusal to grant credit in substantially the same amount or on terms substantially similar to those requested.

Investigative Consumer Report. An "investigative" consumer report is a consumer report (or portion thereof) regarding character, general reputation, personal characteristics or mode of living obtained through personal interviews with neighbors, friends or associates of the consumer. However, these interviews do not include specific factual information on a consumer's credit record obtained directly from a creditor of the consumer, or from a consumer reporting agency.

Creditor. In FCRA, the terms "credit" and "creditor" have the same meanings as in ECOA.

Consumer reporting agencies have a significant amount of personal information about consumers. This information, along with the credit score, is required to determine the consumer's creditworthiness. The FCRA requires any prospective user of a consumer report (e.g. a lender, insurer, landlord or employer) to have a legally permissible purpose to obtain a report. As a lender, you have a permissible purpose to obtain a consumer report in connection with a transaction that could extend credit to the consumer. Company policy requires employees to obtain authorization from the consumer prior to obtaining consumer report.

Applicants have a right to receive a copy of their credit report, and now that email is the preferred method of communication, it's more important than ever that you safeguard all credit reports. Users should employ procedures, controls or other safeguards to ensure that credit reports don't fall into the wrong hands (see Section 5.1 for data security).

Prescreened Consumer Reports and Opt-Out Notice

If you have ever purchased leads from a lead-generation company, then you have used prescreened consumer reports and as such, there are additional regulations to follow. Sections 604(c) allow persons, including financial institutions, to obtain and use consumer reports on any consumer in connection with any credit or insurance transaction that the consumer does not initiate, and to make firm offers of credit or insurance. This process, known as prescreening, occurs when a financial institution obtains a list from a consumer reporting agency of consumers who meet certain predetermined creditworthiness criteria and who have not elected to be excluded from such lists. These lists may only contain certain information:

Section 4.50 Fair Credit Reporting Act (FCRA) (continued)

- The name and address of a consumer.
- An identifier that is not unique to the consumer, and is used solely for the purpose of verifying the identity of the consumer.
- Other information pertaining to a consumer that does not identify the relationship or experience of the consumer with respect to a particular creditor or other entity.

Each name appearing on the list is considered an individual consumer report. This means In order to use these lists, you must make a “firm offer of credit” to each person on the list. Red Diamond Home Loans is not required to grant credit if the consumer is not creditworthy, or cannot furnish required collateral, provided that the company determines the underwriting criteria in advance and applies it consistently. Red Diamond Home Loans may obtain a full consumer report on anyone responding to the offer, to verify that the consumer continues to meet the creditworthiness criteria.

If Red Diamond Home Loans uses or decides to use prescreened consumer reports, the company must maintain the criteria used for the product (including that used to generate the prescreened report and any other criteria such as collateral requirements) on file for a period of three years, beginning on the date that the company made the offer to the consumer.

Example of criteria used to generate the prescreened report: Red Diamond Home Loans requested consumers that have a 700 FICO score or higher, and who have (or have had) a mortgage listed for at least five years on their credit report.

Example of required criteria by the lender not in the prescreened report: Red Diamond Home Loans may also decide to evaluate other non-consumer report factors, in addition to those used in the prescreened list for this product. An example might be a total debt-to-income ratio (DTI) of 45% or less. The consumer reporting agency can screen some criteria such as the DTI. If a consumer responds to the offer, but has a DTI of 46%, the company is not required to extend credit.

Example of a product offering sent to consumers on the report: Red Diamond Home Loans may offer a 20-year fixed rate mortgage at 4.875% on a rate-and-term transaction with no points.

Example of collateral requirements for product offering: The offer is contingent on the borrower having at least 25% available equity in their home.

It’s important to remember that all the criteria used for purchasing prescreened reports be defined, and kept on file with the QC officer, for a period of three years. In addition, Red Diamond Home Loans is allowed to obtain a full consumer report on anyone responding to the offer to verify that the consumer continues to meet the creditworthiness criteria.

Opt-Out Requirements

The FCRA requires nationwide consumer reporting agencies to jointly operate an “opt-out” system, whereby consumers can elect to be excluded from prescreened lists by calling a toll-free number. When Red Diamond Home Loans uses these lists, it must provide consumers with a Prescreened Opt-Out Notice

Section 4.50 Fair Credit Reporting Act (FCRA) (continued)

with the offer of credit. This notifies consumers that they are receiving the offer because they meet certain creditworthiness criteria. The notice must also provide the toll-free telephone number, which is operated by the nationwide consumer reporting agencies, for consumers to call to opt out of prescreened lists.

Short and Long Notices to opt-out

Red Diamond Home Loans must provide both “short” and “long” notices of the prescreened opt-out information with each written solicitation made to consumers using prescreened consumer reports. The company must also comply with specific requirements concerning the content and appearance of these notices. The short notice must be clear, conspicuous, simple and easy to understand:

- A) Content- The short notice must state that the consumer has the right to opt out of receiving prescreened solicitations. It must provide the toll-free number, and direct consumers to the existence and location of the long notice. It should also state the title of the long notice. The short notice may not contain any other information.
- B) Form- The short notice must be in a type size larger than the principal text on the same page, but it may not be smaller than 12-point type. If a company, such as a financial institution, provides the notice by electronic means, the type size must be larger than that of the principal text on the same page.
- C) Location- The short form must be on the front side of the first page of the principal promotional document in the solicitation. If provided electronically, it must be on the same page and in close proximity to the principal marketing message. The statement must be located so that it is distinct from other information, such as inside a border. It must be in a distinct type style such as bolded, italicized, underlined, and/or in a color that contrasts with the principal text on the page, if the solicitation is provided in more than one color.

The long notice must also be clear and conspicuous, simple and easy to understand:

- A) Content- The long notice must contain the information listed below, and may not include any other information that interferes with, detracts from, contradicts or otherwise undermines the purpose of the notice.
 - i) Information contained in the consumer report was used in connection with the transaction;
 - ii) The consumer received the offer of credit or insurance because the consumer satisfied the criteria for creditworthiness or insurability under which the consumer was selected for the offer;
 - iii) If applicable, the credit or insurance may not be extended if, after the consumer responds to the offer, the consumer does not meet the criteria used for selection. Reasons for this can include creditworthiness, insurability or is unable to furnish any required collateral;

Section 4.50 Fair Credit Reporting Act (FCRA) (continued)

- iv) The consumer has a right to prohibit information contained in their file with any consumer reporting agency from being used in connection with any credit transaction that is not initiated by the consumer; and
 - v) The consumer may exercise the rights referred to in any subparagraphs.
- B) Form- The notice must appear in the solicitation, and be in a type size that is no smaller than the type size of the principal text on the same page. Solicitations provided may not be smaller than 8-point type. The notice must begin with a heading in capital letters, underlined and identifying the long notice as the “PRESCREEN & OPT-OUT NOTICE.” It must be in a type style that is distinct from the principal type style used on the same page, such as bolded, italicized or underlined. If the solicitation is multicolored, the color used must contrast with the principal text. The notice must have blank lines before and after the rest of the content, and needs to be contained inside a border.

Disclosure of Credit Scores

As a mortgage originator who uses credit scores as one of the determining factors for an applicant’s qualification, you must provide the applicant with a copy of their credit report and score. If more than a single credit report is pulled (a tri-merge) then you must provide the applicant with a copy of all three credit reports and their respective scores. This applies to all transactions.

In addition to the short and long notices we’ve discussed, there is another disclosure that must be provided to all applicants. It’s called *Notice to the Home Loan Applicant*, and it contains very specific language. That being said, we’ve included it below and a copy is on file with your QC officer.

Notice to the Home Loan Applicant

In connection with your application for a home loan, the lender must disclose to you the score that a consumer reporting agency distributed to users and the lender used in connection with your home loan, and the key factors affecting your credit scores.

The credit score is a computer-generated summary calculated at the time of the request, based on information that a consumer reporting agency or lender has on file. The scores are based on data about your credit history and payment patterns. Credit scores are important because they are used to assist the lender in determining whether you will obtain a loan. They may also be used to determine what interest rate you may be offered on the mortgage. Credit scores can change over time, depending on your conduct, how your credit history and payment patterns change, and how credit scoring technologies change.

Because the score is based on information in your credit history, it is very important that you review the credit-related information that is being furnished to make sure it is accurate. Credit records may vary from one company to another.

If you have questions about your credit score or the credit information that is furnished to you, contact the consumer reporting agency at the address and telephone number provided with this notice, or contact the lender if that entity developed or generated the credit score. The consumer reporting agency plays no part in the decision to take any action on the loan application, and is unable to provide you with specific reasons for the decision on a loan application.

If you have questions concerning the terms of the loan, contact the lender.

Section 4.50 Fair Credit Reporting Act (FCRA) (continued)

A long-form notice must include the applicant's score, the full range of possible scores, any key factors that adversely affected the credit score, the date the report was pulled, and the credit provider that issued the score. The reasons adversely affecting the credit score for the particular individual must be listed in the order of their importance, and can be found directly below the score on the credit report. You can simply cut and paste these into your notices. The total number of factors to be disclosed must not exceed four (4). However, if one of the key factors is the number of inquiries into a consumer's credit information, then the total number of factors must not exceed five (5). In the case where joint applicants' scores were used, only a single Notice to the Home Loan Applicant must be sent. This differs from the Adverse Action Notice, where forms must be sent to each individual borrower. Red Diamond Home Loans requires that these notices be sent to applicants within 10 days of a determination being made if they qualify for the original solicitation.

Adverse Action Disclosures

While similar to ECOA Adverse Action Notices (Denials), the FCRA must contain additional information. An easy way to think of this would be: ECOA denials are based on the entire application including credit; FCRA denials are based on just the credit report. You must send an applicant an Adverse Action Disclosure when:

1. The adverse action is based, totally or partly, on information contained within the consumer report.
2. You, as the lender, deny credit for personal, family or household purposes.
3. You take certain adverse action based in whole or in part on information from an affiliate.

The Adverse Action Disclosure must contain:

1. Written or electronic disclosures of a numerical credit score used by a lender in taking any adverse action based, totally or partly, on any information in a consumer report and the following information:
 - a. The range of possible credit scores under the model used;
 - b. All of the key factors that adversely affected the credit score, which shall not exceed four (4) key factors, except that if one of the key factors is the number of enquiries made with respect to the consumer report, the number of key factors shall not exceed five (5);
 - c. The date on which the credit score was created; and
 - d. The name of the person or entity that provided the credit score or file upon which the credit score was created;
 - e. The name, address, and telephone number of the consumer reporting agency from which the information was received (including a toll-free telephone number established by the agency, if the consumer reporting agency maintains files on a nationwide basis); and
 - f. A statement that the consumer reporting agency did not make the decision to take the adverse action, and is unable to provide the consumer the specific reasons why the adverse action was taken;
 - g. Provide a notice of the consumer's right to obtain a free copy of the consumer report from the consumer reporting agency within 60 days of receiving the adverse action notice, along with their right to dispute the accuracy of any information it contains.

Section 4.51 Risk-Based Pricing Notice

The Dodd-Frank Act amended risk-based pricing notices to include mortgage lenders, and the CFPB made these changes effective December 21, 2011. Referred to as Section 615(h) of the Fair Credit Reporting Act (FCRA), it requires users of consumer reports, such as creditors or lenders, to provide a risk-based pricing notice to a consumer when the creditor, based on a consumer report, extends credit to the consumer on terms that are “materially less favorable” than the terms the creditor has extended to other consumers. This means when Red Diamond Home Loans makes an offer to a borrower below a certain credit score, the company must provide the borrower with a notice that, due to their credit score, they may be receiving a higher interest rate and fees than someone with a higher credit score.

Materially less favorable means generally that the terms granted, extended or otherwise provided to a consumer differ from the terms provided to another consumer, such that the cost of credit would be significantly greater than to the other consumer. Relevant factors in determining the significance of a difference in cost include the type of credit product, the term of the credit extension, and the extent of the difference between the material terms granted, extended or otherwise provided to the two consumers.

Credit Score Proxy Method

The Credit Score Proxy Method is Kelly Stephens’ preferred approach to determining the FICO score that will be used in determining materially less-favorable loans. The process will consist of the QC officer reviewing the FICO score data from loans made from the prior 6 months, and tabulating these scores into eight (8) “buckets.” These buckets will be used to determine a cutoff score that represents the point at which approximately 40% of borrowers have higher FICO scores, and 60% have lower FICO scores. Once the cutoff score has been established, the company will provide a risk-based pricing notice to each new borrower whose FICO score is lower than the cutoff score.

Example:

	JAN	FEB	MAR	APR	MAY	JUNE		
FICO Scores							Score Totals:	Totals:
> 750	5	2	4	2	3	3	19	203
720 - 749	10	9	10	8	9	12	58	184
700 - 719	6	4	8	7	5	4	34	126
680 - 699	5	8	5	6	7	4	35	92
660 - 679	3	4	3	6	2	1	19	57
640 - 659	4	6	2	3	5	4	24	38
620 - 639	1	0	1	2	0	2	6	14
< 619	0	0	0	2	2	4	8	
Total Loans Closed	34	33	33	36	33	34		
Total Loans:	203							
60% of Total Loans:	121.8							

In this example 40% of the borrowers had FICO scores above 719, and 60% of the borrowers’ scores were below. Therefore, any borrower whose score is below 719 must be given a materially less-favorable notice.

Section 4.51 Risk-Based Pricing Notice (continued)

The Materially Less-Favorable Notice must contain the following:

1. A statement that a consumer report (or credit report) includes information about the consumer's credit history and the type of information included in that history;
2. A statement that the consumer is encouraged to verify the accuracy of the information contained in the consumer report, and has the right to dispute any inaccurate information;
3. The identity of each consumer reporting agency that furnished a consumer report used in the credit decision;
4. A statement that federal law gives the consumer the right to obtain a copy of a consumer report from the consumer reporting agency or agencies identified in the notice without charge for 60 days after receipt of the notice;
5. A statement informing the consumer how to obtain a consumer report from the consumer reporting agency or agencies identified in the notice, and providing contact information (including a toll-free telephone number, where applicable) specified by the consumer reporting agency or agencies;
6. A statement directing consumers to the website of the CFPB to obtain more information about consumer reports;
7. If a credit score of the consumer to whom a person grants, extends or otherwise provides credit is used in setting the material terms of credit:
 - a. A statement that a credit score is a number that takes into account information in a consumer report, that the consumer's credit score was used to set the terms of credit offered, and that a credit score can change over time to reflect changes in the consumer's credit history;
 - b. The applicant's credit score used in making the credit decision, along with the range of possible credit scores under the model used to generate the credit score;
 - c. All of the key factors that adversely affected the credit score, which shall not exceed four (4) key factors, except that if one of the key factors is the number of inquiries made with respect to the consumer report, the number of key factors shall not exceed five (5);
 - d. The date on which the credit score was created; and
 - e. The name of the consumer reporting agency or other person that provided the credit score
8. A statement that the terms offered, such as the APR, have been set based on information from a consumer report; and
9. A statement that the terms offered may be less favorable than the terms offered to consumers with better credit histories.

It's important to remember since Red Diamond Home Loans evaluates applicants and borrowers using tri-merge credit reports and the middle score is used to determine their eligibility, the middle score and the corresponding consumer reporting agency must be used in the notice. The notice must be provided to the consumer as soon as reasonably practicable after the credit score has been obtained.

Section 4.51 Risk-Based Pricing Notice (continued)

In a transaction involving two or more consumers who are granted, extended or otherwise provided credit, a lender must provide a risk-based pricing notice to each consumer. If the consumers have the same address, and the notice does not include a credit score(s), a lender may satisfy the requirements by providing a single notice addressed to both consumers. However, if a notice includes a credit score(s), the lender must provide a separate notice to each consumer whether the consumers have the same address or not. Each separate notice that includes a credit score(s) must contain only the credit score(s) of the consumer to whom the notice is provided, and not the credit score(s) of the other consumer. Similarly, for credit score disclosure exception notices, whether the consumers have the same address or not, the lender must provide a separate notice to each consumer, and each separate notice that includes a credit score(s) must contain only the credit score(s) of the consumer to whom the notice is provided.

Exceptions

Adverse Action Notice - No notice required if you provide an "adverse action" notice to the consumer.

The Mortgage/HELOC exception - in the Risk Based Pricing Rule is what allows you as a lender to send a risk based pricing exception notice to all consumers rather than having to determine specific disadvantaged consumers.

The Mortgage/HELOC Exception:

- Applies to credit secured by 1 to 4 units of residential real property
- Lender is not required to provide Risk-Based Pricing Notice if lender provides **to all consumers the Notice to Home Loan Applicant (including credit score), and the Exception Notice**
- Delivered at the same time as the Notice to Home Loan Applicant ("as soon as reasonably practicable"), but not later than the consummation of a closed-end loan or the first transaction under an open-end credit plan.

Red Diamond Home Loans has opted to send the Mortgage/ HELOC Exception form. **This means that all loan officers are required to send the notice to Home Loan Applicant and the Exception Notice to every applicant for which credit is extended, i.e. a Good-Faith-Estimate is sent.**

Section 4.52 Consumer Alerts and Identity-Theft Protections

The FCRA contains provisions for both consumer reporting agencies and users of consumer reports, including financial institutions, that are designed to help combat identity theft. Two primary requirements exist for users of consumer reports: first, a user of a consumer report that contains a fraud or active duty alert must take steps to verify the identity of an individual to whom the consumer report relates, and second, users of consumer reports must disclose certain information when consumers allege that they are the victims of identity theft.

Section 4.52 Consumer Alerts and Identity-Theft Protections (continued)

Consumers who suspect that they may be the victims of fraud including identity theft may request nationwide consumer reporting agencies to place initial fraud alerts in their consumer reports. These alerts must remain in a consumer's report for no less than 90 days. In addition, members of the armed services who are called to active duty may also request that active duty alerts be placed in their consumer reports. Active duty alerts must remain in these service members' files for no less than 12 months.

Section 4.60 Truth in Lending Act (TILA) Regulation Z

The Truth in Lending Act (TILA) was passed on May 29, 1968, as Title I of the Consumer Credit Protection Act), and became effective July 1, 1969. TILA has been amended multiple times since then to reflect current market conditions and issues. TILA is intended to ensure that credit terms are disclosed in a meaningful way, so that consumers can compare credit terms more readily and knowledgeably. It's important to understand that TILA was designed to provide more transparency to the lending process, created time frames for disclosing information to the borrower, and most recently set forth guidelines on how loan officers are to be paid. Check your LO Compensation plan for your specific pay structure.

In 2010 and again in 2013, the Board further amended Regulation Z to prohibit payment to a loan originator based on the terms of the loan, other than the amount of credit extended. The amendments apply to mortgage brokers and the companies that employ them, as well as to mortgage loan officers employed by depository institutions and other lenders. In addition, the amendments prohibit a loan originator from directing or "steering" a consumer to a loan that is not in the consumer's best interest to increase the loan originator's compensation. Separately, the Dodd-Frank Wall Street Reform and Consumer Protection Act amended TILA to include several provisions that protect the integrity of the appraisal process when a consumer's home is securing the loan. The rule also requires appraisers to receive customary and reasonable payments for their services. The appraiser and loan originator compensation requirements became effective on April 1, 2011.

Additionally, TILA provides consumers with rescission rights; provides for rate caps on certain dwelling-secured loans; imposes limitations on home equity lines of credit and certain closed-end home mortgages. TILA also delineates and prohibits unfair or deceptive mortgage lending practices. In October 2015 as part of the government Paper Reduction Act and TILA-RESPA Integrated Mortgage Disclosure (TRID) rules the initial and final Truth-In-Lending disclosure was incorporated into the new Loan Estimate (LE) and Closing Disclosure (CD).

Section 4.61 TILA- RESPA Integrated Mortgage Disclosure (TRID)

As of October 3, 2015 closed-end mortgage transactions secured by real property must follow the new TRID guidelines. The purpose of the TRID is to help consumers understand the transaction through the use of clear disclosures and understandable language. TRID guidelines must be applied to lot-loans up to 25 acres, construction-only loans, purchase transactions, cash-out refinances (A6 loans in TX), and second homes. TRID does NOT apply to: reverse mortgages, HELOCs; federally related mortgage loans extended by a person and not a creditor as defined in Regulation Z; personal property loans, chattel-dwelling loans – example: loans on mobile homes or other dwellings not attached to real property.

Section 4.61 TILA- RESPA Integrated Mortgage Disclosure (continued)

Under the regulations, as long as the property is purchased for investment purposes only, i.e., rental property, the borrower would not be a consumer under TILA and the transaction would not be subject to the new regulations. However, your company should check with each of its investors to insure there are no overlays.

