

Current Issues in Mortgage Origination and Servicing

Responding to Heightened Regulatory Demands and Scrutiny

Mary Jo Johnson, Lisa Jack, Jonathan McKernan, Eamonn Moran

March 19, 2015

Attorney Advertising



WILMER CUTLER PICKERING HALE AND DORR LLP®



Speakers



Mary Jo Johnson
Partner
WilmerHale



Lisa Jack
Special Counsel
WilmerHale



Jonathan McKernan
Counsel
WilmerHale



Eamonn Moran
Counsel
WilmerHale



Webinar Guidelines

- Participants are in listen-only mode
- Submit questions via the Q&A box on the bottom right panel
- Questions will be answered as time permits
- Offering 1.0 CLE credit in California and New York*
- WebEx customer support: +1 888 447 1119, press 2

** WilmerHale has been accredited by the New York State and California State Continuing Legal Education Boards as a provider of continuing legal education. This program is being planned with the intention to offer CLE credit in California and non-transitional credit in New York. This program, therefore, is not approved for New York newly admitted attorneys. WilmerHale is not an accredited provider of Virginia CLE, but we will apply for Virginia CLE credit if requested. The type and amount of credit awarded will be determined solely by the Virginia CLE Boards. Attendees requesting CLE credit must attend the entire program.*



Areas of Increased Scrutiny

- CFPB / FHFA Enforcement Trends
- Compliance Systems & Vendor Management
- TILA-RESPA Disclosures
- RESPA Kickbacks
- Loan Origination Compensation
- Loss Mitigation
- Servicing Transfers

The New Normal: More Agency Enforcement

- CFPB has made mortgage finance an enforcement priority.
 - More than 20 public enforcement actions.
 - Focus has been on kickbacks, loan originator compensation, and Home Mortgage Disclosure Act (HMDA) reporting.
 - The Wells Fargo \$21 M Civil Money Penalty (CMP) was the second largest by the CFPB yet.
 - Flagstar order might be indicative of things to come, e.g., scrutiny of loss mitigation practices and also aggressive use of UDAAP authority.
- FHFA is also focused on compliance issues.
 - Advisory Bulletin 2014-07 provides that Government-Sponsored Enterprises' (GSEs') third-party risk management policies “should also include standards for taking timely remedial action . . . for example, against a Seller/Servicer . . . that poses reputation risk because of noncompliance with applicable laws and regulations or unsound business practices.”
 - Authority to veto Mortgage Servicing Rights (MSR) transfers gives FHFA significant leverage to drive changes.
- Shift to non-bank servicers raises unique issues.
 - New York Department of Financial Services (DFS) has frozen an MSR transfer.
 - FHFA OIG found “escalating risks” posed by non-bank servicers to Fannie and Freddie (July 1, 2014 Report).
 - Cliff White, Director of the DOJ's U.S. Trustee Program, opined on the risks to consumers posed by non-bank servicers.
 - The FSOC wants prudential standards developed (FSOC 2014 Annual Report).



