

ETHICS IN MORTGAGE LENDING

The Federal Government, and most states have adopted legislation intended to protect the rights of individuals in a mortgage loan transaction. RESPA, HOEPA, Reg. Z, Fair Credit and the Equal Credit Opportunity Act have been put in place to regulate the processes and procedures for residential lenders. Many of these federal laws are mirrored by the states to provide further protection. These are the mandated regulations the violation of which can result in legal action against the lender. Most states take the governing of lending activities a step further and establish Codes of Ethics by which lenders are further regulated. In some instances Codes of Ethics are mandated, in others they are suggested. At the same time Mortgage Banking and Mortgage Brokerage organizations also establish ethical guidelines to which they expect their membership to adhere.

Compliance with lending regulations is imperative. Improper disclosures or failure to properly give a Right of Rescission may lead to significant refunds or extension of time for the borrower to opt out of the transaction. If a lender is audited by a regulatory agency such as the Office of the Comptroller of the Currency, or some state regulatory agency, and there are improper disclosures, fees, or disclosure calculations, these can result in the lender being required to do a complete audit of all loans to discover similar errors, and then to write checks to the borrowers to reimburse for the errors. Although many times the amount of a single check is not significant, the number of events and the cost to audit all loans made during a prescribed period of time causes the event to be a significant expense.

Anyone who has ever been a party to a mortgage loan closing transaction knows that the cost of home financing is not inexpensive. The litany of closing costs seems to go on and on, and fills up the entire second page of a closing statement (HUD 1). While the lender and closing agent might seem to be nickel and dimeing the borrower to death, most charges are necessary and unavoidable. Comparing one mortgage to another is not as simple as comparing only rates

and points. Borrowers need to shop other components of the mortgage transaction including rates, points and fees. Some costs can range from being reasonable, to being somewhat out of line, to being vastly overcharged. By knowing when costs are excessive a borrower can position himself to avoid overpaying. Many closing costs are flexible or negotiable, many others are not.

Even borrowers who shop diligently for the right loan with the right lender can be misled by the disclosures given at the time of application. The Good Faith Estimate is a disclosure that was promulgated through the Department of Housing and Urban Development, the watchdog federal agency that was established in part to protect the rights of mortgage borrowers. Under the Real Estate Settlement and Procedures Act (RESPA) the requirement was established that all providers of mortgage services in a residential mortgage transaction must provide the applicant with an estimate of closing costs. This Good Faith Estimate (GFE) is intended to inform the applicant of all closing costs that will be incurred on behalf of the lender in the loan transaction. While this should give comfort to the applicant that he is protected by these disclosures, there are simply too many areas where an unscrupulous mortgage lender or broker can under-disclose or fail to disclose without fear of reprisal or legal action.

A mortgage applicant may use an abundance of caution and sit down with a number of different lenders to compare closing cost estimates before committing to one of them to be the service provider. The applicant would have to be very astute to catch the subtle differences between the various estimates, and may select a lender because his rates and costs appear most competitive only to find out that the lender has either under-disclosed certain items or left other items completely out.

As an example, in order to make his closing costs look favorable a loan officer might estimate that the title insurance for a loan is \$350 as compared to another lender's estimate of \$1,200. The applicant might look at the two estimates and conclude that the first estimate is \$850 lower than the second and be compelled to go with that lender. The fact is that title insurance is not an expense of the lender, it is a charge of the title company or attorney providing the closing services and title insurance. The lender who provided the estimate for \$350 is not bound by that estimate as it is not a cost that is incurred on the lender's

behalf. It is fallacious to think that the first lender's costs are lower just because he gave a lower estimate for title insurance. disclosed as a single day's interest by one lender while another lender's estimate may show 30 days of interest. The first lender's estimate is going to look better because of this, but it in no way means that his costs are at all lower. While a hazard policy may be a lender requirement, it is an expense attributable to the insurance company, not the lender. In a typical transaction a lender would want the policy paid a year in advance plus a two months cushion of premiums in the escrow account. One lender's estimate might cover the entire fourteen months of hazard insurance while another's might not estimate for it at all making his estimate look much better than the one with the full disclosure.

These tricks of the Good Faith Estimate are not always innocent errors. They are frequently calculated to mislead the applicant into a sense that one transaction is less expensive than another. A prudent borrower will not only compare these estimates and find out the basis for the differences, but will also seek the advice of an expert in these matters if the facts remain unclear.

There are many thousands of mortgage lenders operating within the United States. In fact there are thousands of mortgage lenders including brokers, finance companies, banks, credit unions, and savings and loan associations operating in every state. This leaves the field wide open for consumers to make choices with respect to what resource they want to use to handle their mortgage transaction. Before committing to a single lender for a loan, a borrower is well advised to thoroughly study the lender's proposal for financing, interview a number of lending sources, and check references. An honest and ethical lender or broker will be able to supply references from banks, Realtors, closing agents, and previous satisfied customers

Below is a compilation of Codes, or Cannons of Ethics extracted from several of the states and mortgage industry trade groups:

1. Members shall conduct their business in a professional manner, ensuring that their personnel are knowledgeable in the areas of mortgage lending in which they participate and are acting in compliance with sound industry practices.
2. Members shall conduct their business without regard to race, creed, color, sex, marital status, familial status, religion, national origin, ancestry, age or handicap of the persons with whom they deal.
3. Members shall preserve the integrity of all parts of a loan submission and make full disclosure of all pertinent facts including any interest they

may have in the transaction

4. Members shall make all reasonable efforts to process loan application approval or disapproval promptly and to close and disburse in a timely manner.

5. Members shall not breach or avoid an agreement or commitment.

6. Members shall accord oral agreements with the same sanctity given to written agreements.

7. Members shall maintain all moneys that are received as escrow funds in a prudent manner and shall disburse these funds for the purposes for which they have been received or as required by law.

8. Members shall act in conformity with applicable laws and regulations and shall cooperate in every appropriate way with all governmental bodies in the interest of establishing and maintaining an efficient and fair framework for mortgage credit.

9. Members shall act in a way that recognizes honor, integrity and fidelity are essential in the mortgage lending business.

10. Members shall not quote to a prospective borrower interest rates or other loan terms that are not likely to be realized.

11. Members shall encourage healthy competition in the mortgage lending business.

12. Members shall at all times avoid unauthorized disclosure of confidential information.

13. Members shall not speak falsely or disparagingly of the business practices of a competitor or of a transaction being negotiated by a competitor.

14. Members shall use all efforts available in servicing investments entrusted to their care to effectively discharge their obligations to both investor and debtor.

15. Members shall cooperate with the Ethics and/or Consumer Relations Committee in furnishing information relative to any investigation of a possible violation of the Code of Ethics.