Definitions:

Under TRID an **Application** is considered “complete” when the following six items have been collected:

- (1) The borrower’s name
- (2) The borrower’s gross monthly income
- (3) The borrower’s Social Security number (to obtain a credit report)
- (4) The property address
- (5) An estimate of the value of the property
- (6) The mortgage loan amount sought

Under TRID there are two different definitions for the term ‘**business day**’:

- General definition: creditor’s offices open to the public for carrying on substantially all of its business functions
- Specific definition: all calendar days except Sundays and legal public holidays

The loan originator may require additional information to the six items listed above. When the mandatory six items have been collected, an application has officially been taken; at that point, an LE must be issued. A loan originator is prohibited from charging a borrower any fee for issuing the LE, unless the fee is limited to the cost of a credit report.

Fee Worksheets

IF all six items listed above have not been submitted by the borrower, and they are requesting an estimate of charges, you are permitted to give them a fee worksheet. If you provide a written estimate of terms or costs specific to that consumer prior to receiving the Loan Estimate, it must contain the following disclosure:

“Your actual rate, payment and costs could be higher. Get an official Loan Estimate before choosing a loan.”

Your disclosure MUST be:

- Clear and conspicuous
- Located at the top of the first page of the worksheet
- At least 12-point font
- Your fee worksheet must not contain headings, formatting, or content that is substantially similar to the Loan Estimate or Closing Disclosure

Disclosures:

TRID has not only replaced the old GFE; it has married the Truth-In-Lending document into the Loan Estimate and Closing Disclosure. The Loan Estimate (or LE) represents the approximate total of all costs

[Section 4.61 TILA- RESPA Integrated Mortgage Disclosure \(continued\)](#)

associated with the loan. In addition, it contains the Truth-In-Lending figures, all combined into a single document. The Closing Disclosure (or CD) shows the borrower the total final costs associated with the loan, and should mirror the LE with a few exceptions. The forms use clear language, designed to make it easier for consumers to locate key information such as the interest rate, monthly payments and costs to close the loan. The forms also provide information to help consumers decide whether the loan is truly affordable, and to compare the costs (including over the duration) of different loan offers.

Loan Estimate (or LE) - The first page of the LE includes a summary of loan terms and estimated settlement charges, also referred to as closing costs. It also includes information about key dates, such as when the interest rate for the loan quoted in the LE expires, and when the estimate for the settlement charges expires. The second page discloses settlement charges into three different sections: A, B and C. Also included are other costs, such as taxes and prepaids. The third page provides a comparison chart borrowers can use to measure against other loans, also known as the initial Truth-In-Lending. Borrowers will find additional considerations related to the transaction, along with a signature line.

LE Requirements

- The law states that the lender must provide the completed LE to the borrower within three business days of receipt of an application for a mortgage loan. At Red Diamond Home Loans, the company requires the loan officer to be responsible for ensuring the LE is sent within the appropriate timeframe. It's important to note that the company is not required to provide an LE if the application is denied prior to the end of the three-business-day period, or the borrower withdraws the application.
- An LE can be emailed; however, you first need an email from the consumer approving email as a delivery method. With approval, you'll need a delivery receipt confirmed by consumer. If you don't receive a confirmation of delivery, you must assume 3 business days (Mailbox rule).

LE Revisions – The following reasons can trigger a Revised Loan Estimate:

- A changed circumstance
- A consumer-requested change
- The consumer eligibility or property value changes
- The Loan Estimate expires
- Interest-rate-dependent charges
- Delayed closing date on construction loan

Key LE Form Contents

Red Diamond Home Loans must ensure that the required LE form is completed in accordance with the instructions set forth Under TRID document number 2015-18239 in Appendix C of 12 CFR Part 1024 and 1026. The following five paragraphs (highlighted by bullet points) are taken directly from the restated RESPA guidelines in the CFPB manual:

[Section 4.61 TILA- RESPA Integrated Mortgage Disclosure \(continued\)](#)

Page One of the LE

- The first page discloses identifying information such as the name and address of the “loan originator”, which includes the lender or the mortgage broker originating the loan. The “purpose” section indicates what the LE is about, and directs the borrower to save the loan estimate to compare with their closing disclosure.
- While the interest rate stated on the LE is not required to be locked for any specific period of time, the estimate for the other settlement charges and loan terms must be honored for at least 10 business days from the date the LE was provided.
- The form must state how many calendar days are allowed for the borrower to go to settlement once the interest rate is locked (rate lock period). The form also requires disclosure of how many days prior to settlement the interest rate would have to be locked, if applicable. The LE requires disclosure of the loan amount, loan term, initial interest rate and initial monthly payment for principal, interest and any mortgage insurance. Also included are whether the interest rate can increase; and if so, the maximum rate to which it can increase over the life of the loan, and the period of time after which the interest rate can first change. This section must declare if the loan balance can increase even if payments are made on time; and if so, the maximum amount to which it can increase over the life of the loan. If the monthly amounts owed for principal, interest and any mortgage insurance can rise even if payments are made on time must also be declared; and if so, the maximum amount to which the monthly amount owed can ever increase over the life of the loan. Additional information must include whether the loan has a prepayment penalty; and if so, the maximum amount it could be; whether or not the loan has a balloon payment; and if so, the amount of such payment and in how many years it will be due.
- The “escrow account information” section requires the loan originator to indicate whether the loan does or does not have an escrow account to pay property taxes or other property-related charges. In addition, this section also requires the disclosure of the monthly amount owed for principal, interest and any mortgage insurance.
- The bottom of the first page includes subtotals for the adjusted closing costs, and for all other settlement charges listed on Page Two, along with the total estimated Cash to Close.

Page Two of the LE

The second page of the LE requires disclosure of all settlement charges. It provides for the estimate of total settlement costs in three blocks discussed below. The origination charges are disclosed in Block (A), service charges selected by the lender are disclosed in Block (B), and service charges which may be selected by the borrower are listed in Block (C). The amounts in these blocks are to be added to arrive at the total estimated loan costs, which must be listed at the bottom of the page. The adjusted origination

Section 4.61 TILA- RESPA Integrated Mortgage Disclosure (continued)

charge results from the subtraction of a credit from the origination charge, or any additions to the origination charge

Block (A) – the origination charges, which includes lender processing and underwriting fees, and any fees paid to a mortgage broker.

Origination charge note: This block requires the disclosure of all charges that all loan originators involved in the transaction will receive for originating the loan (excluding any charges for points). A loan originator may not separately charge any additional fees for getting the loan such as application, processing or underwriting fees. The amount in Block (A) is subject to zero variance, i.e., the amount cannot change at settlement. ***** Important: Fees listed in Block (A) may not be altered.**

Points paid by the borrower for the interest rate chosen must be disclosed as a “charge” (reflected on the LE in Block A). A loan cannot include both a charge (points) and a credit (yield spread premium).

Block (B) – Services Borrowers Cannot Shop For

Block (B) contains the sum of charges for settlement services that are required, and for which the borrower may not choose the source. For example, the lender provides such services as appraisal and flood certification fees. *****Important: The total of fees listed in Block (B) may only vary by 10%.**

Block B Note - Fees paid to an unaffiliated third-party if the creditor permits the consumer to shop for the service and the consumer selects a provider on the list the creditor provides to the consumer. *The creditor must disclose on the list that consumer may select a service provider not included on the list.*

Block (C) – Services Borrowers Can Shop For

Block C is the sum of charges for all settlement services other than the origination charges. Variances Allowed - These fees and charges can exceed the amounts disclosed on the Loan Estimate if they were consistent with the best information reasonably available at the time of disclosure:

- Prepaid interest
- Property insurance premium
- Amounts placed into an escrow account
- Charges paid to third-party providers not included in the written list
- Charges paid for third-party services not required by the creditor (these charges may be paid to affiliates of the creditor)

Disclosure of Charges for All Other Settlement Services (Block E, F, G, H)

Page Three of the LE

The third page of the LE has three sections: It now contains the initial Truth-In-Lending statement, and includes the following information:

- A “Comparisons” function that borrowers can use to measure and compare different loans.
- An “Other Considerations” section that must be completed by the loan officer or lender. Examples would be assumption of the loan, and late payments.
- A signature and date by all applicants.

Section 4.61 TILA- RESPA Integrated Mortgage Disclosure (continued)

Binding LE

The loan originator is bound, within the tolerances provided, to the settlement charges and terms listed on the LE provided to the borrower, unless a new LE is provided prior to settlement (see discussion below on changed circumstances). This also means that if a lender accepts an LE issued by a mortgage broker, the lender is subject to the loan terms and settlement charges listed in the LE, unless a new LE is issued prior to settlement.

Changed circumstances are defined as:

- Acts of God, war, disaster or other emergency
- Information particular to the borrower or transaction that was relied on when providing the LE that changed, or was later proved to be inaccurate
- New information particular to the borrower or transaction not relied on in providing the LE
- Other circumstances that are particular to the borrower or transaction, including boundary disputes, the need for flood insurance or environmental problems

Changed circumstances do not include the borrower's name or monthly income, the property address, an estimated value of the property, the mortgage loan amount sought, or any information contained in any credit report obtained by the loan originator prior to providing the LE, unless the information changes or is found to be inaccurate after the LE has been provided. In addition, market price fluctuations, by themselves, do not constitute changed circumstances.

Borrower-related Changes

Changed circumstances affecting settlement costs are those that result in increased costs for settlement services, such that the charges at settlement would exceed the tolerances or limits on those charges established by the regulations.

Changed circumstances affecting the loan are those that affect the borrower's eligibility for the loan. For example, if underwriting and verification indicate that the borrower is ineligible for the loan described in the LE, the loan originator would no longer be bound to provide said loan. In such cases, if a new LE is to be provided, the loan originator must do so within three (3) business days of receiving information sufficient to establish changed circumstances. The loan originator must document the reason that a new LE was provided, and must retain the documentation for no less than three years after settlement.

None of the information collected by the loan originator prior to issuing the LE may later become the basis for a "changed circumstance" upon which a revised LE may be offered, unless: 1) it can be demonstrated that there was a change in the particular information; 2) that the information was inaccurate; or 3) that the particular information was not critical in order to issue the LE. A loan originator has the burden of demonstrating no reliance on the collected information, but may do so through various means including a documented record in the underwriting file, or an established policy of relying on a more limited set of information in providing LEs.

Section 4.61 TILA- RESPA Integrated Mortgage Disclosure (continued)

Revised Loan Estimates

If a loan originator issues a revised LE based on information previously collected in issuing the original LE and “changed circumstances,” the reasons for issuing the revised LE must be documented, such as having no reliance on or the inaccuracy of such information. If a borrower requests changes to the mortgage loan identified in the LE that change the settlement charges or the terms of the loan, the loan originator may provide a revised LE to the borrower. **If a revised LE is provided, the loan originator must do so within three (3) business days*. In addition, any revised LE’s must be received by the consumer at least four (4) business days* prior to close.** *specific definition - all but Sunday and legal holidays

Expiration of Original LE

If a borrower does not express an intent to continue with an application within ten (10) business days after the LE is provided, or longer if so offered, the loan originator is no longer bound by the LE.

Interest-rate-dependent Charges and Terms

If the interest rate has not been locked by the borrower, or a locked interest rate has expired, all interest-rate-dependent charges on the LE are subject to change. The charges that may change include the charge or credit for the interest rate chosen, the adjusted origination charges, per-diem interest and loan terms related to the interest rate. However, the loan originator’s origination charge (listed in Block (A) of Page Two of the LE) is not subject to change, even if the interest rate floats, unless there is another changed circumstance or borrower-requested change.

If the borrower subsequently locks the interest rate, a new LE must be provided, showing the revised interest-rate-dependent charges and terms. All other charges and terms must remain the same as on the original, unless changed circumstances or borrower-requested changes result in increased costs for settlement services, or affect the borrower’s eligibility for specific loan terms identified in the original LE.

New Home Purchases

In transactions involving new home purchases, where settlement is expected to occur more than 60 calendar days from the time an LE is provided, the loan originator may provide the LE to the borrower with a clear and conspicuous disclosure stating that at any time up until 60 calendar days prior to closing, the loan originator may issue a revised LE. If the loan originator does not provide such a disclosure, he cannot issue a revised LE except as otherwise provided in Regulation X.

Closing Disclosure Preparation and Delivery

The creditor is ultimately responsible for timely delivery of an accurate Closing Disclosure to the consumer, the creditor and settlement agent may agree to share responsibilities in completing and delivering the documentation. The settlement agent is responsible for delivering the Closing Disclosure to the seller.

[Section 4.61 TILA- RESPA Integrated Mortgage Disclosure \(continued\)](#)

Three-Day Advance Inspection of the Settlement Statement

Effective October 3rd, 2015 the Closing Disclosure (CD) must be completed and made available to the borrower for inspection during the business day three days prior to close (specific definition).

Changes to Closing Disclosure Prior to Signing

If any of the following occur prior to the CD being signed, a new three-business-day waiting period is required:

- Disclosed APR becomes inaccurate
- Loan product changes
- Prepayment penalty is added

A three-business-day waiting period is not required for other changes.

Retention

Red Diamond Home Loans must retain each completed Closing Disclosure and related documents for five years after settlement, unless the lender disposes of its interest in the mortgage and does not service it.

[Section 4.62 Finance Charge and Annual Percentage Rate \(APR\)](#)

The finance charge is a measure of the cost of consumer credit represented in dollars and cents. Along with APR disclosures, the disclosure of the finance charge is central to the uniform credit cost disclosure envisioned by the TILA. Finance charges include any charges or fees payable directly or indirectly by the consumer, and imposed directly or indirectly by the financial institution. These charges can be incident to or as a condition of an extension of consumer credit. The finance charge on a loan always includes any interest charges, and often other charges.

Annual Percentage Rate (APR) is a measure of the cost of credit, expressed as a yearly rate. Giving the borrower the APR on a specific loan will allow them to compare it against other offers they may receive. Since fees differ from lender to lender along with rates offered, having an APR allows borrowers to have a uniform measure or “apples to apples” of what the cost of their loan will be. ****Important**** You need to remember that an APR measures the total cost of credit, including costs such as transaction charges or premiums for credit guarantee insurance; it is not an “interest” rate, as the term is generally used.

[Section 4.63 Rescission Rights](#)

Regulation Z provides consumers with the ability to change their mind on certain types of transactions. A consumer has the right to rescind (cancel) a refinance transaction in which a security instrument is or will be retained on the consumer’s principal residence. A lender must ensure the consumer receives two copies of the Notice of Right to Rescind. Consumers may rescind on refinance transactions only on their primary residence. Borrowers have three business days from the date (and time) of signing their closing documents to rescind their loan. Sundays and federal holidays are exempt from rescission days, and will not be counted toward the borrower’s three business days.

[Section 4.64 TILA/REG Z - Mortgage Disclosure Improvement Act \(MDIA\)](#)

The Mortgage Disclosure Improvement Act was enacted as an amendment to Regulation Z. MDIA regulates the time periods in which the borrower must receive certain disclosures, and when it is permissible to collect loan-related fees from the borrower.

MDIA time requirements:

- **Initial fees:** As a lender, Red Diamond Home Loans may only collect a fee for the reasonable cost of a credit report prior to sending the initial disclosures.
- **Appraisal fees:** Regulation Z states that an applicant may not be charged an appraisal fee until three business days have passed of the initial disclosures. However, if the borrower waives the three day waiting period, the appraisal may be ordered immediately. Additionally, if the lender pays for the appraisal up front, the three-day waiting period may be waived.
- **Seven business days prior to consummation:** Lenders must wait seven (7) business days to close a loan after delivering the initial TIL. This means the lender cannot close a borrower's loan for any reason at least 7 days after providing the initial disclosures, even if the borrower would agree to waive this waiting period.
- **Revised TIL for APR tolerance violation – four business day notice:** If the APR is out of tolerance per TILA guidelines, lenders must re-disclose at least four business days prior to closing the loan.
- **No requirement to complete statement:** The MDIA requires that the initial disclosures contain a clear and conspicuous notice containing the following statement: "You are not required to complete this agreement merely because you have received these disclosures or signed a loan application."

[Section 4.65 TILA/REG Z – Closed-End Advertising Rule](#)

Red Diamond Home Loans must comply with the Federal Trade Commission's Mortgage Act and Practices Advertising Rule (MAP) which applies to mortgage lenders, brokers and servicers. Ironically, the rule does not apply to banks, savings and loan institutions, and federal credit unions that are excluded from the FTC's jurisdiction. While TILA contains advertising guidelines, please refer to section 6.1 for the full REG N guidelines.

Disclosures required by this section must be made "clearly and conspicuously." To meet this standard in general, credit terms need not be printed in extremely small type size nor appear in any particular place in the advertisement. Advertisements for credit secured by a dwelling, a clear and conspicuous disclosure means that the required information is disclosed with equal prominence and in close proximity to the advertised rates or payments triggering the required disclosures

The TILA advertising rule "prohibits any material misrepresentation, whether made expressly or by implication, in any commercial communication, regarding any term of any mortgage credit product." Red Diamond Home Loans needs to comply with the FTC rules concerning mortgage advertising misrepresentations, prevent false or deceptive claims regarding loan terms, fees and costs, the consumer's potential for savings or approval, and additional services or affiliated providers. In order to comply with the rules, management will be looking at each of the following areas in all advertisements:

Section 4.65 TILA/REG Z – Closed-End Advertising Rule (continued)

Loan terms:

- The interest charged for a mortgage product
- The APR, simple annual rate, period rate or any other rate, including payment rate
- The amount or percentage of any down payment
- Any pre-payment penalty
- The number of payments or period of repayment
- The variability of interest, payments or other terms
- The type of mortgage credit product offered
- The potential for default
- The right to reside in the subject dwelling

Fees and costs:

- The existence, nature or amount of any fees and finance charges associated with any mortgage loan
- The taxes and insurance associated with a mortgage credit product
- The consumer's ability to obtain any mortgage product or term
- The consumer's ability to refinance or modify any mortgage product or term

Payments and consumer savings:

- Comparison between rates or payments
- The amount of the obligation or existence, nature or amount of cash or credit the consumer may receive from a loan
- The existence, number or amount of timing of any minimum or required payments
- The effectiveness of a product in helping consumers resolve problems paying debts

Additional products or services offered and affiliated services:

- The terms associated with additional products or features sold along with a mortgage
- The association between the mortgage product or provider and any other person or program
- The source of commercial communications
- The availability, nature or substance of counseling services, or any other expert advice offered to the consumer

The regulation prohibits the following seven deceptive or misleading acts or practices in advertisements for closed-end mortgage loans:

- Stating that rates or payments for loans are “fixed” when those rates or payments can vary without adequately disclosing that the interest rate or payment amounts are “fixed” only for a limited period of time, rather than for the full term of the loan;
- Making comparisons between actual or hypothetical credit payments or rates and any payment or rate available under the advertised product that are not available for the full term of the loan, with certain exceptions for advertisements for variable rate products;

Section 4.65 TILA/REG Z – Closed-End Advertising Rule (continued)

- Characterizing the products offered as “government loan programs,” “government-supported loans,” or otherwise endorsed or sponsored by a federal or state government entity even though the advertised products are not government-supported or -sponsored loans;
- Displaying the name of the consumer’s current mortgage lender, unless the advertisement also prominently discloses that the advertisement is from a mortgage lender not affiliated with the consumer’s current lender;
- Making claims of debt elimination if the product advertised would merely replace one debt obligation with another;
- Creating a false impression that the mortgage broker or lender is a “counselor” for the consumer; and
- In foreign-language advertisements, providing certain information, such as a low introductory “teaser” rate, in a foreign language, while providing required disclosures only in English.

In addition to the areas mentioned above, there are additional advertising/ marketing requirements that are covered in section 6.1 of this QC policy. ***ALL advertising and marketing materials, in printed or digital format, must be approved by your QC officer prior to distribution.*** Any employee discovered to have distributed any advertisement or marketing material, prior to approval by management, will have incurred grounds for immediate termination.

Section 4.66 Home Ownership and Equity Protections Act (HOEPA)

In 2010, the Dodd-Frank Act amended TILA by expanding the scope of HOEPA coverage to include purchase-money mortgages and open-end credit plans (i.e., home equity lines of credit, or HELOCs) and amended HOEPA’s coverage tests. The final rule amends Regulation Z (Truth in Lending Act) by expanding the types of mortgage loans that are subject to the protections of the Home Ownership and Equity Protections Act of 1994 (HOEPA), revising and expanding the tests for coverage under HOEPA, and imposing additional restrictions on mortgages that are covered by HOEPA. The final rule also amends Regulation Z and Regulation X (Real Estate Settlement Procedures Act) by imposing certain requirements related to home ownership counseling, including information about counseling providers.