CFPB CMP Trends

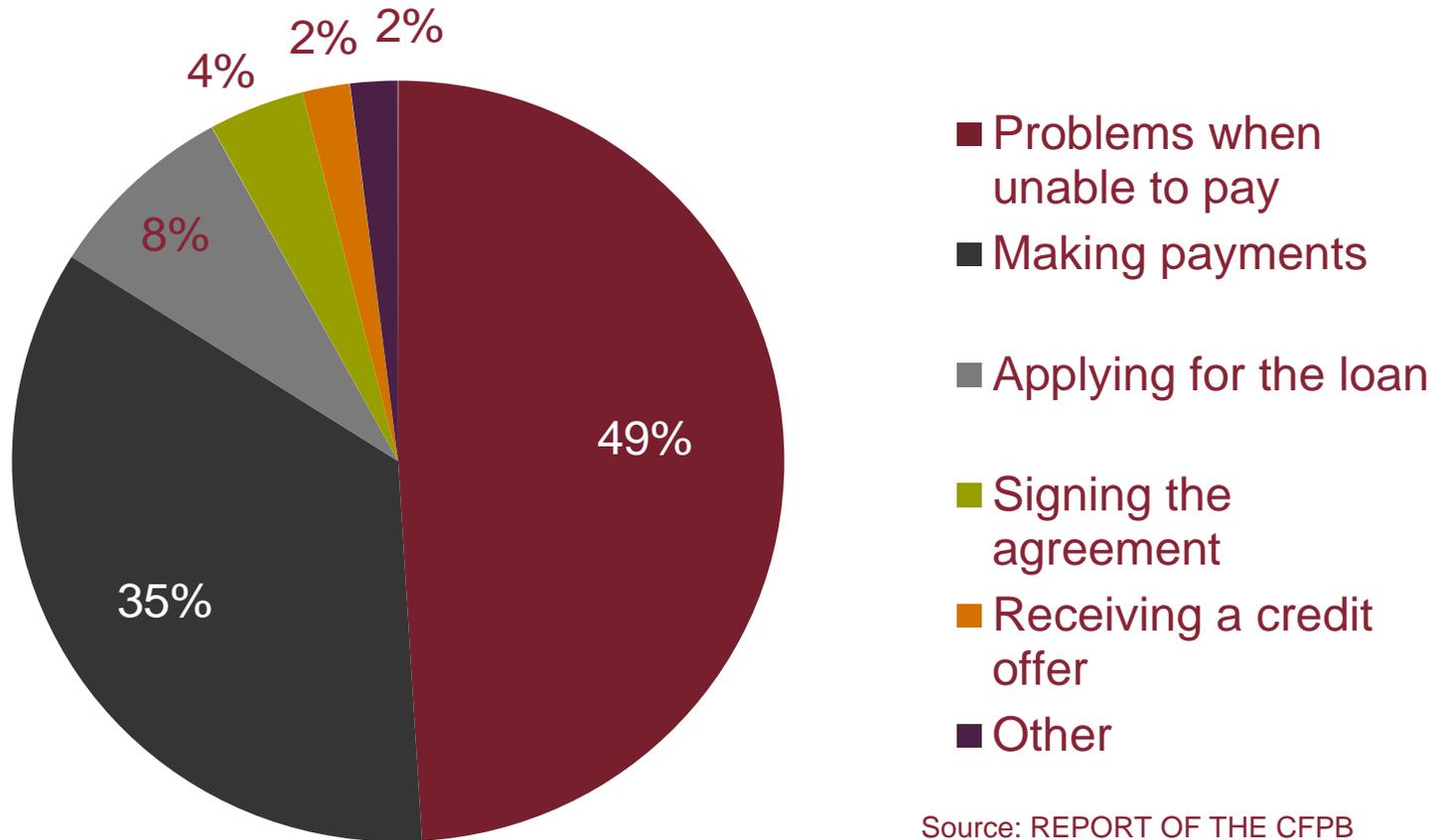
- One key factor in the CMP amount is the scope of the customer impact.
 - Emphasizes need to continually monitor actions that negatively impact customers and correct them immediately.
- However, CMP amounts in mortgage finance enforcement actions often exceed customer harm.
 - In part due to different methods of calculation when a matter goes to enforcement, but also due to areas where harm is less readily identifiable or amenable to refunds.
- The culpability of the conduct and “responsible conduct” also inform the CMP amount.
 - The vastly different penalties in the recent CFPB kickback actions involving payments by the same title company (\$24 million vs. \$600,000), were due in part to the breadth of the conduct but also to the failure to have adequate systems in place to identify problems and the failure to take action to stop practices once identified.



UDAAP Enforcement Authority

- UDAAP is a powerful gap filler.
 - It is no longer enough to comply with the strict letter of the law.
 - The breadth and vagueness of “unfair,” “deceptive,” and “abusive” allows for a wide range of regulatory actions.
 - Over half of the CFPB’s public enforcement actions contain UDAAP violations.
- Notable Enforcement Actions:
 - *Flagstar* order enforced loss mitigation rules prior to their effective date.
 - *ACE Cash* order extended Fair Debt Collection Practices Act (FDCPA) requirements to first-party collections.
- UDAAP concerns are particularly acute in marketing context.
 - *Amerisave* order: CFPB sanctioned deceptive advertising.
- UDAAP remains a regulatory focus in 2015.
 - 3 UDAAP enforcement actions just last month: Flagship Financial Group, NewDay Financial, and American Preferred Lending
- Subject matter experts and legal review are critical to ensuring compliance.