In general, all mortgages secured by the borrower’s principal dwelling are subject to HOEPA coverage. HOEPA places limits on APR’s, points and fees, and prohibits certain types of loans. Transactions that may potentially be high-cost mortgages must be tested against HOEPA’s coverage tests, and are referred to as transactions that are “subject to HOEPA coverage.”

Coverage Test Rate

- First-lien with an APR exceeding the APOR by 6.5%
- Second-lien with an APR exceeding the APOR by 8.5%
- First-lien on a manufactured home titled as personal property with a transaction amount less than \$50,400, with an APR exceeding APOR by 8.5%
- Changed reference instrument from Treasury Securities to Average Prime Offer Rate (APOR)

Section 4.66 Home Ownership and Equity Protections Act (HOEPA) (continued)

Coverage Test Points and Fees

- Points and fees exceed 5% of total transaction amount if loan is greater than \$20k
- Points and fees exceed 8% of total transaction amount if loan is less than \$20k
- Pre-payment Penalty Exceeding 36 months
- Pre-payment Penalty with fees and penalties greater than 2% of the pre-paid amount

High-Cost Prohibited Terms

- Balloon payments
- Pre-payment penalties
- Due-on-demand features (allowed in certain circumstances)
- Negative amortization
- Creditors and mortgage brokers are prohibited from recommending default on an existing loan to be refinanced by a high-cost mortgage.
- Refinancing any high-cost mortgage into another high-cost mortgage within one year after having extended credit, unless the refinancing is in the consumer's interest

Exempt Transactions

The following loan programs are exempt from HOEPA coverage:

- Reverse mortgages
- Construction loans
- USDA loans

Exceptions to the Exemptions:

- The exemption for construction loans applies only to loans that finance the initial construction of a new dwelling. It does not extend to loans that finance home improvements or home remodels.

The exemption is straightforward for construction-only loans, but a bit more complicated for construction-to-permanent loans.

- When you make a construction-to-permanent loan as two separate transactions, the construction loan transaction is exempt, but the permanent financing transaction is not. (Comment 32(b)-1)
- For a construction-to-permanent loan originated as a single transaction, coverage must be determined in accordance with appendix D to Regulation Z. (Comment 32(b)-1 and Appendix D)
- The exclusions for FHA and USDA loans apply only to loans that these organizations directly finance, not loans they guarantee or insure.

Section 4.67 High Priced Mortgage Loans (HOEPA) – Section 35 loans

Section 35 is part of TILA and Regulation Z pertaining to high-priced mortgage loans (HPML). This change was enacted October 1, 2009 and all lenders making first lien mortgage loans must comply with its requirements. The regulation was created to protect consumers from predatory lending practices such as not verifying the borrower's ability to pay or imposing large prepayment penalties.

[Section 4.67 High Priced Mortgage Loans \(HOEPA\) – Section 35 loans \(continued\)](#)

HPML loans are defined as first mortgage loans where the annual percentage rate exceeds the interest rate on a loan by more than 1.5%, and where the annual percentage rate exceeds the interest rate on a subordinate lien by more than 3.5%. Types of loans that may fall into an HPML category are small loan amounts (under \$50,000), home equity loans that are the only mortgage against the property, loans with mortgage insurance (MI) and mortgage loans with no up-front closing costs. Jumbo loans (loans exceeding \$417,000) cannot have an annual percentage rate that exceeds the interest rate by more than 2.5%. HPML are not illegal. On HPML the lender has certain tests and a list of restrictions that must be adhered to on each HPML originated.

Borrower's Ability to Pay

For an HPML the lender must conduct a viability test to ensure that the borrower is financially sound enough to make the payment. The lender must verify all income sources and account for any future changes, such as retirement, when making a determination. This also includes any payment changes that may occur over the life of the loan due to changing interest rates on adjustable rate mortgages (ARM). The lender must calculate the maximum payment in the criteria, and use the borrower's credit history as an indication of viability and the willingness of the borrower to pay the loan. ***There are no set definitions, ratios, or credit score requirements. Each lender, if audited, must make the case for each HPML they have underwritten.***

Prepayment Penalties

Lenders are restricted on prepayment penalties for HPML loans. The lender cannot have a prepayment penalty longer than 2 years. The initial rate on an adjustable mortgage loan must last for at least four years.

Escrow Account

On any HPML, the lender is required to escrow for property taxes and homeowners' insurance. First-lien home equity loans also carry this requirement. The escrow requirement covers all stick-built homes, modular homes, mobile homes, and boats or trailers used as a primary residence. Condominium property taxes are required to be escrowed.

Negative Amortization Mortgages

Negative amortization is not allowed on HPML transactions. Negative amortization is a mortgage where the outstanding principal balance can rise even if all payments have been made on time. Most negative amortization loans were called "pay-option" mortgages which permitted minimum payments that did not cover the full principal and interest amount each month.

[Section 4.67 High Priced Mortgage Loans \(HOEPA\) – Section 35 loans \(continued\)](#)

Home Ownership Counseling for High-Cost/Priced Mortgage Loans

Prior to making a high-cost mortgage, you must receive written certification that the consumer has received home ownership counseling on the advisability of the mortgage from a HUD-approved counselor or a state housing finance authority, if permitted by HUD. The home ownership counselor cannot be affiliated with or employed by Red Diamond Home Loans. We cannot refer the consumer to a specific counseling agency. The consumer must have received the RESPA good-faith estimate before the home ownership counseling session on the advisability of the mortgage. Note that the home ownership counselor must confirm that the consumer received all the high-cost mortgage disclosures, or the disclosures required under RESPA, before the counselor can issue the certification of counseling. The rule does not require in-person counseling; it may be provided by telephone, so long as it is provided by a HUD-approved counselor. A self-study program may not be used to satisfy the counseling requirement. The counselor can send you the written certification via mail, email or facsimile, so long as the certification is in a retainable form.

Civil Liability

A creditor that fails to comply with section 129 of TILA, 15 U.S.C. §1639, (requirements for certain mortgages which include high-cost mortgage loans under 1026.32(a)) may be held liable to the consumer for all finance charges and fees paid by the consumer unless the creditor demonstrates that the failure was not material.

Criminal Liability

Anyone who willingly and knowingly fails to comply with any requirement of the TILA will be fined not more than \$5,000 or imprisoned not more than one year, or both.

[Section 4.68 TILA/Reg Z- Flood Disaster Protection Act](#)

The purpose of the Flood Disaster Protection Act (1973) and the National Flood Insurance Act (1968) is to provide federal disaster relief assistance in areas designated as special flood hazards by FEMA. When a subject dwelling is located in a designated flood hazard area, the institution shall not make, increase, extend or renew any loan unless the subject dwelling is covered by flood insurance for the term of the loan. All lenders shall use the FEMA Standard Flood Hazard Determination Form to determine whether the subject is or will be in a flood hazard zone. The written notice provided to the borrower prior to closing must include:

- A warning that the subject dwelling is in a specially designated flood zone
- A description of the flood insurance purchase requirements
- A statement that flood insurance coverage is available under the NFIP
- A statement whether federal disaster relief assistance may be available due to flooding

Section 4.70 Unfair, Deceptive, or Abusive Acts or Practices (UDAAP)

Unfair, Deceptive, or Abusive Acts or Practices (UDAAP) makes it unlawful for the provider of consumer financial products or services to engage in any unfair, deceptive, or abusive acts or practices with any transaction involving a consumer financial product or service, or the offering of a consumer financial product or service. UDAAP was implemented by the Dodd-Frank Act, but gave rulemaking and enforcement authority to the CFPB. In addition, CFPB has supervisory authority for detecting and assessing risks to consumers by conducting periodic investigations, responding to consumer complaints and conducting data analyses.

UDAAPs often cause significant financial injury to consumers, erode consumer confidence and undermine the financial marketplace. UDAAPs apply to lenders, loan originators, service providers and other covered persons involved in collecting debt related to any financial product or service.

Section 4.71 Unfair Acts

The standard for unfairness in the Dodd-Frank Act is that an act or practice is unfair when:

- 1) It causes or is likely to cause substantial injury to consumers;
- 2) The injury is not reasonably avoidable by consumers; and
- 3) The injury is not outweighed by countervailing benefits to consumers or to competition.

Substantial Injury

Substantial injury to consumers can be proven in several different ways; however, it typically takes the form of monetary harm by way of fees paid by the consumer due to the unfair act or practice. Any act or practice that causes a small amount of harm to a large number of people may also be deemed to cause substantial injury.

The consumer is not required to prove an actual injury. However, trivial or merely speculative harms are typically insufficient for a finding of substantial injury. Emotional impact and other more subjective types of harm also will not ordinarily be considered substantial injury. In certain circumstances, such as unreasonable debt collection harassment, emotional impacts may amount to or contribute to substantial injury.

Reasonably Avoidable Injury

An injury is not reasonably avoidable when an act or practice interferes with the consumer's ability to make a decision or take action to avoid injury. We need to ensure that we are providing our customers with access to information which allows them to compare available alternatives, and not coerce them into unwanted products or services.

Examples of Unfair Acts

The CFPB has provided the following examples which have been identified as unfair acts by other regulators:

[Section 4.71 Unfair Acts \(continued\)](#)

Refusing to release lien after consumer makes final payment on a mortgage. The FTC brought an enforcement action against a mortgage company based on allegations, described below, that repeatedly failed to release liens after consumers fully paid the amount due on their mortgages.

- **Substantial injury:** Consumers sustained economic injury when the mortgage servicer did not release the liens on their properties after the consumers had repaid the total amount due on the mortgages.
- **Not outweighed by benefits:** Countervailing benefits to competition or consumers did not result from the servicer's alleged failure to appropriately service the mortgage loan and release the lien promptly.
- **Not reasonably avoidable:** Consumers had no way to know before obtaining the loan that the mortgage servicer would not release the lien after full payment. Moreover, consumers generally could not avoid the harm caused by the improper practices of a mortgage servicer who is chosen by the owner of the loan, not the borrower. Consumers cannot choose their loan servicer, or modify their selection, if they are dissatisfied with the quality of the loan servicing.

Processing payments for companies engaged in fraudulent activities. The OCC brought an enforcement action in a case involving a bank that maintained deposit account relations with telemarketers and payment processors, based on the following allegations. The telemarketers regularly deposited large numbers of remotely-created checks drawn against consumers' accounts. A large percentage of the checks were not authorized by consumers. The bank failed to establish appropriate policies and procedures to prevent, detect or remedy such activities.

- **Substantial injury:** Consumers lost money from fraudulent checks created remotely and drawn against their accounts.
- **Not outweighed by benefits:** The cost to the bank of establishing a minimum level of due diligence, monitoring, and response procedures sufficient to remedy the problem would have been far less than the amount of injury to consumers that resulted from the bank's avoiding those costs.
- **Not reasonably avoidable:** Consumers could not avoid the harm, because the harm resulted principally from transactions to which the consumers had not consented.

[Section 4.72 Deceptive Acts or Practices](#)

The Dodd-Frank Act prohibits conduct that constitutes a deceptive act or practice. A representation, omission, act or practice is deceptive when:

- 1) The representation, omission, act or practice misleads or is likely to mislead the consumer;
- 2) The consumer's interpretation of the representation, omission, act or practice is reasonable under the circumstances; and
- 3) The misleading representation, omission, act or practice is material.

Section 4.72 Deceptive Acts or Practices (continued)

Misleading to the Consumer

When determining if an act misleads or is likely to mislead the consumer, management shall consider the totality of the circumstances. By definition, this does not require the consumer to have already been misled by the act or practice as long as it is likely to mislead consumers. We will take the following factors into consideration:

- The overall context of the situation: It is necessary to evaluate an individual statement, representation or omission not in isolation, but rather in the context of the entire advertisement, transaction or course of dealing, to determine whether the overall net impression is misleading or deceptive.
- The overall net impression of the statement, act or omission: Factors to consider include insufficient corrections and fine print. Written disclosures may be insufficient to correct a misleading statement or representation, particularly where the consumer is directed away from qualifying limitations in the text, or is counseled that reading the disclosures is unnecessary. Oral, fine-print or contract disclosures may be insufficient to cure a misleading headline or a prominent written representation. Similarly, a deceptive act or practice may not be cured by subsequent truthful disclosures.

Acts or practices that may be deceptive include: making misleading cost or price claims; offering to provide a product or service that is not in fact available; using bait-and-switch techniques; omitting material limitations or conditions from an offer; or failing to provide the promised services.

The FTC's "four Ps" test can assist in the evaluation of whether a representation, omission, act or practice is likely to mislead:

- Is the statement prominent enough for the consumer to notice?
- Is the information presented in an easy-to-understand format that does not contradict other information in the package, and in such a way that the consumer's attention is not distracted elsewhere?
- Is the placement of the information in a location consumers can be expected to notice?
- Finally, is the information in close proximity to the claim it qualifies?

The Reasonable Consumer Standard

When Red Diamond Home Loans makes a representation or launches a marketing practice to target a specific audience, such as older Americans, young people or financially distressed consumers, the communication must be evaluated from the point of view of a reasonable member of that group. Misleading statements should be avoided, even if only a minority (possibly significant) could be misled.

Misrepresentative Material

Material information is defined as that which is likely to affect a consumer's selection, or conduct regarding the product or service. The CFPB has identified certain categories of information as being deemed material due to their nature as "central characteristics." These categories include costs, benefits

[Section 4.72 Deceptive Acts or Practices \(continued\)](#)

and restrictions on the use or availability of the product; in this case, residential mortgage loans. If a representation or claim is not presumed to be material, it could still be deemed material if there is evidence that it is likely to be considered important to consumers.

Examples of Deceptive Acts

The CFPB has provided the following examples which have been identified as unfair acts by other regulators:

Misrepresentation about loan terms. In 2004, the FTC sued a mortgage broker advertising mortgage refinance loans at “3.5% fixed payment 30-year loan” or “3.5% fixed payment for 30 years,” implying that the offer was for a 30-year loan with a 3.5% fixed interest rate. Instead, the FTC claimed that the broker offered adjustable rate mortgages (ARMs) with an option to pay various amounts, including a minimum monthly payment that represented only a portion of the required interest. As a result, unpaid interest was added to the principal of the loan, resulting in negative amortization.

- Practice likely to mislead: The FTC claimed that the advertisements were misleading because they compared payments on a mortgage that would have been fully amortized to payments on a non-amortizing loan with payments that increased after the first year. In addition, the FTC claimed that after application, the broker provided Truth in Lending Act (TILA) disclosures that misstated the annual percentage rate (APR), and that failed to state that the loan was a variable rate loan.
- Reasonable consumer perspective: It was reasonable for consumers to believe that they would obtain fixed-rate mortgages, based on the representations.
- Material representation: The representations were material because consumers relied on them when making the decision to refinance their fully amortizing 30-year fixed loans. As a result, the consumers ended up with adjustable rate mortgages that would negatively amortize if they made payments at the stated 3.5% payment rate.

[Section 4.73 Abusive Acts or Practices](#)

The Dodd-Frank Act also prohibits conduct that is considered an “abusive act or practice.” An act or practice is abusive when:

- It materially interferes with the ability of a consumer to understand a term or condition of a consumer financial product or service or
- It takes unreasonable advantage of:
 - A lack of understanding on the part of the consumer of the material risks, costs or conditions of the product or service;
 - The inability of the consumer to protect their interests in selecting or using a consumer financial product or service; or
 - The reasonable reliance by the consumer on lenders’ personnel to act in the interests of the consumer.

[Section 4.73 Abusive Acts or Practices \(continued\)](#)

The Abusive Acts standard requires that the act or practice meet at least one of the following criteria:

- It “materially” interferes with the consumer’s ability to understand the product; or
- It “takes unreasonable advantage of” the consumer’s position.

This standard will require more clear evidence than the “reasonable basis to conclude” standard that applies to unfair acts. Abusive acts and practices may also be unfair or deceptive, but each prohibition is separate and distinct since they are governed by separate legal standards.

Consumer Complaints in Identifying Unfair, Deceptive, or Abusive Acts or Practices

Consumer complaints play a key role in the detection of unfair, deceptive or abusive practices. Consumer complaints have been an essential source of information for examinations, enforcement and rule-making for regulators. In general, consumer complaints can indicate weaknesses in elements of a compliance management system, e.g. training, internal controls or monitoring. Red Diamond Home Loans will aggressively be monitoring and replying to consumer complaints, as the company will evaluate and use them to determine if any employees are using UDAAP tactics.

[Section 4.80 Real Estate Procedures Act \(RESPA\) Regulation X](#)

The Real Estate Procedures Act requires lenders, mortgage brokers or servicers of home loans to provide borrowers with pertinent and timely disclosures regarding the nature and costs of the real estate settlement process. The Act also protects borrowers against certain abusive practices, such as kickbacks, and places limitations on the use of escrow accounts.

The National Affordable Housing Act of 1990 amended RESPA to require detailed disclosures concerning the transfer, sale or assignment of mortgage servicing. It also requires disclosures for mortgage escrow accounts at closing and annually thereafter, itemizing the charges to be paid by the borrower and what is paid out of the account by the servicer. In 2009 HUD clarified that all disclosures required by RESPA are permitted to be provided electronically, in accordance with the Electronic Signatures in Global and National Commerce Act (ESIGN). Finally, The Dodd-Frank Act granted rule-making authority and enforcement under RESPA to the CFPB.

RESPA is applicable to all lenders, creditors** and dealers dealing, financing or originating any federally-related mortgage loans on 1- to 4-unit family properties including condominiums, cooperative apartments and mobile homes, that are secured by a first or subordinate lien of the real property.

** It’s worth noting that under RESPA, mortgage brokers or correspondents would be considered as creditors, as opposed to the TILA’s definition of those parties as lenders.

There are a few types of transactions that are exempt from RESPA:

- A loan on property of 25 acres or more (whether or not a dwelling is located on the property).
- A loan primarily for business, commercial or agricultural purposes (definition identical to Regulation Z, 12 CFR 1026.3(a) (1)).

Section 4.80 Real Estate Procedures Act (RESPA) Regulation X (continued)

- A temporary loan, such as a construction loan. (The exemption does not apply if the loan is used as, or may be converted to, permanent financing by the same financial institution, or is used to finance transfer of title to the first user of the property.) If the lender issues a commitment for permanent financing, it is covered by the regulation.
- Any construction loan with a term of two years or more is covered by the regulation, unless it is made to a bona fide contractor. “Bridge” or “swing” loans are not covered by the regulation.
- A loan secured by vacant or unimproved property where no proceeds of the loan will be used to construct a one-to-four family residential structure. If the proceeds will be used to locate a manufactured home or build a structure within two years from the date of settlement, the loan is covered.
- An assumption, unless the mortgage instruments require lender approval for the assumption, and the lender approves the assumption.
- A renewal or modification where the original obligation (note) is still in effect but modified.
- A bona fide transfer of a loan obligation in the secondary market. (However, the mortgage servicing transfer disclosure requirements of 12 CFR 1024.21 still apply.) Mortgage broker transactions that are table-funded (the loan is funded by a contemporaneous advance of loan funds, and an assignment of the loan to the person advancing the funds) are not secondary market transactions, and therefore are covered by RESPA.

Special Information Booklet

At Red Diamond Home Loans, loan officers are required to provide the borrower with a copy of the Special Information Booklet or CFPB Settlement Booklet, when a written application is submitted, or no later than three business days after the application is received. If the application is denied before the end of the three-business-day period, the loan originator is not required to provide the booklet.

If the borrower uses a mortgage broker, the broker - rather than the lender - must provide the booklet. The booklet does not need to be provided for refinancing transactions, closed-end subordinate lien mortgage loans and reverse mortgage transactions, or for any other federally-related mortgage loan not intended for the purchase of a one-to-four family residential property.

Additional booklets are available and should be given to the borrower if applicable. The “Charm” booklet should be given to anyone selecting an adjustable rate mortgage. The “HELOC” booklet should be given to those selecting a HELOC. The newest booklet, “Your Home Loan Toolkit,” should be given to all borrowers. You must have at least one (1) printed copy of each booklet in your lobby for borrowers, but all the booklets can be emailed as a PDF.

Prohibition of Fees for Preparing Federal Disclosures

For loans subject to RESPA, no fee may be charged for preparing the Closing Disclosure Settlement Statement or the Escrow Account Statement, or any disclosures required by the Truth in Lending Act.

[Section 4.80 Real Estate Procedures Act \(RESPA\) Regulation X \(continued\)](#)

Written Provider List

When Red Diamond Home Loans allows a borrower to shop for third-party settlement services, we must provide the borrower with a written list of settlement service providers (SSP) at the time of the LE, on a separate document. The list should contain SSPs that are likely to be available to provide the settlement service for the borrower. As a lender, we cannot list a national provider assuming it will serve all markets. If the borrower selects an SSP from the written list of providers, then the 10% tolerance will apply. If the borrower chooses a provider who is not on the loan originators list, then the 10% tolerance does not apply.

[Section 4.82 Prohibition against Kickbacks and Unearned Fees](#)

Any person who accepts or receives a fee, kickback or item of value (payments, commissions, gifts, tangible items or special privileges) for the referral of settlement business is in violation of Section 8(a) of RESPA. Any person who gives or accepts any portion, split or percentage of a charge for real estate settlement services, other than for services actually performed, is in violation of Section 8(b) of RESPA. Appendix B of Regulation X provides guidance on the meaning and coverage of the prohibition against kickbacks and unearned fees. RESPA Section 8(b) is not violated when a single party charges and retains a settlement service fee which is unearned or excessive.

Penalties and Liabilities

Civil and criminal liability is provided for violating the prohibition against kickbacks and unearned fees including:

- Civil liability to the parties affected, equal to three times the amount of any charge paid for such settlement service.
- The possibility that the costs associated with any court proceeding, together with reasonable attorney's fees, could be recovered.
- A fine of not more than \$10,000, or imprisonment for not more than one year, or both.

Affiliated Business Arrangements

The regulation reads as follows: If a loan originator has either an affiliate relationship or a direct or beneficial ownership interest of more than one percent in a provider of settlement services, and the loan originator directly or indirectly refers business to the provider, it is an affiliated business arrangement. This is not a violation of Section 8 of RESPA and of 12 CFR 1024.14 of Regulation X, if the following conditions are satisfied. If Red Diamond Home Loans becomes affiliated with any investment company, it's imperative that the company provide borrowers with a disclosure that shall specify the following:

- The nature of the relationship (explaining the ownership and financial interest) between the provider and the loan originator; and
- The estimated charge, or range of charges, generally made by such provider.

Section 4.82 Prohibition against Kickbacks and Unearned Fees (continued)

This disclosure must be provided on a separate document, either at the time of loan application, with the LE or at referral.

Red Diamond Home Loans may not require the use of a service provider, with the following exceptions: the institution may require a buyer, borrower or seller to pay for the services of an attorney, credit reporting agency or real estate appraiser chosen by the institution to represent its interest. The ABA entity may only receive a return on ownership, franchise interest or payment otherwise permitted by RESPA.

Title Companies

Sellers that hold legal title to a property being sold are prohibited from requiring borrowers, either directly or indirectly, to use a specific title company as a condition of selling the property. *****Important***** Civil liability for violating this prohibition is an amount equal to three times all charges made for such title insurance. This means that a seller OR their representative agent cannot tell a buyer they must use a specific title company. If the seller or agent refuses to change to a different title company, then the seller must pay an amount equal to three times all the buyers' title charges to the borrower.

Escrow Accounts

It's important to know that RESPA sets guidelines and standards in regards to escrow accounts. The amount of escrow funds that can be collected at settlement, or upon creation of an escrow account, is restricted to an amount sufficient to pay charges, such as taxes and insurance, that are attributable to the period from the date such payments were last paid until the initial new loan payment date.

Section 4.90 Red Flags

The Red Flags Rules are implemented under the Fair and Accurate Credit Transactions Act of 2003 (FACTA). Enforcement of the rules began May 1st, 2009. The Red Flags Rules require all creditors and financial institutions to implement an Identity Theft Prevention Program to detect, prevent and mitigate identity theft. Under the Red Flags Rules, an institution must designate a person to oversee its implementation. For Red Diamond Home Loans, your Red Flags officer is Mike Porter. The designated individual will train employees, oversee audits, complete annual reports and monitor compliance with the Red Flags Rules.

Section 4.91 Red Diamond Home Loans Red Flags Policy

Plan Overview

The purpose of the Red Flags program is to detect, prevent and mitigate identity theft and fraud. It's the nature of the business for borrowers to go through several checks to verify their identity throughout the loan underwriting process, and it's much harder - and far less common - to see identity theft used in obtaining a mortgage. With that said, it's not impossible; and many of the items to monitor are the same as in Anti-Money Laundering (Section 4.3).

[Section 4.91 Red Diamond Home Loans Red Flags Policy \(continued\)](#)

Executive Policy Statement

Red Diamond Home Loans is committed to the mortgage industry, and to producing quality loans. To ensure that we continue to deliver a superior product, we must be vigilant when reviewing our borrowers and their requested transaction. We must verify every borrower's identity, and must verify every transaction. By outlining exactly what to look for, and incorporating this in to our day-to-day transactions, we can ensure the superior product our investors expect.

Red Flag Detection

Here we will discuss where to find, and how to detect red flags. Red flags may be identified in various different sources including:

- Documents furnished by the consumer
- Documents furnished by other parties involved in the transaction
- Documents furnished by employers or other income sources
- Notices received from outside persons or entities in connection with the borrower or transaction (i.e. credit agencies or title companies)

Simply put, a red flag is an inconsistency. Example: Your borrower claims to be 40 years old, but their social security number was issued 75 years ago. It's the duty of each and every loan officer and processor to look for red flags and investigate them. We investigate red flags to either:

- A)** Clear the inconsistency. Did we make a mistake in taking the app? Does this borrower actually pass inspection? or
- B)** Report the inconsistency to management, because the borrower's information cannot be verified.

Sometimes red flags will be very easy to spot; other times you will come across them as you attempt to verify information provided by the borrower:

- Inconsistencies in identifying information
- Inconsistencies between identification and the borrower's appearance
- Inability to answer routine questions
- Information provided that does not match data that is already on file
- Documents or signature appear altered, forged, etc.

Sometimes red flags can be identified in consumer reports, law enforcement or by using third-party vendors:

- Credit report fraud alerts, freezes, or warnings
- Alerts noted on Social Security number validation check
- Alerts noted on a Factual ID or Fraud Check
- Social Security verifications at <http://www.ssnvalidator.com/>
- An enforcement agency may even give notice of a specific borrower's name and/or SSN being related to fraud or misrepresentation in the area
- Personal identifying information associated with known fraud activity

Section 4.91 Red Diamond Home Loans Red Flags Policy (continued)

- A customer tries to persuade an employee not to file required reports or maintain required records.
- A customer's background differs from that which would be expected based on his or her business activities.

Relevant Red Flags

To begin, we are going to list red flags to watch for while taking the borrower's application, or processing the loan. It's important to note that a red flag could come up at any time, and it's everyone's job to be on the lookout. It does not matter if the loan has just been closed, or is clear-to-close when a red flag is discovered. The loan will be immediately placed on hold, and a thorough investigation must be conducted; the red flag must be cleared, or a denial issued and the fraudulent activity reported to the appropriate authorities.

Identity Theft Red Flags

- Documents provided for identification appear to be altered or forged
- Photograph on ID is inconsistent with appearance of borrower
- Information on ID is inconsistent with information provided by borrower
- Information on ID does not match any address in the consumer report
- SSN has not been issued, or appears on the SS Administration's Death Master File
- The date of birth provided by the borrower does not match the SS number range
- Alerts, notifications or other warnings received from consumer reporting agencies
- Personal identifying information associated with known fraud activity
- A customer tries to persuade an employee not to file required reports or maintain required records
- A customer's background differs from that which would be expected on the basis of his or her business activities

Verification Procedures

The two most common verification procedures you will likely encounter:

Address Discrepancy Procedures

- 1) Gather all documentation provided by the borrower that will have their address listed. This list might include 1003, paystubs, driver's license, W2's, tax returns, and bank statements.
- 2) Compare the addresses on the documentation the borrower provided against documentation that you've obtained from a third-party source. This may include Verification of Employment, Verification of Mortgage or Rent, credit reports, SSN verification, 4506-T verification (IRS) or USPS.

Section 4.91 Red Diamond Home Loans Red Flags Policy (continued)

- 3) Determine if the borrower's primary street name may also be known by a different name.
- 4) If all the other information the borrower has provided checks out, and a determination whether the discrepancy was a typographical error or incorrect data recorded, ask the borrower for a written explanation as to the discrepancy, and move on to the Risk Assessment.

Customer Identification Verification Procedures

- 1) Gather all documentation provided by the borrower that will have their SSN, D.O.B., and full legal name. This list might include 1003, paystubs, driver's license, Social Security Card, Credit Card, birth certificate, visa, W2's, tax returns, and bank statements.
- 2) Compare the SSN, D.O.B. and full legal name on the documentation the borrower provided against documentation that you've obtained from a third-party source. This may include Verification of Employment, Verification of Mortgage or Rent, credit reports, SSN verification, 4506-T verification (IRS) or USPS.
- 3) Compare the borrower's picture ID to the borrower
- 4) If all the other information the borrower has provided checks out, and a determination whether the discrepancy was a typographical error or incorrect data recorded, ask the borrower for a written explanation as to the discrepancy, and move on to the Risk Assessment.

Response to Red Flags Detected

Now that we've outlined where to look for red flags, the most common examples an employee would encounter and their verification procedures, let's discuss what actions to take.

Risk Assessment

How great is the risk resulting from the red flag? For example: The borrower lists their previous address as 213 Main St on their 1003 application. While checking their credit report, you notice that their previous address is listed as 123 Main St. All the other information checks out; D.O.B., SSN and current address. This is obviously a typographical mistake on the part of the credit agency, and there is little to no risk the borrower is not who they say they are. In this example, you've identified a red flag, and determined it doesn't pose a risk to the transaction. You may proceed with the transaction.

Next example: The borrower provides their name, D.O.B. and SSN in order to check their credit. When you receive the report, it comes back with an entirely different name. You decide to run an SSN verification, which indicates that the SSN was issued between 1977 and 1978; however, the D.O.B. the borrower provided shows they were born in 1973. This appears to be a case of identity theft, and poses a great risk to the transaction; and in turn, Red Diamond Home Loans. You must report this red flag and the evidence you have gathered to your Red Flags officer.

Not all cases will be as clear-cut as these two examples. If you suspect that a red flag may be present, you should bring the information to your Red Flags officer and have them make the determination regarding the risk, and whether or not it should be reported to the appropriate authorities.

Section 4.91 Red Diamond Home Loans Red Flags Policy (continued)

Fraud

There are two main types of fraud committed in the mortgage industry: borrower and employee fraud. The first, borrower fraud, is much easier to spot. If a borrower doctors a W2, paystub, bank statement or tax return, it's easy enough to verify with a VOE, VOD, or 4506-t form. However, borrowers can also commit the following types of fraud:

Fraudulent Red Flags

- **Occupancy Fraud:** Borrowers attest the subject property will be their primary residence to obtain better interest rates and lower down payment requirements. In reality, the subject is actually an investment property.
- **Income Fraud:** The borrower actually understates their income to qualify for hardship concessions and/or loan modifications.
- **Employment Fraud:** The borrower misrepresents where and for how long they have been employed; whether they are independent contractors or business owners; whether they are actually employed, or collecting unemployment.

While far less common today due to the new system of checks and balances, "straw" buys used to be far more common. A straw buy involves a fictitious individual who purchases or cashes-out on a property. While not impossible, this type of fraud is very difficult to commit.

Employee and Vendor Fraud

Employee and vendor frauds are more difficult to identify than borrower fraud. Employees know what underwriters will look for, and they can doctor income and asset statements far more easily than borrowers. In fact, employee fraud occurs three times as often as borrower fraud. Some indications are altered documentation, along with a low volume of business and the anxious behavior of someone attempting to commit fraud. While no one wants to be labeled as a whistleblower, especially on one of their own co-workers, it's your responsibility to report any suspicious activity to senior management or your Red Flags Officer. It's the responsibility of senior management to investigate any suspicious activity brought to them, and determine the validity of the claims. Any employee found committing fraud will be immediately terminated, and the proper authorities will be contacted. Failing to report fraudulent activity is grounds for termination, and you could be charged as an accessory after-the-fact and face fines and/or imprisonment.

Fraud and Active Duty Alert

Consumers who suspect that they may be victims of identity theft may place initial or extended fraud alerts on their consumer reports. Members of the armed services that are called to active duty may also place active-duty alerts on their accounts. These alerts are intended to prevent identity theft. No prospective user of a consumer report that includes an alert may establish a new credit plan or extension of credit in the name of the consumer, issue an additional card on an existing account or increase a credit limit, unless the user follows effective policies and procedures to verify the consumer's identity.

[Section 4.91 Red Diamond Home Loans Red Flags Policy \(continued\)](#)

Prevention of Re-Pollution of Consumer Reports

Victims of identity theft may block a consumer reporting agency from including information about allegedly fraudulent accounts on their consumer reports. In turn, the consumer reporting agency will inform the furnisher of this information about the block. Furnishers must establish and follow reasonable procedures to ensure that this information is not refurnished to the consumer reporting agency, thus “re-polluting” the victim’s consumer report. This section of the FACT Act also prohibits a financial institution from selling, transferring or placing for collection a debt caused by an identity theft.

Data Security, Internet Security, and Phishing

These topics are discussed in Section 5.1 Internet and Data Security of this quality control policy.

Risk Monitoring, Quality Control and Audit Policy

Annually, senior management along with our Red Flags Officer will conduct an audit of our red flags policy and procedures. Any areas found lacking from the prior year will have updated guidelines. In addition, we will conduct a QC audit of employees in regards to red flags. Each employee will be expected to have a general knowledge of red flags including detection, verification and relevant red flags. Employees will also need to show an understanding of consumer identity theft detection and verification procedures. All Red Diamond Home Loans employees will be required to take an annual online training course, along with a general knowledge test. Failure to complete the course and knowledge test will result in a 30-day probation. Failure to complete the course during the probationary period will result in termination. All QC and red flags audits will be kept for a period no less than five (5) years.

Proper Authorities

It will be the responsibility of management to report any fraud within 10 days of discovery to the following authorities:

Federal Trade Commission (FTC): (202) 326-2222

Consumer Financial Protection Bureau (CFPB): (855) 729-CFPB (2372)

Borrowers who have been the victim of identity theft should be encouraged to call the three main credit depositories immediately upon discovery.

Equifax: 1-800-525-6285 Experian: 1-888-397-3742 TransUnion: 1-800-680-7289

FinCen resource center: 1-800-767-2825 or (703) 905-3591 or by emailing your inquiry to FRC@fincen.gov.

[Section 4.100 Secure and Fair Enforcement for Mortgage Licensing \(SAFE Act\) Regulation G](#)

Congress passed The Secure and Fair Enforcement for Mortgage Licensing Act of 2008 (SAFE Act) in direct response to the foreclosure epidemic which devastated real estate markets, and forced many financial institutions to restrict lending activities - or even close their doors. Enacted on July 30, 2008, the SAFE Act mandates a nationwide licensing and registration system for residential mortgage loan originators (MLOs)

The SAFE Act requires that federal registration, state licensing and registration be accomplished through the same online registration system, the Nationwide Mortgage Licensing System and Registry (NMLS).

The objectives of the SAFE Act include aggregating and improving the flow of information to and between regulators; providing increased accountability and tracking of MLOs; enhancing consumer protections; supporting anti-fraud measures; provides consumers with easily accessible information at no charge regarding employment history, and publicly-adjudicated disciplinary and enforcement actions against MLOs.

Lastly, in the summer of 2011, rule-making authority for the SAFE Act was transferred to the CFPB. Before we lay out our SAFE Act procedures, some definitions that are important:

Annual renewal period means November 1st through December 31st of each year.

Administrative or clerical tasks means the receipt, collection and distribution of information common for the processing or underwriting of a loan in the residential mortgage industry; also communication with a consumer to obtain information necessary for the processing or underwriting of a residential mortgage loan.

Mortgage loan originator or MLO means an individual who (1) takes a residential mortgage loan application and (2) offers or negotiates terms of a residential mortgage loan for compensation or gain.

Registry means the Nationwide Mortgage Licensing System and Registry, or NMLS system, developed and maintained by the Conference of State Bank Supervisors and the American Association of Residential Mortgage Regulators for the state licensing and registration of state-licensed MLOs, and through which federal MLO registrations must be accomplished.

Registered mortgage loan originator or registrant means any individual who (1) meets the MLO definition; (2) is an employee of a covered financial institution; (3) is registered pursuant to the regulation with the Registry; and (4) maintains a unique identifier through the Registry.

Residential mortgage loan means any loan primarily for personal, family or household use that is secured by a mortgage, deed of trust, or other equivalent consensual security interest on a dwelling (as defined in Section 103(v) of the Truth in Lending Act, 15 U.S.C. Section 1602(v)) or residential real estate upon which is constructed or intended to be constructed as a dwelling (including manufactured homes), and includes refinances, reverse mortgages, home equity lines of credit, and other first and additional lien loans.

Unique identifier (NMLS #) means a number or other identifier that: (1) permanently identifies a registered MLO; (2) is assigned by protocols established by the Registry and the Bureau to facilitate electronic tracking of MLOs, as well as uniform identification of, and public access to, the employment history of and the publicly-adjudicated disciplinary and enforcement actions against MLOs; and (3) must not be used for purposes other than those set forth under the SAFE Act.

Section 4.101 SAFE Act – Red Diamond Home Loans Policies and Procedures

New MLO's

Per the company's and the SAFE Act guidelines, all new employees including MLO's employment offers will be contingent on a satisfactory criminal history background check, along with their ability to be issued an NMLS number under the national registry.

New and Current MLO's

Under the SAFE Act, Red Diamond Home Loans is required to monitor our MLO's registration and updates within the NMLS Registrant system. This means that within 30 days of your annual renewal within NMLS, we will require a copy of any information you submit to NMLS, along with a copy of your updated license. This includes new registrations, updates and renewals. If for any reason you are unable to renew due to failure to complete continuing education or recent criminal charges, you must inform management immediately. If an MLO fails to comply with either the registration requirements of the SAFE Act or Kelly Stephens' policies, that person will be placed on a 30-day probation. If the MLO does not achieve compliance within the probation period, that person will be terminated.

Annual Reviews

Management will test for compliance with the SAFE Act annually, by randomly auditing MLO personnel files for accuracy and compliance with the MLO's NMLS numbers in regards to marketing communications and contact with borrowers. We may randomly run criminal background checks to insure the MLO is still operating within applicable federal laws.

Registration

Per regulations, we must require an MLO employee to register with the Registry, maintain this registration, and obtain a unique identifier. We must also confirm each MLO's employment status once the MLO submits registration information to the Registry, and before the registration is activated.

Within 30 days of the date an MLO ceases to be an employee of the company, Red Diamond Home Loans must notify the Registry of that fact, along with the date the MLO ceased being an employee, so that consumers searching for an MLO in the publicly available consumer access portal will know that the MLO no longer has a relationship with the company.

Federal Registration Requirements

Each employee of a federally regulated institution who is an MLO must submit to the Registry the following:

- Identifying information, including name, home address, social security number, gender, date of birth and principal business location;
- Financial-services-related employment history for the prior 10 years;

Section 4.101 SAFE Act- Red Diamond Home Loans Policies and Procedures (continued)

- Disclosure of specified criminal, civil, judicial, state, federal or foreign financial authority regulatory actions against the employee, including:
 - i) Convictions of any criminal offense involving dishonesty, breach of trust or money laundering against the employee or organizations controlled by the employee, or agreements entered into a pretrial diversion in connection with the prosecution for such offenses;
 - ii) Civil judicial actions against the employee in connection with financial service-related activities, dismissals with settlements or judicial findings that the employee violated financial service-related statutes or regulations;
 - iii) Orders issued by a state or federal regulatory agency or foreign financial regulatory authority based on violations of law, or regulations that prohibit fraudulent, manipulative or deceptive conduct;
- Fingerprints, for purposes of a Federal Bureau of Investigation background check;
- Revocation or suspension of the employee's authorization to act as an attorney, accountant or state or federal contractor;
- Any customer-initiated financial service-related arbitration or civil action against the employee.

The employee must attest to the veracity of the information submitted to the Registry; must authorize the Registry and the institution to obtain information related to any administrative, civil or criminal action to which the employee is a party; and must authorize the Registry to make certain information available to the public.

Maintaining Federal Registration

A registered MLO must:

- 1) Renew the registration during the annual renewal period, which includes confirming and updating identifying information.
- 2) Update the registration within 30 days of any change in the name of the registrant; if the registrant ceases to be an employee of the institution; or if Registry-required information becomes inaccurate, incomplete or out-of-date.

A registered MLO must maintain his or her registration, unless the individual is no longer engaged in the activity of a mortgage loan originator. Any registration that is not renewed during the annual two-month renewal period will become inactive, and the individual cannot act as an MLO until the registration requirements are met.

Section 4.101 SAFE Act – Red Diamond Home Loans Policies and Procedures (continued)

Company Requirements for MLO Registration, Renewal and Changes in Information

In connection with the registration of one or more MLOs, Red Diamond Home Loans must submit certain required information to the Registry:

- Contact information;
- Employer Tax Identification Number;
- Research Statistics Supervision and Discount (RSSD) number issued by the Board;
- Primary Federal regulator;
- Primary point of contact for the Registry;
- Individuals with authority to enter information into the Registry.

Once registered, the institution will receive an NMLS identification number for the institution to use in attesting to MLO employment, and for other Safe Act-related purposes.

Unique Identifier (NMLS #)

When an MLO registers with the Registry, he or she receives a unique identifier — a series of numeric characters assigned for life. The unique identifiers allow MLOs to be tracked if they move between state and federal jurisdictions and/or change employers, and help consumers to find certain information about a particular MLO when they search on the Registry's consumer access portal. The MLO information publicly available on the consumer access portal will ultimately include federal and state registrations and licenses held, the MLO's employment history, and publicly adjudicated disciplinary and enforcement actions, if any.

*****Important***** To make sure that consumers have access to an MLO's unique identifier before committing to a mortgage loan transaction, an MLO must provide the unique identifier upon request (orally or in writing), before acting as an MLO; and in any initial written communication (paper or electronic) from the MLO to the consumer (such as a commitment letter, Loan Estimate or disclosure statement). MLO unique identifiers may be used on written materials or promotional items distributed by the institution for general use; for example on loan program descriptions, advertisements, business cards, stationery, notepads and similar materials; the SAFE Act regulation does not prohibit such use. Your NMLS number needs to be on everything you send to consumers, whether printed marketing materials or emails. Any MLO discovered not having their NMLS number on any of their communications will be put on probation for a period of 30 days. If a second violation is discovered, the MLO will be terminated by Red Diamond Home Loans.

The company is also required to make mortgage loan originators' NMLS numbers available to consumers in an openly-available way; therefore we will post all registered MLO's and their corresponding NMLS numbers in the lobby of our building at:

165 S. Kimball Avenue, Suite 100, Southlake, Texas 76092

Section 4.102 Third-Party Vendor Compliance

Red Diamond Home Loans does business with a number of vendors, third-party service providers, brokers, dealers and agents who offer the company a variety of required services in the origination and closing of residential mortgages. This policy ensures that the company will take steps to minimize any risks arising from arrangements with third parties. This policy includes steps for appropriate due diligence prior to entering a third-party arrangement, and to establish monitoring procedures for compliance.

The compliance officer is responsible for monitoring compliance of vendors. The compliance officer may designate an internal or outsourced auditor to conduct a review of the company's vendor management annually and report the results of the audit, including management responses, to management.

As per the CFPB, Red Diamond Home Loans is required to establish procedures designed to ensure that any third party with which the institution has arrangements related to mortgage loan origination has policies and procedures to comply with the SAFE Act and SAFE Act regulation, including appropriate licensing and/or registration of individuals acting as MLOs. Therefore, going forward, we will require the following to be obtained and placed within each file:

Appraisers and Appraisal Management Companies (AMC's)

- Appraisers must submit current license
- AMC's must submit their SAFE Act policies and procedures (if obtainable)
- AMC's certification

Title Companies

- Title companies must send a copy of their current license
- Closing Protection Letter
- A copy of their E & O (if obtainable)
- A copy of their SAFE Act policies and procedures (if obtainable)

Real Estate Agents

- A copy of their current license for each agent involved in the transaction
- A copy of their E & O (if obtainable)
- A copy of their SAFE Act policies and procedures (if obtainable)

Builder (if borrower is dealing directly and has no real estate agent)

- A copy of their current state license
- A copy of their E & O (if obtainable)
- A copy of their SAFE Act policies and procedures (if obtainable)

Credit Agencies

- A copy of their SAFE Act policies and procedures (if obtainable)

Surveyor (if applicable – only if the borrower requires a new survey)

- A copy of their current state license
- A copy of their E & O (if obtainable)
- A copy of their SAFE Act policies and procedures (if obtainable)

Doc Prep Companies

- A copy of their E & O (if obtainable)
- A copy of their SAFE Act policies and procedures (if obtainable)

Lender/Investor

- A copy of their E & O (if obtainable)
- A copy of their SAFE Act policies and procedures (if obtainable)

[Section 4.102 Third-Party Vendor Compliance \(continued\)](#)

Lastly, Red Diamond Home Loans requires that the processor sign and date our Third-Party Vendor Compliance disclosure. This states that we have made every reasonable effort to obtain compliance material from the vendors involved in the transaction.

[Section 4.110 Gramm-Leach-Bliley Act \(GLBA\)](#)

Privacy of Consumer Financial Information

Title V of the Gramm-Leach-Bliley Act (GLBA) governs the treatment of nonpublic personal information about consumers by financial institutions. Section 502 of the Subtitle, subject to certain exceptions, prohibits a financial institution from disclosing nonpublic personal information about a consumer to nonaffiliated third parties, unless the institution satisfies various notice and opt-out requirements, and provided that the consumer has not elected to opt out of the disclosure. Section 503 requires the institution to provide notice of its privacy policies and practices to its customers. The Dodd-Frank Act granted rule-making authority of Title V of the GLBA to the CFPB in December of 2011.

In general, the privacy notice must describe a financial institution's policies and practices with respect to disclosing nonpublic personal information about a consumer to both affiliated and nonaffiliated third parties. Also, the notice must provide a consumer a reasonable opportunity to direct the institution generally not to share nonpublic personal information about the consumer (that is, to "opt out") with nonaffiliated third parties, other than as permitted by the statute (for example, sharing for everyday business purposes, such as processing transactions and maintaining customers' accounts, and in response to properly executed governmental requests). The privacy notice must also provide, where applicable under the Fair Credit Reporting Act ("FCRA"), a notice and an opportunity for a consumer to opt out of certain information sharing among affiliates.

Definitions

In discussing the duties and limitations imposed by the regulations, a number of key concepts are used. Each concept is briefly discussed below.

A financial institution is any institution the business of which is engaging in activities that are financial in nature. Financial institutions can include banks, securities brokers and dealers, insurance underwriters and agents, finance companies, mortgage bankers and travel agents.

Nonpublic personal information generally is any information that is not publicly available and that:

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

[Section 4.110 Gramm-Leach-Bliley Act \(GLBA\) \(continued\)](#)

Nonpublic personal information may include individual items or lists of information. For example, nonpublic personal information may include names, addresses, phone numbers, social security numbers, income, credit score and information obtained through internet collection devices (i.e., cookies).

A nonaffiliated third party is anyone involved in a transaction who is not a financial institution's affiliate, or a person employed jointly by a financial institution and a company that is not the institution's affiliate.

An "affiliate" of a financial institution is any company that controls, is controlled by, or is under common control with the financial institution.

A consumer is an individual, or that individual's legal representative, who obtains or has obtained a financial product or service from a financial institution, that is to be used primarily for personal, family or household purposes.

A customer is a consumer who has a "customer relationship" with a financial institution. This is defined as a continuous relationship between a consumer and a financial institution, under which the institution provides one or more financial products or services to the consumer that are to be used primarily for personal, family or household purposes.

Consumer and Customer:

The distinction between consumers and customers is significant, because financial institutions have additional disclosure duties with respect to customers. All customers covered under the regulation are consumers, but not all consumers are customers.

Consumers are entitled to an initial privacy and opt-out notice.

Customers are entitled to an annual privacy and opt-out notice.

Since Red Diamond Home Loans sells its loans within days of closing, and does not service or accept payments on loans, our clients are considered consumers under GLBA, and are given an initial privacy and opt-out notice.

Opt-out Rights:

Consumers must be given the right to "opt out" of, or prevent, a financial institution from disclosing nonpublic personal information about them to a nonaffiliated third party, unless an exception to that right applies.

As part of the opt-out right, consumers must be given a reasonable opportunity and means to opt out. What constitutes a *reasonable opportunity to opt out* depends on the circumstances surrounding the consumer's transaction, but a consumer must be provided a reasonable amount of time to exercise the opt-out right. For example, it would be reasonable if the financial institution allows 30 days from the date of mailing a notice, or 30 days after customer acknowledgement of an electronic notice for an opt-out direction to be returned. What constitutes a *reasonable means to opt out* may include check-off boxes,

[Section 4.110 Gramm-Leach-Bliley Act \(GLBA\) \(continued\)](#)

a reply form or a toll- free telephone number, again depending on the circumstances surrounding the consumer's transaction. It is not reasonable to require a consumer to write his or her own letter as the only means to opt out.

In our case, we give the consumer our privacy policy and opt-out notice at the time of application, and a signature is required by the consumer.

Notice and Opt-out Duties to Consumers:

If a financial institution intends to disclose nonpublic personal information about any of its consumers (whether or not they are customers) to a nonaffiliated third party, and an exception does not apply, then the financial institution must provide to the consumer:

- An initial notice of its privacy policies;
- An opt-out notice (including, among other things, a reasonable means to opt out); and
- A reasonable opportunity, before the financial institution discloses the information to the nonaffiliated third party, to opt out.

The financial institution may not disclose any nonpublic personal information to nonaffiliated third parties except under the enumerated exceptions, unless these notices have been provided and the consumer has not opted out. Additionally, the institution must provide a *revised notice* before the financial institution begins to share a new category of nonpublic personal information, or shares information with a new category of nonaffiliated third party in a manner that was not described in the previous notice.

Requirements for Notices

Clear and Conspicuous. Privacy notices must be clear and conspicuous, meaning they must be reasonably understandable and designed to call attention to the nature and significance of the information contained in the notice.

Delivery Rules. Privacy notices must be provided so that each recipient can expect to receive an actual notice in writing; or if the consumer agrees, electronically. To meet this standard, a financial institution could, for example (1) hand-deliver a printed copy of the notice to its consumers, (2) mail a printed copy of the notice to a consumer's last known address, or (3) for the consumer who conducts transactions electronically, post the notice on the institution's website, and require the consumer to acknowledge receipt of the notice as a necessary step to completing the transaction.

[Section 4.111 Gramm-Leach-Bliley Act \(GLBA\) Red Diamond Home Loans Policy](#)

At Red Diamond Home Loans we do not share or sell nonpublic personal information to anyone, nor do we share information with our affiliates. Any employee found collecting (for future personal gains) or selling nonpublic information will be immediately terminated. Any complaints from consumers regarding treatment of nonpublic personal information will be investigated and logged. If complaints from multiple consumers arise who have had the same MLO, that person will be placed on probation indefinitely until an investigation can be conducted. The purpose of the investigation will be to determine whether the MLO in question is in fact selling nonpublic information, or if the MLO has been making non-malicious mistakes. If the MLO has been making mistakes, he or she will be released from probation after completing additional training.

Red Diamond Home Loans will review our GLBA policy annually, or additionally as needed.

Section 4.120 Home Mortgage Disclosure Act (HMDA) Regulation C

Financial institutions must report data regarding loan originations, applications and loan purchases. Requests under a preapproval program (as defined in 12 CFR 1003.2) must also be reported, if the preapproval request is denied or results in the origination of a home-purchase loan. HMDA requires lenders to report the ethnicity, race, gender and gross income of mortgage applicants and borrowers. Lenders must also report information regarding the pricing of the loan, and whether the loan is subject to the Home Ownership and Equity Protection Act. Additionally, lenders must identify the type of purchaser for mortgage loans that they sell. The Dodd-Frank Act requires that the CFPB amend Regulation C to require the reporting of additional data fields. Financial institutions will be required to comply with the additional reporting requirements after those amendments are finalized.

Mortgage Call Reports (MCR)

Financial institutions are required to record data regarding each application for, and each origination and purchase of, home-purchase loans, home-improvement loans and refinances on a Loan/Application Register, also known as a Mortgage Call Report (MCR). Transactions are to be reported for the quarter in which final action was taken. If a loan application is pending at the end of the quarter, it will be reported on the MCR for the following quarter, when the final disposition is made. Loans originated or purchased during the quarter must be reported for the quarter of origination, even if they were subsequently sold.

Finally, a Statement of Condition Report must be submitted to NMLS annually, within 90 days of your company's fiscal year end.

Retention

A financial institution must retain its full (unmodified) call report for at least three years for examination purposes

Section 4.130 Homeowners Protection Act (HPA)

The Homeowners Protection Act requires lenders to provide borrowers with a Mortgage Insurance Disclosure form for conventional single-family owner-occupied transactions. HPA gives the borrower the right to request cancellation of mortgage insurance (MI) when the remaining mortgage has been paid down to 80% of the original purchase price or appraised value of the home when the loan was obtained, whichever is less. Under HPA, borrowers must be sent disclosures informing them of their rights provided by HPA on three different occasions: At closing, annually and upon cancellation or termination of MI.

Section 5

Section 5.1 Internet & Data Security

Employees may have access to confidential information contained in the company's customer data base. This information belongs to Red Diamond Home Loans, and may not be shared with anyone. We require the consumer sign a Consumer Privacy Notice, whether or not an application is taken.

All loan originators, processors and other staff-members referencing file documents from former customers for the purposes of evaluation and processing and application shall adhere to the policies set forth regarding use and re-use of consumer information and information-sharing. For direct marketing to prior customers, the consumer may be unaware of what information, and the extent of information, that has been made available to the company representative, who may be a different loan originator. In these cases, caution must be exercised to assure the borrower that access to their information was duly authorized and in compliance with privacy regulations.

Email is a critical mechanism for business communications. Nevertheless, we live in a world that requires security to protect us, both in physical and in electronic forms. Thousands of people attempt to obtain your digital footprint, and our client's digital footprint, every single day. It's imperative that we don't allow this to happen; and by following some simple steps, we can minimize the chances of clients' data falling into the wrong hands.

Phishing

Phishing is the attempt to acquire sensitive information such as usernames, passwords and credit card details by masquerading as a trustworthy entity in an electronic communication. Communications purporting to be from popular social web sites, auction sites, banks, online payment processors or IT administrators are commonly used to lure the unsuspecting public. Phishing emails may contain links to websites that are infected with malware. Phishing is typically carried out by email or instant messaging, and it often directs users to enter details into a fake website, whose look and feel are almost identical to the legitimate one. If you come across an email or instant message that you are unsure of, DO NOT OPEN & DO NOT CLICK ON HYPERLINKS. Do not forward the email either, as it could contain malware; have your manager review the email to make a determination if it's legitimate or a phishing attempt. Remember that phishing can extend to social media, so be vigilant on Facebook and LinkedIn as well.

Spyware

Spyware is software that enables a user to obtain covert information about another's computer activities by transmitting data covertly from their hard drive. Spyware is mostly classified into four types: system monitors, trojans, adware and tracking cookies. While the term "spyware" suggests software that monitors a user's computing, the functions of spyware can extend beyond simple monitoring. Spyware can collect almost any type of data, including personal information like internet surfing habits, user logins, and bank or credit account information. Spyware can also interfere with user control of a computer by installing additional software or redirecting web browsers. Some spyware can change computer settings which can result in slow internet connection speeds, unauthorized changes in browser settings, or changes to software settings. To combat the threat that spyware poses, our network and any connected

[Section 5.1 Internet & Data Security \(continued\)](#)

devices must be protected by anti-virus and anti-spyware software. We've chosen Norton Security as our system.

A general policy for safeguarding consumer information is to mark all emails and correspondence with "Confidential." For purposes of this policy, confidential information includes, but is not limited to:

- Information regarding personnel who are currently or formerly employed by the company
- Procedures for computer access and passwords of Red Diamond Home Loans employees and system users.
- Any information pertaining to mortgage borrowers who have closed loans with the company.
- Any information regarding mortgage applicants whose loans were closed for being incomplete, withdrawn, denied or counter-offer not accepted.
- Prospect information concerning potential customers of the company.
- Any other information relating to the company's research, marketing, operations, investors, warehouse lenders and secondary marketing agencies.

Electronic Access

Red Diamond Home Loans provides every employee with electronic access to all employees that handle loan origination, closing and post-closing information. Personnel are assigned an email address, a network connection and internet access. This policy governs all use of the company's network, internet access, and email system at all company locations and offices. This policy includes, but is not limited to, electronic mail, chat rooms, the internet, news groups, electronic bulletin boards, the company's VPM/intranet and all other company electronic messaging systems. This policy governs the information security for all documentation utilized by the company and its affiliates, whether the communication is made by telephone, mail, facsimile, courier or any electronic system.

Network and Internet Policy

Network configurations enable loan processors, originators, closing coordinators and administrative staff to access certain files. All rules and policies with respect to consumer information apply to files accessed among network users. Safeguarding confidential information involves local area network (LAN) and wide area network (WAN) configurations. Red Diamond Home Loans requires all users having access to networked information comply with the safeguarding of confidential information. In addition, we reserve the right to suspend access at any time, without notice for technical reasons, suspected policy violations, or other security concerns.

[Section 5.1 Internet & Data Security \(continued\)](#)

Devices

All computers and laptops must have an internet security program installed prior to connecting to Kelly Stephens' network. If employees wish to check their email on handheld devices, they need to show proof to management that Norton Mobile Security or a comparable security program has been installed, before network access will be permitted. All devices used to check email or utilize company servers must be password-protected.

Monitoring and Confidentiality

The email systems and services used at Red Diamond Home Loans are owned by the company, are its property and are intended for business purposes only. When using our computers, electronic equipment and the company's email system (whether to send, receive, store, or delete e-mails), employees have no right to privacy, and shall not expect privacy. The company reserves the right to review, monitor and disclose any and all email traffic passing through its system.

Red Diamond Home Loans also specifically reserves the right to monitor electronic messages and email sent or received with personal, password-protected, web-based email accounts when company computers and other electronic equipment are used, or when employees send or receive electronic messages and e-mail accessing the company's servers remotely using any personal computer, smartphone or similar electronic device.

This monitoring may include, but is not limited to, review by our attorneys during the e-mail discovery phase of litigation, observation by management in cases of suspected abuse or to monitor employee efficiency. Red Diamond Home Loans further reserves the right to forensically retrieve such electronic messages which have been deleted from a company computer or other electronic equipment.

Use extreme caution when communicating confidential or sensitive information via e-mail. Keep in mind that all email messages sent from the company become the property of the receiver. Demonstrate particular care when using the "Reply" or "Reply to all" command during email correspondence, to ensure the resulting message is not delivered to unintended recipients. Federal regulations require that when sending confidential, sensitive or private information, including but not limited to: D.O.B, SSN's, bank statements, pay stubs, tax returns, consumer credit or account numbers etc., that the email must be either (A) encrypted; or (B) password-protected. If using password protection for an email, the password must be sent to the recipient in a separate email; you must not include the password in the original email.

Authorized Use of Software

Red Diamond Home Loans purchases, leases or maintains site licenses for computer software applications from a variety of commercial manufacturers. To ensure compliance with software license agreements, the company's security policy, and to prevent identity theft resulting from shared, copied or unauthorized downloading of software programs, applications and data, all employees must adhere to the following:

Section 5.1 Internet & Data Security (continued)

- (1) Software must be used in accordance with the manufacturer's license agreements. Employees acknowledge that they do not own the Loan Origination System (LOS), Desktop Originator, Loan Prospector, or other mortgage pre-qualification programs used in connection or as an adjunct to the firm's LOS system that are supplied by the company.
- (2) Employees may not make additional copies of any software, unless expressly authorized by the company and software publisher.
- (3) Any employee who knowingly makes, acquires or uses unauthorized copies of computer software licensed to the company, or who places or uses unauthorized software on the company premises or equipment shall be subject to disciplinary action or termination.
- (4) Employees must obtain permission from the Security Officer prior to installing personal software onto the company's computer system. Employees are not permitted to copy software from the company's computer system for installation on home or other computers without prior authorization.
- (5) In cases that require an employee to use software at home, the company will purchase an additional copy or license. Employee acknowledges that any additional copies or licenses purchased for home use are the property of the company. Employees who are required to use software at home should consult with the Security Officer to determine if appropriate licenses allow for home use.
- (6) Employees who suspect or become aware of software misuse by any employee are required to notify the Security Officer in confidence.

Administrative Access Control

The Security Officer shall maintain confidential passwords and access codes for technology on a corporate-wide level. The company president and key personnel shall have copies of access code information. Changes in personnel, termination, extended leave, etc. shall warrant changes in passwords or other access codes. All changes must be documented by memorandum, and placed as an addendum to this policy manual.

Physical Data

It's important to remember that physical data, i.e. paper, needs protection just as digital data does. Employees are expected to keep sensitive and private data secure at all times. After the retention periods have been met and physical data needs to be destroyed, it must be done on site. This means that all shredding either done in-house or by an outside party must be done at our main office, documents may not be sent out or picked up to be destroyed offsite. This includes credit reports, mortgage applications, financial statements, tax returns, paystubs, W-2's and any other income or asset documentation. Any lost or misplaced confidential documents must be reported to management immediately.

General Expectations of End Users

Email users are responsible for mailbox management, including organization and cleaning. If a user subscribes to a mailing list, he or she must be aware of how to unsubscribe from the list, and is responsible for doing so if their current email address changes. Red Diamond Home Loans email users are responsible for honoring any requests for "do-not-send" or "opt-out" from e-mail recipients.

Section 5.1 Internet & Data Security (continued)

Email users are expected to remember that email sent from the company's accounts reflects on the company. Please comply with normal standards of professional and personal courtesy and conduct.

Inappropriate Use

Email use at Red Diamond Home Loans must comply with all applicable laws, all company policies and all company contracts. Email users should have no expectation of privacy in any emails sent or received, saved or deleted, regarding any matter over the company email system or while using company computers.

The following activities are deemed inappropriate uses of the company's email systems and services, and are strictly prohibited:

- Use of email for illegal or unlawful purposes, including: copyright infringement, obscenity, libel, slander, fraud, defamation, plagiarism, harassment, intimidation, threats, forgery, impersonation, soliciting for illegal pyramid schemes or computer tampering (e.g. spreading of computer viruses).
- Use of email for inappropriate content, either embedded within a message or within a link, including but not limited to: sexual, pornographic, racist or other offensive materials.
- Forwarding any business-related email to an external, personal or other email account. This includes misappropriation of confidential and proprietary company information, and/or trade secrets.
- Sending or forwarding messages containing borrower consumer credit, confidential information or account numbers without using proper encryption.
- Sending or forwarding messages that disclose information without company authorization. This shall include accessing, transmitting, receiving or seeking confidential information about borrowers or mortgage transactions without authorization.
- Use of email in any way that violates Red Diamond Home Loans policies, rules or federal regulations.
- Use of company email systems and services for mass mailings, distribution or marketing of any type without prior management approval.
- Viewing, copying, altering or deleting email accounts or files belonging to Red Diamond Home Loans, or another individual, without authorized permission.
- Opening email attachments from unknown or unsigned sources. Attachments are the primary source of computer viruses, and should be treated with extreme caution.
- Sharing email account passwords with another person, or attempting to obtain another person's email account password. Email accounts are only to be used by the registered user.
- Red Diamond Home Loans prohibits personal use of its e-mail systems and services for unsolicited mass mailings, non-company commercial activity, political campaigning, dissemination of chain letters and use by non-employees, and for any use prohibited in this policy. Please note that personal emails will be considered the same as personal messages. Users should not use company email to send messages that the user wishes to remain private.

[Section 5.1 Internet & Data Security \(continued\)](#)

Retention

Users are responsible for saving all email communications in conjunction with loan production, applicant, client, customer and borrower communications. All aforementioned communications shall be kept for a period of twenty-four months.

Failure to Comply

Red Diamond Home Loans assumes no liability for direct or indirect damages arising from the use of the company's email system and services. Users are solely responsible for the content they disseminate.

Violations of this policy will be treated like other allegations of wrongdoing at Red Diamond Home Loans. Allegations of misconduct will be investigated according to established procedures. Consequences for inappropriate use of the company's email systems and services may include, but are not limited to, one or more of the following:

- Temporary or permanent revocation of e-mail access;
- Probationary action according to applicable policies;
- Termination of employment; and/or
- Legal action according to applicable laws and contractual agreements.

Incident Response and Preparedness

Red Diamond Home Loans must respond to information security incidents to ensure the protection of confidential consumer information. The federal Anti-Cybersquatting Consumer Protection Act (ACCPA) allows the company to initiate immediate action in federal district court under section 43(d) of the Lanham Act, 15 USC 1125(d). The following resources can be used to disable a spoofed website, recover customer information and mitigate other types of security threats:

- A complaint can be filed with the Internet Fraud Complaint Center, a partnership of the FBI and the National White Collar Crime Center at: <http://www.ifccfbi.gov/>
- The Uniform Domain Name Dispute Resolution Process (UDRP) resolves disputes for names or trademarks that have been illegally infringed upon. The company is to take action against domain name registrars to stop a spoofing incident. Information is explained at: <http://www.icann.org/udrp/udrp-policy>
- Digital Phishnet is a joint initiative of industry and law enforcement designed to support apprehension of perpetrators of phishing-related crimes, including spoofing. The FTC, FBI, Secret Service and other electronic crimes task forces assist financial institutions in identifying persons involved in phishing-type crimes. <http://www.digitalphishnet.com/>.

Section 6

Section 6.1 Mortgage Acts and Practices-Advertising MAP (Regulation N)

The Mortgage Acts and Practices (MAP) originally came out of the 2009 Omnibus Appropriations Act that set forth advertising and disclosure rules. Under Dodd-Frank, the rules were restated in 2010 and given to the CFPB for rule-making authority and oversight in 2011. Regulation N puts forth acceptable standards for advertising verbally, written or digitally. It's also worth repeating that any and all forms of advertising by a loan officer, either by scripts for sales calls or flyers to hand out, must be approved by management before they may be distributed. Loan officers need to pay close attention to this section.

Definitions

For the purposes of this section, here are some definitions:

Commercial communication - which means any written or oral statement, illustration or depiction, whether in English, or any other language that is designed to affect a sale or create interest in purchasing goods or services. This applies to labels, packages, package inserts, radio, television, cable television, brochures, newspapers, magazines, pamphlets, leaflets, circulars, mailers, book inserts, free-standing inserts, letters, catalogues, posters, charts, billboards, public transit cards, point-of-purchase displays, films, slides, audio programs transmitted over a telephone system, telemarketing scripts, on-hold scripts, upsell scripts, training materials provided to telemarketing firms, program-length commercials ("infomercials"), the internet, cellular network or any other medium. Promotional materials, items and web pages are included in the term *commercial communication*.

Consumer - means an individual to whom a mortgage credit product is offered or extended.

Credit - means the right to defer payment of debt, or to incur debt and defer its payment.

Dwelling - means a residential structure that contains one to four units, whether or not that structure is attached to real property. The term includes any of the following if used as a residence: an individual condominium unit, cooperative unit, mobile home, manufactured home or trailer.

Mortgage credit product - means any form of credit that is secured by real property or a dwelling, and that is offered or extended to a consumer primarily for personal, family or household purposes.

Person - means any individual, group, unincorporated association, limited or general partnership, corporation or other business entity.

Term - means any of the fees, costs, obligations or characteristics of, or associated with the product. It also includes any of the conditions on or related to the availability of the product.

Prohibited representations

It is a violation for any employee of Red Diamond Home Loans to make any material misrepresentation, expressly or by implication, in any commercial communication, regarding any term of any mortgage credit product, including but not limited to misrepresentations regarding:

Section 6.1 Mortgage Acts and Practices-Advertising (MAP) Regulation N (continued)

- (1)** The interest charged for the mortgage credit product, including but not limited to misrepresentations concerning:
 - (i)** The amount of interest that the consumer owes each month that is included in the consumer's payments, loan amount or total amount due, or
 - (ii)** Whether the difference between the interest owed and the interest paid is added to the total amount due from the consumer;
- (2)** The annual percentage rate, simple annual rate, periodic rate or any other rate;
- (3)** The existence, nature or amount of fees or costs to the consumer associated with the mortgage credit product, including but not limited to misrepresentations that no fees are charged;
- (4)** The existence, cost, payment or any other terms associated with any additional product or feature that is or may be sold in conjunction with the mortgage credit product, including but not limited to credit insurance or credit disability insurance;
- (5)** The terms, amounts, payments or other requirements relating to taxes or insurance associated with the mortgage credit product, including but not limited to misrepresentations about:
 - (i)** Whether separate payment of taxes or insurance is required; or
 - (ii)** The extent to which payment for taxes or insurance is included in the loan payments, loan amount or total amount due from the consumer;
- (6)** Any prepayment penalty associated with the mortgage credit product, including but not limited to misrepresentations concerning the existence, nature, amount or terms of such penalty;
- (7)** The variability of interest, payments or other terms of the mortgage credit product, including but not limited to misrepresentations using the word "fixed";
- (8)** Any comparison between:
 - (i)** Any rate or payment that will be available for a period less than the full length of the mortgage credit product; and
 - (ii)** Any actual or hypothetical rate or payment; the type of mortgage credit product, including but not limited to misrepresentations that the product is or involves a fully amortizing mortgage;
- (9)** The amount of the obligation, or the existence, nature or amount of cash or credit available to the consumer in connection with the mortgage credit product, including but not limited to misrepresentations that the consumer will receive a certain amount of cash or credit as part of a mortgage credit transaction;

Section 6.1 Mortgage Acts and Practices-Advertising (MAP) Regulation N (continued)

- (10)** The existence, number, amount or timing of any minimum or required payments, including but not limited to misrepresentations about any payments, or that no payments are required in a reverse mortgage or other mortgage credit product;
- (11)** The potential for default under the mortgage credit product, including but not limited to misrepresentations concerning the circumstances under which the consumer could default for nonpayment of taxes, insurance or maintenance, or for failure to meet other obligations;
- (12)** The effectiveness of the mortgage credit product in helping the consumer resolve difficulties in paying debts, including but not limited to misrepresentations that any mortgage credit product can reduce, eliminate or restructure debt, or result in a waiver or forgiveness, in whole or in part, of the consumer's existing obligation with any person;
- (13)** The association of the mortgage credit product or any provider of such product with any other person or program, including but not limited to misrepresentations that:
 - (i)** The provider is, or is affiliated with, any governmental entity or other organization; or
 - (ii)** The product is or relates to a government benefit, or is endorsed, sponsored by, or affiliated with any government or other program, including but not limited to the use of formats, symbols or logos that resemble those of such entity, organization or program;
- (14)** The source of any commercial communication, including but not limited to misrepresentations that a commercial communication is made by or on behalf of the consumer's current mortgage lender or servicer;
- (15)** The right of the consumer to reside in the dwelling that is the subject of the mortgage credit product, or the duration of such right, including but not limited to misrepresentations concerning how long or under what conditions a consumer with a reverse mortgage can remain in the dwelling;
- (16)** The consumer's ability or likelihood to obtain any mortgage credit product or term, including but not limited to misrepresentations concerning whether the consumer has been preapproved or guaranteed for any such product or term;
- (17)** The consumer's ability or likelihood to obtain a refinancing or modification of any mortgage credit product or term, including but not limited to misrepresentations concerning whether the consumer has been preapproved or guaranteed for any such refinancing or modification; and
- (18)** The availability, nature or substance of counseling services, or any other expert advice, offered to the consumer regarding any mortgage credit product or term, including but not limited to the qualifications of those offering the services or advice.

[Section 6.1 Mortgage Acts and Practices-Advertising \(MAP\) Regulation N \(continued\)](#)

Waiver Not Permitted

It is a violation of this part for any person to obtain, or attempt to obtain, a waiver from any consumer of any protection provided by, or any right of the consumer under this part.

Retention Requirements

- (1)** Red Diamond Home Loans must keep for a period of twenty-four months from the last date the employee made or disseminated an approved commercial communication regarding any term of any mortgage credit product, the following evidence of compliance with this part:
 - (i)** Copies of all materially different commercial communications, as well as sales scripts and training and marketing materials, regarding any term of any mortgage credit product, that the person made or disseminated during the relevant time period;
 - (ii)** Documents describing or evidencing all mortgage credit products available to consumers during the time period in which the employee made or disseminated each commercial communication regarding any term of any mortgage credit product, including but not limited to the names and terms of each such mortgage credit product available to consumers; and
 - (iii)** Documents describing or evidencing all additional products or services (such as credit insurance or credit disability insurance) that are or may be offered or provided with the mortgage credit products available to consumers during the time period in which the employee made or disseminated each commercial communication regarding any term of any mortgage credit product, including but not limited to the names and terms of each such additional product or service available to consumers.
- (2)** Red Diamond Home Loans may keep the records required by paragraph (1) of this section in any legible form, and in the same manner, format or location as such records are normally stored in the ordinary course of business. Failure to keep all records required under paragraph (1) of this section will be considered as a violation of MAP.

[Section 6.2 Social Media](#)

In today's world, social media has become another channel for reaching consumers. The CFPB, FTC and FFIEC are all in the process of creating social media guidelines, but do not have any officially published as of yet. However, there are still certain guidelines you will need to apply when utilizing online marketing. In this section we will discuss what constitutes a solicitation vs networking, and what is required for each. As with all of our marketing, any homepage, online account, video, website or online profile must be approved by management prior to its posting. Failure to get approval prior to posting will result in termination of employment. Any online accounts used for business purposes, and created prior to July 2013, must have their URL/web address submitted to management for review and approval.

Section 6.2 Social Media (continued)

Networking vs. Solicitation

Red Diamond Home Loans encourages all our employees to network within the industry, and to seek additional business. However, there is a distinct difference between networking and a solicitation for business. Let's look at the definitions:

net-work-ing *noun*

1: the exchange of information or services among individuals, groups or institutions; specifically: the cultivation of productive relationships for employment or business.

so-lic-i-ta-tion *noun*


1: to ask for (something, such as money or help) from people, companies, etc.

2: to ask (a person or group) for money, help, etc.

When networking, you are permitted to let another individual know the nature of your business; for example, you may tell someone that you are a residential loan officer for Red Diamond Home Loans who specializes in purchases transactions. When soliciting, you are asking for that individual's business. Using the same example, you might tell someone that you are a residential loan officer for Kelly Stephens who specializes in purchases transactions, and to call you when they're ready to buy. Simply adding the phrase "call me," is enough to change the interaction from networking to soliciting.

Solicitation/ Advertising Requirements

When you are soliciting in print or online, there are several items that must accompany the solicitation with no exceptions:

- the name of the originator followed by the phrase "Residential Mortgage Loan Originator"
- the originator's Nationwide Mortgage Licensing System and Registry identification number;
- the name of the company and the company's physical office or branch office address;
- You must display the Equal Housing Lender logo, along with the phrase "Equal Housing Lender"
 Equal Housing Lender
- If soliciting for a specific product, you must list the criteria for obtaining that product including: required credit score, maximum debt-to-income ratio, maximum loan-to value, reserve requirements, etc.
- You must have the phrase: "Additional terms and conditions may apply."

Approved Social Media Platforms

- Facebook
- YouTube
- LinkedIn
- Google +

Section 6.2 Social Media (continued)

Non-Approved Social Media Platforms

- Craig's List
- Instagram*
- Twitter*
- SnapChat*
- Pinterest*

*Due to the limited number of characters, it is not possible to meet the requirements when soliciting for business.

Monitoring of Accounts

All employees are required to have all URL's/web addresses on file with the QC Officer. The QC Officer, along with management, will be responsible for monitoring these websites for compliance, and to ensure the content posted was already approved. Any accounts discovered to contain adult language, hate speech, inappropriate content, malicious links or other risky content or activity will be grounds for immediate termination.

Retention and Compliance

It shall be the policy of Red Diamond Home Loans to retain all electronic communications relating to solicitation and advertising for a period of twenty-four months. Loan officers will be required to save all electronic communications relating to solicitation and advertising on our company server. Management will randomly select email chains to be reviewed once every 90 days to ensure compliance. The QC Officer, along with management, will review the Social Media Policy to consider updates or revisions on an annual basis, or more frequently if required.

Section 7

Section 7.1 Ability-to-Repay (ATR) and Qualified Mortgages (QM)

The Dodd-Frank Act made several amendments to the Truth in Lending Act (TILA), which we have already discussed. However, the two biggest changes implemented and adopted by the CFPB are the Ability to Repay (ATR) requirement, and the Qualified Mortgage (QM) designation for mortgage loans. The CFPB amended TILA and Reg. Z to create the new ATR/QM section – minimum standards for transactions secured by a dwelling.

The ATR/QM rule requires that you make a reasonable good-faith determination, before or when you consummate a mortgage loan, that the consumer has a reasonable ability to repay the loan. In exchange for meeting the requirements of ATR, the loan receives a QM status. A legal “safe harbor” is provided to the lender originating the loan if the transaction is a QM, and not considered a high-priced loan. This safe harbor eliminates any potential claims brought by a consumer that their lender failed to satisfy the ATR requirement. Therefore, the consumer cannot claim they really could not afford the mortgage, but felt pressured by the lender and closed regardless. Important - for high-priced QM the consumer has the right to sue to the lender, and while it is presumed the institution complied with the ATR requirements, a successful rebuttal could expose the lender to paying potential damages.

Section 7.1 Ability-to-Repay (ATR) and Qualified Mortgages (QM) (continued)

General QM definition - General QM loans may not have negative-amortization, interest-only, or balloon-payment features or terms that exceed 30 years. They also may not have points and fees that exceed the specified limits. In addition, in order for a loan to be a General QM loan, the creditor must:

- Underwrite based on a fully-amortizing schedule, using the maximum rate permitted during the first five years after the date of the first periodic payment.
- Consider and verify the consumer's income or assets, current debt obligations, alimony and child-support obligations.
- Determine that the consumer's total monthly debt-to-income ratio is no more than 43 percent, using the definitions and other requirements provided in appendix Q*, which is derived from the Federal Housing Administration manual.

Temporary QM definition - Loans must meet the same requirements as General QM loans regarding prohibitions on risky features (negative-amortization, interest-only, and balloon-payment features), a maximum loan term of 30 years, and points-and-fees restrictions. They must also meet at least one of these additional requirements:

- Eligible for purchase or guarantee by the Federal National Mortgage Association (Fannie Mae) or the Federal Home Loan Mortgage Corporation (Freddie Mac) while operating under federal conservatorship or receivership.
- Eligible for Federal Housing Administration (FHA) insurance.
- Eligible to be guaranteed by the U.S. Department of Veterans Affairs (VA).
- Eligible to be guaranteed by the U.S. Department of Agriculture (USDA).
- Eligible to be insured by the Rural Housing Service.

Temporary QM was created for loans originated during a transitional period if they are eligible for purchase or guarantee by Fannie Mae or Freddie Mac (the government-sponsored enterprises (GSEs), or for insurance or guarantee by the federal agencies listed above. The temporary provision expires for loans eligible for purchase or guarantee by the GSEs when one of the following occurs:

- The date that the GSEs exit federal conservatorship or receivership
- The date that the relevant agency's own QM rules take effect or on January 10, 2021, whichever occurs first.

The ATR/QM rule also implements other provisions of the Dodd-Frank Act that:

- Limit prepayment penalties
- Require that records be retained for three years after consummation, proving the company complied with ATR and other provisions of this rule

In order to originate a QM, the lender must ensure that the transaction satisfies the six criteria set forth below:

- (1)** Regular periodic payments are substantially equal
- (2)** Loan term is less than or equal to 30 years
- (3)** Total points and fees do not exceed established limits

Section 7.1 Ability-to-Repay (ATR) and Qualified Mortgages (QM) (continued)

- (4) Monthly payment for mortgage-related obligations is based on a maximum interest rate applicable during the first five years and fully-amortizing periodic payments
- (5) Income, assets and debt-to-income ratio are verified in accordance with TILA's Appendix Q of Regulation Z (also provided at the end of this policy)
- (6) Consumer total monthly debt-to-income ratio is less than or equal to 43%*

*To meet the Temporary QM definition, loans must be underwritten using the required guidelines of the entities listed above, including any relevant DTI guidelines. They do not have to meet the 43 percent debt-to-income ratio threshold that applies to General QM loans until the temporary provision expires.

Ability-to-Repay

The ATR rule requires lenders to make a good-faith determination that the borrower will have a reasonable ability to repay the loan, and must verify the information from which its credit decision was made. Prior to ATR we called this... underwriting. The lender can meet this requirement in one of two ways:

- (1) Determining whether the borrower has the ability to repay by considering each of the eight underwriting criteria below:
 - a) Current or reasonable expected income and assets
 - b) Current employment status
 - c) Monthly payment on proposed loan
 - d) Monthly payment on any concurrent loan(s)
 - e) Monthly payment on any additional mortgages
 - f) Current debt obligations, alimony and child support
 - g) Monthly debt-to-income ratio
 - h) Credit history
- (2) Making a "Qualified Mortgage" (QM) as outlined previously in this section.

Reasonably Reliable Third-Party Records

When attempting to verify information the borrower has provided, you must use a reliable source for verification. The list of reliable third-party records is the same as used in underwriting, borrower identification and audits contained within this QC policy.

Covered Transactions

The ATR/QM rule applies to almost all closed-end consumer credit transactions secured by a dwelling, including any real property attached to the dwelling. This means loans made to consumers and secured by residential structures that contain one to four units, including condominiums and co-ops. Unlike some other mortgage rules, the ATR/QM rule is not limited to first liens or to loans on primary residences.

Exempt Transactions

There are specific categories of loans excluded from ATR/QM. The rule does not apply to:

- Open-end credit plans (home equity lines of credit, or HELOCs)

Section 7.1 Ability-to-Repay (ATR) and Qualified Mortgages (QM) (continued)

- Time-share plans
- Reverse mortgages
- Temporary or bridge loans with terms of 12 months or less (with possible renewal)
- A construction phase of 12 months or less (with possible renewal) of a construction-to-permanent loan
- Consumer credit transactions secured by vacant land

Exception for Certain Programs and Lenders

The ATR rule does not apply if the transaction involves the extension of credit under the program administered by the Housing Finance Agency (FHA - defined in 24 CFR 266.5), or Emergency Economic Stabilization Act program.

Additional exceptions exist for credit extended by:

- Community-development financial institutions;
- Down-payment assistance through secondary financing providers;
- Community housing-development organizations

Retention

The rule requires that evidence be retained for three years after consummation, proving that the company complied with the ATR/QM rule.

Section 8

Section 8.1 Consumer Complaints

Under the CFPB, Red Diamond Home Loans is required to provide all applicants, customers and borrowers with information to access the CFPB website for consumer complaints. This notice should be placed in the lobby and on the company website. We are committed to providing our borrowers with least stressful financing experience possible, while following all state and federal requirements. As such, we should look at any complaint filed as constructive criticism and a learning experience. The address for filing complaints with the CFPB is:

<http://www.consumerfinance.gov/complaintdatabase/>

The Complaint Process

When an applicant, customer or borrower submits a complaint to the CFPB, it is forwarded to the lender or finance company, and the CFPB will work with both parties to resolve the issue. The process works as follows:

1. Complaint submitted - An applicant, customer or borrower submits a complaint concerning an issue with a company about a consumer financial product or service. The complainant will receive email updates, and can log in to track the status of their complaint.

Section 8.1 Consumer Complaints (continued)

2. Review and route - The CFPB will forward the complaint and any documents provided to the company, and encourage a response. If the CFPB finds that another government agency would be better able to assist, the complaint will be forwarded to the other agency, and all parties are to be informed.
3. Company response - The company reviews the complaint, communicates with the complainant as needed, and reports back to the CFPB concerning actions taken (or to be taken shortly) on the issue identified in the complaint.
4. Consumer review - The CFPB will inform the complainant when the company responds. The complainant can review that response and provide feedback.
5. Review and investigate - If warranted, complaint data is shared with state and federal law enforcement agencies. Complaints tell the CFPB about business practices that may pose risks to consumers.
6. Analyze and report - Complaints help the CFPB to supervise companies, enforce federal consumer financial laws, and write better rules and regulations. The bureau also reports to Congress about the complaints received, and post some consumer complaint data.

In July 2011, the CFPB started accepting complaints against the entities it regulates regarding mortgages, credit cards, bank accounts, debt collection, private student loans, consumer loans, credit reporting, money transfers and payday loans. According to the CFPB, the database contains the nation's largest public collection of consumer financial complaints, currently totaling more than 400,000.

Section 8.2 Ethics

At Red Diamond Home Loans, we feel strongly that not enough emphasis has been put on the subject of unethical behavior within our industry in recent years. The unethical actions of lenders, secondary markets, loan originators, Fannie and Freddie, and Congress were all contributing factors to the crash that led to the Great Recession. Lastly, it's a sound business decision; the better we treat our customers, the more likely they are to give us referrals today, and repeat business in the future.

Eth·ics [eth-iks]

Plural noun

1. A system of moral principles.
2. The rules of conduct recognized in respect to a specific class of human actions or a particular group, culture, e.g. medical ethics; Christian ethics.
3. The branch of philosophy dealing with values relating to human conduct, with respect to the moral value of certain actions, the motives behind them and the results of those actions.

Section 8.2 Ethics (continued)

Ethics, like many regulations we discuss in this training series, do not reside in a vacuum. Ethics applied in the real world are influenced by opinions, interpretations and perceptions. While it may be improper to say that ethics lives in a gray area, it's difficult to prove that ethics are a black-or-white situation.

As a licensed loan officer, you have a legal - and moral - responsibility to treat all clients equally. This means you must conduct your business without regard to race, age, creed, sex, sexual orientation, gender identity, marital status, pregnancy, religion, national origin, ancestry, disability, genetic information or handicap of your clientele.

Your responsibility to treat all clients equally also extends to the terms of the loan you provide. While no two loans are identical, the CFPB looks for patterns of loan terms offered by an originator.

How can we avoid being examined for Fair Lending violations?

1. Attempt to keep borrower-paid compensation levels as similar as possible to lender-paid compensation levels.
2. Keeping our lender-paid compensation levels the same with all our investors. Explaining to an auditor why we have different compensation rates with different investors is not a conversation we want to have, or will be able to win.
3. Save email correspondence between you and the borrower. Take notes! Borrowers are going to shop you; that is the nature of this business. Show regulators some evidence that in order for you to save the transaction, the borrower left you little choice but to reduce your fees.

The takeaway on this is to remember to document all our communications between us and the borrower, and keep our fees as consistent as possible. These may appear as common sense; however, very few loan originators actually practice them.

The subject of ethics is not just a section within this quality control policy or a training module; ethics are a code of conduct, and a moral way of conducting business.

Section 8.3 Training

We utilize a 3rd party compliance firm for our annual training, The Compliance Shop LLC. Every employee will receive a username and password for TCS's website, www.thecomplianceshop.net, in order to access the required annual compliance training modules. Every employee is required to complete the following training annually:

- All CFPB required training
- Red Flags, AML/BSA, GLBA, Fair Lending, Internet and Data Security, UDAAP, HOEPA, ECOA, Ethics
- RMLO's will be required to follow the continuing education schedule per NMLS or the State.
- All employees must review and signoff on this quality control policy.

[Appendix Q to Truth-in-Lending, Part 1026 \(Regulation Z\)](#)

Section 1026.43(e)(2)(vi) provides that, to satisfy the requirements for a qualified mortgage the ratio of the consumer's total monthly debt payments to total monthly income at the time of consummation cannot exceed 43 percent.* This requires the creditor to calculate the ratio of the consumer's total monthly debt payments to total monthly income using the following standards. Where guidance issued by the U.S. Department of Housing and Urban Development, the U.S. Department of Veterans Affairs, the U.S. Department of Agriculture, or the Rural Housing Service, or issued by the Federal National Mortgage Association (Fannie Mae) or the Federal Home Loan Mortgage Corporation (Freddie Mac) while operating under the conservatorship or receivership of the Federal Housing Finance Agency, or issued by a limited-life regulatory entity succeeding the charter of either Fannie Mae or Freddie Mac (collectively, Agency or GSE guidance) is in accordance with appendix Q, creditors may look to that guidance as a helpful resource in applying appendix Q. Moreover, when the following standards do not resolve how a specific kind of debt or income should be treated, the creditor may either (1) exclude the income or include the debt, or (2) rely on Agency or GSE guidance to resolve the issue. The following standards resolve the appropriate treatment of a specific kind of debt or income where the standards provide a discernible answer to the question of how to treat the debt or income. However, a creditor may not rely on Agency or GSE guidance to reach a resolution contrary to that provided by the following standards, even if such Agency or GSE guidance specifically addresses the specific type of debt or income but the following standards provide more generalized guidance.

I. CONSUMER EMPLOYMENT RELATED INCOME

A. Stability of Income.

1. *Effective Income.* Income may not be used in calculating the consumer's debt-to-income ratio if it comes from any source that cannot be verified, is not stable, or will not continue.

2. *Verifying Employment History.*

a. The creditor must verify the consumer's employment for the most recent two full years, and the creditor must require the consumer to:

i. Explain any gaps in employment that span one or more months, and

ii. Indicate if he/she was in school or the military for the recent two full years, providing evidence supporting this claim, such as college transcripts, or discharge papers.

b. Allowances can be made for seasonal employment, typical for the building trades and agriculture, if documented by the creditor.

Note: A consumer with a 25 percent or greater ownership interest in a business is considered self-employed and will be evaluated as a self-employed consumer.

3. *Analyzing a Consumer's Employment Record.*

a. When analyzing a consumer's employment, creditors must examine:

Appendix Q to Truth-in-Lending, Part 1026 (Regulation Z) (continued)

- i. The consumer's past employment record; and
- ii. The employer's confirmation of current, ongoing employment status.

Note: Creditors may assume that employment is ongoing if a consumer's employer verifies current employment and does not indicate that employment has been, or is set to be terminated. Creditors should not rely upon a verification of current employment that includes an affirmative statement that the employment is likely to cease, such as a statement that indicates the employee has given (or been given) notice of employment suspension or termination.

- b. Creditors may favorably consider the stability of a consumer's income if he/she changes jobs frequently within the same line of work, but continues to advance in income or benefits. In this analysis, income stability takes precedence over job stability
4. *Consumers Returning to Work after an Extended Absence.* A consumer's income may be considered effective and stable when recently returning to work after an extended absence if he/she:
- a. Is employed in the current job for six months or longer; and
 - b. Can document a two year work history prior to an absence from employment using:
 - i. Traditional employment verifications; and/or
 - ii. Copies of IRS Form W-2s or pay stubs.

Note: An acceptable employment situation includes individuals who took several years off from employment to raise children, then returned to the workforce.

- c. Important: Situations not meeting the criteria listed above may not be used in qualifying. Extended absence is defined as six months.

B. Salary, Wage and Other Forms of Income.

1. General Policy on Consumer Income Analysis.

- a. The income of each consumer who will be obligated for the mortgage debt and whose income is being relied upon in determining ability to repay must be analyzed to determine whether his/her income level can be reasonably expected to continue.
- b. In most cases, a consumer's income is limited to salaries or wages. Income from other sources can be considered as effective, when properly verified and documented by the creditor.

Notes:

- i. Effective income for consumers planning to retire during the first three-year period must include the amount of:
 - a. Documented retirement benefits;
 - b. Social Security payments; or
 - c. other payments expected to be received in retirement.
- ii. Creditors must not ask the consumer about possible, future maternity leave.
- iii. Creditors may assume that salary or wage income from employment verified in accordance with section I.A.3 above can be reasonably expected to continue if a consumer's employer verifies current employment and income and does not indicate that employment has been, or is set to be terminated. Creditors should not assume that income can be reasonably expected to continue if a verification of current employment includes an affirmative statement that the employment is likely to cease, such as a statement that indicates the employee has given (or been given) notice of employment suspension or termination.

Appendix Q to Truth-in-Lending, Part 1026 (Regulation Z) (continued)

2. Overtime and Bonus Income.

- a. Overtime and bonus income can be used to qualify the consumer if he/she has received this income for the past two years, and documentation submitted for the loan does not indicate this income will likely cease. If, for example, the employment verification states that the overtime and bonus income is unlikely to continue, it may not be used in qualifying.
- b. The creditor must develop an average of bonus or overtime income for the past two years. Periods of overtime and bonus income less than two years may be acceptable, provided the creditor can justify and document in writing the reason for using the income for qualifying purposes.

3. Establishing an Overtime and Bonus Income Earning Trend.

- a. The creditor must establish and document an earnings trend for overtime and bonus income. If either type of income shows a continual decline, the creditor must document in writing a sound rationalization for including the income when qualifying the consumer.
- b. A period of more than two years must be used in calculating the average overtime and bonus income if the income varies significantly from year to year.

4. Qualifying Part-Time Income.

- a. Part-time and seasonal income can be used to qualify the consumer if the creditor documents that the consumer has worked the part-time job uninterrupted for the past two years, and plans to continue. Many low and moderate income families rely on part-time and seasonal income for day to day needs, and creditors should not restrict consideration of such income when qualifying the income of these consumers.
- b. Part-time income received for less than two years may be included as effective income, provided that the creditor justifies and documents that the income is likely to continue.
- c. Part-time income not meeting the qualifying requirements may not be used in qualifying.

Note: For qualifying purposes, "part-time" income refers to employment taken to supplement the consumer's income from regular employment; part-time employment is not a primary job and it is worked less than 40 hours.

5. Income from Seasonal Employment.

- a. Seasonal income is considered uninterrupted, and may be used to qualify the consumer, if the creditor documents that the consumer:
 - i. Has worked the same job for the past two years, and
 - ii. Expects to be rehired the next season.
- b. Seasonal employment includes, but is not limited to:
 - i. Umpiring baseball games in the summer; or

Appendix Q to Truth-in-Lending, Part 1026 (Regulation Z) (continued)

- ii. Working at a department store during the holiday shopping season.

6. Primary Employment Less Than 40 Hour Work Week.

- a. When a consumer's primary employment is less than a typical 40-hour work week, the creditor should evaluate the stability of that income as regular, on-going primary employment.
- b. Example: A registered nurse may have worked 24 hours per week for the last year. Although this job is less than the 40-hour work week, it is the consumer's primary employment, and should be considered effective income.

7. Commission Income.

- a. Commission income must be averaged over the previous two years. To qualify commission income, the consumer must provide:
 - i. Copies of signed tax returns for the last two years; and
 - ii. The most recent pay stub.
- b. Consumers whose commission income was received for more than one year, but less than two years may be considered favorably if the underwriter can:
 - i. Document the likelihood that the income will continue, and
 - ii. Soundly rationalize accepting the commission income

Notes:

- i. Unreimbursed business expenses must be subtracted from gross income.
- ii. A commissioned consumer is one who receives more than 25 percent of his/her annual income from commissions.
- iii. A tax transcript obtained directly from the IRS may be used in lieu of signed tax returns.

8. Qualifying Commission Income Earned for Less Than One Year.

- a. Commission income earned for less than one year is not considered effective income. Exceptions may be made for situations in which the consumer's compensation was changed from salary to commission within a similar position with the same employer.
- b. A consumer may also qualify when the portion of earnings not attributed to commissions would be sufficient to qualify the consumer for the mortgage.

9. Employer Differential Payments. If the employer subsidizes a consumer's mortgage payment through direct payments, the amount of the payments:

- a. Is considered gross income, and
- b. Cannot be used to offset the mortgage payment directly, even if the employer pays the servicing creditor directly.

Appendix Q to Truth-in-Lending, Part 1026 (Regulation Z) (continued)

10. *Retirement Income.* Retirement income must be verified from the former employer, or from Federal tax returns. If any retirement income, such as employer pensions or 401(k)'s, will cease within the first full three years of the mortgage loan, such income may not be used in qualifying.
11. *Social Security Income.* Social Security income must be verified by a Social Security Administration benefit verification letter (sometimes called a "proof of income letter," "budget letter," "benefits letter," or "proof of award letter"). If any benefits expire within the first full three years of the loan, the income source may not be used in qualifying.

Notes:

- i. if the Social Security Administration benefit verification letter does not indicate a defined expiration date within three years of loan origination, the creditor shall consider the income effective and likely to continue. Pending or current re-evaluation of medical eligibility for benefit payments is not considered an indication that the benefit payments are not likely to continue.
- ii. Some portion of Social Security income may be "grossed up" if deemed nontaxable by the IRS.

12. *Automobile Allowances and Expense Account Payments.*

- a. Only the amount by which the consumer's automobile allowance or expense account payments exceed actual expenditures may be considered income.
- b. To establish the amount to add to gross income, the consumer must provide the following:
 - i. IRS Form 2106, Employee Business Expenses, for the previous two years; and
 - ii. Employer verification that the payments will continue.
- c. If the consumer uses the standard per-mile rate in calculating automobile expenses, as opposed to the actual cost method, the portion that the IRS considers depreciation may be added back to income.
- d. Expenses that must be treated as recurring debt include:
 - i. The consumer's monthly car payment; and
 - ii. Any loss resulting from the calculation of the difference between the actual expenditures and the expense account allowance.

C. Consumers Employed by a Family Owned Business.

1. *Income Documentation Requirement.* In addition to normal employment verification, a consumer employed by a family owned business is required to provide evidence that he/she is not an owner of the business, which may include:
 - a. Copies of signed personal tax returns, or
 - b. A signed copy of the corporate tax return showing ownership percentage.

Note: A tax transcript obtained directly from the IRS may be used in lieu of signed tax returns.

Appendix Q to Truth-in-Lending, Part 1026 (Regulation Z) (continued)

D. General Information on Self-Employed Consumers and Income Analysis.

1. *Definition: Self Employed Consumer.* A consumer with a 25 percent or greater ownership interest in a business is considered self-employed.

2. *Types of Business Structures.* There are four basic types of business structures. They include:

- a. Sole proprietorships;
- b. Corporations;
- c. Limited liability or "S" corporations; and
- d. Partnerships.

3. *Minimum Length of Self Employment.*

- a. Income from self-employment is considered stable, and effective, if the consumer has been self-employed for two or more years.
- b. Due to the high probability of failure during the first few years of a business, the requirements described in the table below are necessary for consumers who have been self-employed for less than two years.

If the period of self-employment is:	Then:
Between one and two years	<p>For an individual's income to be effective, the individual must have at least two years of documented previous successful employment in the line of work in which the individual is self-employed, or in a related occupation.</p> <p>Note: A combination of one year of employment and formal education or training in the line of work [in which] the individual is self-employed or in a related occupation is also acceptable.</p>
Less than one year	The income from the consumer may not be considered effective income.

4. *General Documentation Requirements for Self Employed Consumers.* Self-employed consumers must provide the following documentation:

- a. Signed, dated individual tax returns, with all applicable tax schedules for the most recent two years;
- b. For a corporation, "S" corporation, or partnership, signed copies of Federal business income tax returns for the last two years, with all applicable tax schedules; and
- c. Year to date profit and loss (P&L) statement and balance sheet.

5. *Establishing a Consumer's Earnings Trend.*

- a. When qualifying income, the creditor must establish the consumer's earnings trend from the previous two years using the consumer's tax returns.

Appendix Q to Truth-in-Lending, Part 1026 (Regulation Z) (continued)

b. If a consumer:

i. Provides quarterly tax returns, the income analysis may include income through the period covered by the tax filings, or

ii. Is not subject to quarterly tax returns, or does not file them, then the income shown on the P&L statement may be included in the analysis, provided the income stream based on the P&L is consistent with the previous years' earnings.

c. If the P&L statements submitted for the current year show an income stream considerably greater than what is supported by the previous year's tax returns, the creditor must base the income analysis solely on the income verified through the tax returns.

d. If the consumer's earnings trend for the previous two years is downward and the most recent tax return or P&L is less than the prior year's tax return, the consumer's most recent year's tax return or P&L must be used to calculate his/her income.

6. Analyzing the Business's Financial Strength: The creditor must consider the business's financial strength by examining annual earnings. Annual earnings that are stable or increasing are acceptable, while businesses that show a significant decline in income over the analysis period are not acceptable.

E. Income Analysis: Individual Tax Returns (IRS Form 1040).

1. *General Policy on Adjusting Income Based on a Review of IRS Form 1040.* The amount shown on a consumer's IRS Form 1040 as adjusted gross income must either be increased or decreased based on the creditor's analysis of the individual tax return and any related tax schedules.

2. *Guidelines for Analyzing IRS Form 1040.* The table below contains guidelines for analyzing IRS Form 1040:

IRS Form 1040 heading:	Description
Wages, Salaries and Tips	<p>An amount shown under this heading may indicate that the individual:</p> <p>Is a salaried employee of a corporation; or</p> <p>Has other sources of income.</p> <p>This section may also indicate that the spouse is employed, in which case the spouse's income must be subtracted from the consumer's adjusted gross income.</p>
Business Income and Loss (from Schedule C)	<p>Sole proprietorship income calculated on Schedule C is business income.</p> <p>Depreciation or depletion may be added back to the adjusted gross income.</p>
Rents, Royalties, Partnerships (from Schedule E)	<p>Any income received from rental properties or royalties may be used as income, after adding back any depreciation shown on Schedule E.</p>

Capital Gains and Losses (from Schedule D)	<p>Capital gains or losses generally occur only one time, and should not be considered when determining effective income.</p> <p>However, if the individual has a constant turnover of assets resulting in gains or losses, the capital gain or loss must be considered when determining the income. Three years' tax returns are required to evaluate an earnings trend. If the trend:</p> <p>Results in a gain, it may be added as effective income, or Consistently shows a loss, it must be deducted from the total income.</p> <p>Creditor must document anticipated continuation of income through verified assets. <i>Example:</i> A creditor can consider the capital gains for an individual who purchases old houses, remodels them, and sells them for profit.</p>
Interest and Dividend Income (from Schedule B)	<p>This taxable/tax-exempt income may be added back to the adjusted gross income only if it:</p> <p>Has been received for the past two years; and Is expected to continue.</p> <p>If the interest-bearing asset will be liquidated as a source of the cash investment, the creditor must appropriately adjust the amount.</p>
Farm Income or Loss (from Schedule F)	<p>Any depreciation shown on Schedule F may be added back to the adjusted gross income.</p>
IRA Distributions, Pensions, Annuities, and Social Security Benefits	<p>The non-taxable portion of these items may be added back to the adjusted gross income, if the income is expected to continue for the first three years of the mortgage.</p>
Adjustments to Income	<p>Adjustments to income may be added back to the adjusted gross income if they are:</p> <p>IRA and Keogh retirement adjustments; Penalties on early withdrawal of savings; Health insurance deductions; and Alimony payments.</p>
Employee Business Expenses	<p>Employee business expenses are actual cash expenses that must be deducted from the adjusted gross income.</p>

F. Income Analysis: Corporate Tax Returns (IRS Form 1120).

1. *Description: Corporation.* A corporation is a State-chartered business owned by its stockholders.
2. *Need To Obtain Consumer Percentage of Ownership Information.*
 - a. Corporate compensation to the officers, generally in proportion to the percentage of ownership, is shown on the:
 - i. Corporate tax return IRS Form 1120; and
 - ii. Individual tax returns.

Appendix Q to Truth-in-Lending, Part 1026 (Regulation Z) (continued)

- b. When a consumer's percentage of ownership does not appear on the tax returns, the creditor must obtain the information from the corporation's accountant, along with evidence that the consumer has the right to any compensation.

3. Analyzing Corporate Tax Returns.

- a. In order to determine a consumer's self-employed income from a corporation the adjusted business income must:

- i. Be determined; and
- ii. Multiplied by the consumer's percentage of ownership in the business.

- b. The table below describes the items found on IRS Form 1120 for which an adjustment must be made in order to determine adjusted business income.

Adjustment item	Description of adjustment
Depreciation and Depletion	Add the corporation's depreciation and depletion back to the after-tax income.
Taxable Income	Taxable income is the corporation's net income before Federal taxes. Reduce taxable income by the tax liability.
Fiscal Year vs. Calendar Year	If the corporation operates on a fiscal year that is different from the calendar year, an adjustment must be made to relate corporate income to the individual tax return.
Cash withdrawals	The consumer's withdrawal of cash from the corporation may have a severe negative impact on the corporation's ability to continue operating.

G. Income Analysis: "S" Corporation Tax Returns (IRS Form 1120S).

1. Description: "S" Corporation.

- a. An "S" corporation is generally a small, start-up business, with gains and losses passed to stockholders in proportion to each stockholder's percentage of business ownership.
- b. Income for owners of "S" corporations comes from IRS Form W-2 wages, and is taxed at the individual rate. The IRS Form 1120S, Compensation of Officers line item is transferred to the consumer's individual IRS Form 1040.

2. Analyzing "S" Corporation Tax Returns.

- a. "S" corporation depreciation and depletion may be added back to income in proportion to the consumer's share of the corporation's income.
- b. In addition, the income must also be reduced proportionately by the total obligations payable by the corporation in less than one year.

Appendix Q to Truth-in-Lending, Part 1026 (Regulation Z) (continued)

- c. Important: The consumer's withdrawal of cash from the corporation may have a severe negative impact on the corporation's ability to continue operating, and must be considered in the income analysis.

H. Income Analysis: Partnership Tax Returns (IRS Form 1065).

1. *Description: Partnership.*

- a. A partnership is formed when two or more individuals form a business, and share in profits, losses, and responsibility for running the company.
- b. Each partner pays taxes on his/her proportionate share of the partnership's net income.

2. *Analyzing Partnership Tax Returns.*

- a. Both general and limited partnerships report income on IRS Form 1065, and the partners' share of income is carried over to Schedule E of IRS Form 1040.
- b. The creditor must review IRS Form 1065 to assess the viability of the business. Both depreciation and depletion may be added back to the income in proportion to the consumer's share of income.
- c. Income must also be reduced proportionately by the total obligations payable by the partnership in less than one year.
- d. Important: Cash withdrawals from the partnership may have a severe negative impact on the partnership's ability to continue operating, and must be considered in the income analysis.

II. NON-EMPLOYMENT RELATED CONSUMER INCOME

A. *Alimony, Child Support, and Maintenance Income Criteria.* Alimony, child support, or maintenance income may be considered effective, if:

- 1. Payments are likely to be received consistently for the first three years of the mortgage;
- 2. The consumer provides the required documentation, which includes a copy of the:
 - i. Final divorce decree;
 - ii. Legal separation agreement;
 - iii. Court order; or
 - iv. Voluntary payment agreement; and
- 3. The consumer can provide acceptable evidence that payments have been received during the last 12 months, such as:
 - i. Cancelled checks;

Appendix Q to Truth-in-Lending, Part 1026 (Regulation Z) (continued)

- ii. Deposit slips;
- iii. Tax returns; or
- iv. Court records.

Notes:

- i. Periods less than 12 months may be acceptable, provided the creditor can adequately document the payer's ability and willingness to make timely payments.
- ii. Child support may be "grossed up" under the same provisions as non-taxable income sources.

B. Investment and Trust Income.

1. Analyzing Interest and Dividends.

- a. Interest and dividend income may be used as long as tax returns or account statements support a two-year receipt history. This income must be averaged over the two years.
- b. Subtract any funds that are derived from these sources, and are required for the cash investment, before calculating the projected interest or dividend income.

2. Trust Income.

- a. Income from trusts may be used if constant payments will continue for at least the first three years of the mortgage term as evidenced by trust income documentation.
- b. Required trust income documentation includes a copy of the Trust Agreement or other trustee statement, confirming the:
 - i. Amount of the trust;
 - ii. Frequency of distribution; and
 - iii. Duration of payments.
- c. Trust account funds may be used for the required cash investment if the consumer provides adequate documentation that the withdrawal of funds will not negatively affect income. The consumer may use funds from the trust account for the required cash investment, but the trust income used to determine repayment ability cannot be affected negatively by its use.

3. Notes Receivable Income.

- a. In order to include notes receivable income to qualify a consumer, he/she must provide:
 - i. A copy of the note to establish the amount and length of payment, and
 - ii. Evidence that these payments have been consistently received for the last 12 months through deposit slips, deposit receipts, cancelled checks, bank or other account statements, or tax returns.

Appendix Q to Truth-in-Lending, Part 1026 (Regulation Z) (continued)

b. If the consumer is not the original payee on the note, the creditor must establish that the consumer is able to enforce the note.

4. *Eligible Investment Properties.* Follow the steps in the table below to calculate an investment property's income or loss if the property to be subject to a mortgage is an eligible investment property.

1	Subtract the monthly payment (PITI) from the monthly net rental income of the subject property. Note: Calculate the monthly net rental by taking the gross rents, and subtracting the 25 percent reduction for vacancies and repairs.
2	Does the calculation in Step 1 yield a positive number? <ul style="list-style-type: none">• If yes, add the number to the consumer's monthly gross income.• If no, and the calculation yields a negative number, consider it a recurring monthly obligation.

C. Military, Government Agency, and Assistance Program Income.

1. *Military Income.*

a. Military personnel not only receive base pay, but often times are entitled to additional forms of pay, such as:

- i. Income from variable housing allowances;
- ii. Clothing allowances;
- iii. Flight or hazard pay;
- iv. Rations; and
- v. Proficiency pay.

b. These types of additional pay are acceptable when analyzing a consumer's income as long as the probability of such pay to continue is verified in writing.

Note: The tax-exempt nature of some of the above payments should also be considered.

2. *VA Benefits.*

a. Direct compensation for service-related disabilities from the Department of Veterans Affairs (VA) is acceptable, provided the creditor receives documentation from the VA.

b. Education benefits used to offset education expenses are not acceptable.

3. *Government Assistance Programs.*

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- a. Income received from government assistance programs is acceptable as long as the paying agency provides documentation indicating that the income is expected to continue for at least three years.
- b. If the income from government assistance programs will not be received for at least three years, it may not be used in qualifying.
- c. Unemployment income must be documented for two years, and there must be reasonable assurance that this income will continue. This requirement may apply to seasonal employment.

Note: Social Security income is acceptable as provided in section I.B.11.

4. *Mortgage Credit Certificates.*

- a. If a government entity subsidizes the mortgage payments either through direct payments or tax rebates, these payments may be considered as acceptable income.
- b. Either type of subsidy may be added to gross income, or used directly to offset the mortgage payment, before calculating the qualifying ratios.

5. *Homeownership Subsidies.*

- a. A monthly subsidy may be treated as income, if a consumer is receiving subsidies under the housing choice voucher home ownership option from a public housing agency (PHA). Although continuation of the homeownership voucher subsidy beyond the first year is subject to Congressional appropriation, for the purposes of underwriting, the subsidy will be assumed to continue for at least three years.
- b. If the consumer is receiving the subsidy directly, the amount received is treated as income. The amount received may also be treated as nontaxable income and be "grossed up" by 25 percent, which means that the amount of the subsidy, plus 25 percent of that subsidy may be added to the consumer's income from employment and/or other sources.
- c. Creditors may treat this subsidy as an "offset" to the monthly mortgage payment (that is, reduce the monthly mortgage payment by the amount of the home ownership assistance payment before dividing by the monthly income to determine the payment-to-income and debt- to-income ratios). The subsidy payment must not pass through the consumer's hands.
- d. The assistance payment must be:
 - i. Paid directly to the servicing creditor; or
 - ii. Placed in an account that only the servicing creditor may access.

Note: Assistance payments made directly to the consumer must be treated as income.

Appendix Q to Truth-in-Lending, Part 1026 (Regulation Z) (continued)

D. Rental Income.

1. *Analyzing the Stability of Rental Income.*

- a. Rent received for properties owned by the consumer is acceptable as long as the creditor can document the stability of the rental income through:
 - i. A current lease;
 - ii. An agreement to lease, or
 - iii. A rental history over the previous 24 months that is free of unexplained gaps greater than three months (such gaps could be explained by student, seasonal, or military renters, or property rehabilitation).
- b. A separate schedule of real estate is not required for rental properties as long as all properties are documented on the Uniform Residential Loan Application.

Note: The underwriting analysis may not consider rental income from any property being vacated by the consumer, except under the circumstances described below.

2. *Rental Income from Consumer Occupied Property.*

- a. The rent for multiple unit property where the consumer resides in one or more units and charges rent to tenants of other units may be used for qualifying purposes.
- b. Projected rent for the tenant-occupied units only may:
 - i. Be considered gross income, only after deducting vacancy and maintenance factors, and
 - ii. Not be used as a direct offset to the mortgage payment.

3. *Income from Roommates or Boarders in a Single Family Property.*

- a. Rental income from roommates or boarders in a single family property occupied as the consumer's primary residence is acceptable.
- b. The rental income may be considered effective if shown on the consumer's tax return. If not on the tax return, rental income paid by the roommate or boarder may not be used in qualifying.

4. *Documentation Required To Verify Rental Income.* Analysis of the following required documentation is necessary to verify all consumer rental income:

- a. IRS Form 1040 Schedule E; and
- b. Current leases/rental agreements.

Appendix Q to Truth-in-Lending, Part 1026 (Regulation Z) (continued)

5. Analyzing IRS Form 1040 Schedule E.

- a. The IRS Form 1040 Schedule E is required to verify all rental income. Depreciation shown on Schedule E may be added back to the net income or loss.
- b. Positive rental income is considered gross income for qualifying purposes, while negative income must be treated as a recurring liability.
- c. The creditor must confirm that the consumer still owns each property listed, by comparing Schedule E with the real estate owned section of the URLA.

6. Using Current Leases to Analyze Rental Income.

- a. The consumer can provide a current signed lease or other rental agreement for a property that was acquired since the last income tax filing, and is not shown on Schedule E.
- b. In order to calculate the rental income:
 - i. Reduce the gross rental amount by 25 percent for vacancies and maintenance;
 - ii. Subtract PITI and any homeowners association dues; and
 - iii. Apply the resulting amount to income, if positive, or recurring debts, if negative.

7. Exclusion of Rental Income from Property Being Vacated by the Consumer. Underwriters may not consider any rental income from a consumer's principal residence that is being vacated in favor of another principal residence, except under the conditions described below:

Notes:
 i. this policy assures that a consumer either has sufficient income to make both mortgage payments without any rental income, or has an equity position not likely to result in defaulting on the mortgage on the property being vacated.
 ii. This applies solely to a principal residence being vacated in favor of another principal residence. It does not apply to existing rental properties disclosed on the loan application and confirmed by tax returns (Schedule E of form IRS 1040).

8. Policy Exceptions Regarding the Exclusion of Rental Income from a Principal Residence Being Vacated by a Consumer.

When a consumer vacates a principal residence in favor of another principal residence, the rental income, reduced by the appropriate vacancy factor, may be considered in the underwriting analysis under the circumstances listed in the table below.

Exception	Description
Relocations	<p>The consumer is relocating with a new employer, or being transferred by the current employer to an area not within reasonable and locally-recognized commuting distance. A properly executed lease agreement (that is, a lease signed by the consumer and the lessee) of at least one year's duration after the loan is closed is required.</p> <p>Note: Underwriters should also obtain evidence of the security deposit and/or evidence the first month's rent was paid to the homeowner.</p>

Sufficient Equity in Vacated Property	<p>The consumer has a loan-to-value ratio of 75 percent or less, as determined either by:</p> <p>A current (no more than six months old) residential appraisal; or Comparing the unpaid principal balance to the original sales price of the property.</p> <p>Note: The appraisal, in addition to using forms Fannie Mae 1004/Freddie Mac 70, may be an exterior-only appraisal using form Fannie Mae/Freddie Mac 2055, and for condominium units, form Fannie Mae 1075/Freddie Mac 466.</p>
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E. Non Taxable and Projected Income.

1. *Types of Non Taxable Income.*

Certain types of regular income may not be subject to Federal tax. Such types of nontaxable income include:

- a. Some portion of Social Security, some Federal government employee retirement income, Railroad Retirement Benefits, and some State government retirement income;
- b. Certain types of disability and public assistance payments;
- c. Child support;
- d. Military allowances; and
- e. Other income that is documented as being exempt from Federal income taxes.

2. *Adding Non Taxable Income to a Consumer's Gross Income.*

- a. The amount of continuing tax savings attributed to regular income not subject to Federal taxes may be added to the consumer's gross income.
- b. The percentage of non-taxable income that may be added cannot exceed the appropriate tax rate for the income amount. Additional allowances for dependents are not acceptable.
- c. The creditor:
 - i. Must document and support the amount of income grossed up for any non-taxable income source, and
 - ii. Should use the tax rate used to calculate the consumer's last year's income tax.

Note: If the consumer is not required to file a Federal tax return, the tax rate to use is 25 percent.

3. *Analyzing Projected Income.*

- a. Projected or hypothetical income is not acceptable for qualifying purposes. However, exceptions are permitted for income from the following sources:
 - i. Cost-of-living adjustments;

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ii. Performance raises; and

iii. Bonuses.

b. For the above exceptions to apply, the income must be:

i. Verified in writing by the employer; and

ii. Scheduled to begin within 60 days of loan closing.

4. *Projected Income for New Job.*

a. Projected income is acceptable for qualifying purposes for a consumer scheduled to start a new job within 60 days of loan closing if there is a guaranteed, non-revocable contract for employment.

b. The creditor must verify that the consumer will have sufficient income or cash reserves to support the mortgage payment and any other obligations between loan closing and the start of employment. Examples of this type of scenario are teachers whose contracts begin with the new school year, or physicians beginning a residency after the loan closes.

c. The income does not qualify if the loan closes more than 60 days before the consumer starts the new job.

III. CONSUMER LIABILITIES: RECURRING OBLIGATIONS

1. *Types of Recurring Obligation.* Recurring obligations include:

a. All installment loans;

b. Revolving charge accounts;

c. Real estate loans;

d. Alimony;

e. Child support; and

f. Other continuing obligations.

2. *Debt to Income Ratio Computation for Recurring Obligations.*

a. The creditor must include the following when computing the debt to income ratios for recurring obligations:

i. Monthly housing expense; and

ii. Additional recurring charges extending ten months or more, such as

Appendix Q to Truth-in-Lending, Part 1026 (Regulation Z) (continued)

- a. Payments on installment accounts;
- b. Child support or separate maintenance payments;
- c. Revolving accounts; and
- d. Alimony.

- b. Debts lasting less than ten months must be included if the amount of the debt affects the consumer's ability to pay the mortgage during the months immediately after loan closing, especially if the consumer will have limited or no cash assets after loan closing.

Note: Monthly payments on revolving or open-ended accounts, regardless of the balance, are counted as a liability for qualifying purposes even if the account appears likely to be paid off within 10 months or less.

3. *Revolving Account Monthly Payment Calculation.* If the credit report shows any revolving accounts with an outstanding balance but no specific minimum monthly payment, the payment must be calculated as the greater of:

- a. 5 percent of the balance; or
- b. \$10.

Note: If the actual monthly payment is documented from the creditor or the creditor obtains a copy of the current statement reflecting the monthly payment, that amount may be used for qualifying purposes.

4. *Reduction of Alimony Payment for Qualifying Ratio Calculation.* Since there are tax consequences of alimony payments, the creditor may choose to treat the monthly alimony obligation as a reduction from the consumer's gross income when calculating qualifying ratios, rather than treating it as a monthly obligation.

IV. CONSUMER LIABILITIES: CONTINGENT LIABILITY

1. *Definition: Contingent Liability.* A contingent liability exists when an individual is held responsible for payment of a debt if another party, jointly or severally obligated, defaults on the payment.

2. *Application of Contingent Liability Policies.* The contingent liability policies described in this topic apply unless the consumer can provide conclusive evidence from the debt holder that there is no possibility that the debt holder will pursue debt collection against him/her should the other party default.

3. *Contingent Liability on Mortgage Assumptions.* Contingent liability must be considered when the consumer remains obligated on an outstanding FHA-insured, VA- guaranteed, or conventional mortgage secured by property that:

- a. Has been sold or traded within the last 12 months without a release of liability, or
- b. Is to be sold on assumption without a release of liability being obtained.

4. *Exemption from Contingent Liability Policy on Mortgage Assumptions.* When a mortgage is assumed, contingent liabilities need not be considered if the:

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- a. Originating creditor of the mortgage being underwritten obtains, from the servicer of the assumed loan, a payment history showing that the mortgage has been current during the previous 12 months, or
- b. Value of the property, as established by an appraisal or the sales price on the CD Settlement Statement from the sale of the property, results in a loan-to-value (LTV) ratio of 75 percent or less.

5. *Contingent Liability on Cosigned Obligations.*

- a. Contingent liability applies, and the debt must be included in the underwriting analysis, if an individual applying for a mortgage is a cosigner/co-obligor on:
 - i. A car loan;
 - ii. A student loan;
 - iii. A mortgage; or
 - iv. Any other obligation.
- b. If the creditor obtains documented proof that the primary obligor has been making regular payments during the previous 12 months, and does not have a history of delinquent payments on the loan during that time, the payment does not have to be included in the consumer's monthly obligations.

V. CONSUMER LIABILITIES: PROJECTED OBLIGATIONS AND OBLIGATIONS NOT CONSIDERED DEBT

1. *Projected Obligations.*

- a. Debt payments, such as a student loan or balloon-payment note scheduled to begin or come due within 12 months of the mortgage loan closing, must be included by the creditor as anticipated monthly obligations during the underwriting analysis.
- b. Debt payments do not have to be classified as projected obligations if the consumer provides written evidence that the debt will be deferred to a period outside the 12-month timeframe.
- c. Balloon-payment notes that come due within one year of loan closing must be considered in the underwriting analysis.

2. *Obligations Not Considered Debt.* Obligations not considered debt, and therefore not subtracted from gross income, include:

- a. Federal, State, and local taxes;
- b. Federal Insurance Contributions Act (FICA) or other retirement contributions, such as 401(k) accounts (including repayment of debt secured by these funds);
- c. Commuting costs;

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- d. Union dues;
- e. Open accounts with zero balances;
- f. Automatic deductions to savings accounts;
- g. Child care; and
- h. Voluntary deductions.

Official Appendix Q from TILA Regulation Z