CFPB: Types of Mortgage Complaints Reported by Consumers



Source: REPORT OF THE CFPB
PURSUANT TO § 1017(E)(4) OF THE
DODD-FRANK ACT, December 2014



Complaint Program

- Consumer complaints are an early warning system for compliance issues.
- Regulators expect analysis of trends and root causes.
- Qualitative trend analysis – complaint counts are not enough.
- Oral complaints – some oral complaints should be captured and analyzed.
- Vendor complaints – complaints received by some vendors should be captured and analyzed.
- Involvement of Legal – the legal function should be involved in the resolution and analysis of complaints that suggest a material legal risk.
- Documentation – if it's not documented, it didn't happen.



“Systems” Approach to Compliance

- Heightened regulatory demands and scrutiny underscore the importance of an effective compliance risk management system.
- A compliance function is only one part of a compliance system.
- Regulators expect a three-lines-of-defense approach.
 - Each business unit, as the first line of defense, is responsible for managing the risks arising out of its business.
 - The compliance function and other support functions provide a second line of defense to assist the business units in managing their risks, e.g., by advising on compliance requirements, assisting in the development of controls, and testing the effectiveness of those controls.
 - The internal audit function, as the third line of defense, assesses the processes performed by the first and second lines of defense.
- Non-banks are evolving to meet these new expectations.



“Systems” Approach to Compliance (cont.)

- The systems approach includes a number of compliance-related processes and programs:
 - Board/management reporting and oversight
 - Compliance risk assessments
 - Change and issue management
 - Vendor management
 - Consumer complaint program
 - Compliance training program
- The elevator speech: senior management should be able to explain to examiners and regulators the enterprise’s approach to compliance.
- Documentation: worth repeating, if it’s not documented, it didn’t happen.
- CFPB exam preparedness: use the exam manual to develop written answers to likely CFPB questions.



Vendor Management

- Particular area of regulatory scrutiny:
 - Focus has continued to expand over the last few years (OCC Bulletin 2013-29, FRB SR 13-19, CFPB Bulletin 2012-03 and FFIEC IT Exam Booklet on Technology Service Providers).
 - Since the National Mortgage Settlement, other enforcement actions have targeted vendor management deficiencies (Mortgage foreclosure orders; card add-on orders).
- Drivers of increased scrutiny:
 - Shift in supervisory focus to operational risks: vendors present unique operational risks.
 - Evolving nature of outsourcing relationships (e.g., cloud services).
 - Focus on consumer compliance.
- Regulatory expectations are risk-based:
 - Take appropriate steps to identify, measure, monitor and control vendor risks.
 - Conduct risk planning, due diligence, contracting, and monitoring.



Vendor Management (cont.)

- No “one size fits all” approach: oversight tailored to the vendor’s risk profile.
- Risk assessments:
 - Risk tiers should be based off a separate measure of compliance risk.
- Contingency planning: after the OCC bulletin, there is a new focus on contingency planning; need written plans for significant vendors.
- Template contract language: you need some language to use as a starting point on, e.g., complaint resolution, contingency planning, audits, ability to review key policy documents.
- Consumer complaints: some vendors, especially client-facing vendors, should be required to report on complaints.



TILA-RESPA Integrated Disclosures

- Final Rule: 78 Fed. Reg. 79,730 (December 31, 2013).
- This rule is effective **August 1, 2015**. The final rule applies to transactions for which the creditor or mortgage broker receives an application *on or after* that date.
 - New § 1026.19(e)(2), the amendments to § 1026.28(a)(1), and the amendments to the commentary to § 1026.29, become effective on August 1, 2015 without respect to whether an application has been received.
- One amendment to the final rule:
 - Extends the timing requirement for revised disclosures when consumers lock a rate or extend a rate lock after the Loan Estimate is provided.
 - Permits certain language related to construction loans for transactions involving new construction on the Loan Estimate. (80 Fed. Reg. 8,767).

TILA-RESPA Integrated Disclosures (Liability Calculus)

- The final rule does not change existing TILA and RESPA liability provisions.
 - While the final regulations and official interpretations do not specify which provisions relate to TILA or RESPA requirements, the section-by-section analysis (preamble) of the final rule covers the statutory authority for each of the integrated disclosure provisions.
- Creditors will be responsible for the accuracy, content, and delivery of the Closing Disclosure to the buyer.
- The authority for the integrated disclosure provisions is based on disclosure mandates in TILA and RESPA, and certain rulemaking and exception authorities granted to the Bureau by TILA, RESPA, and Dodd-Frank.
- Determining which liability attaches to particular disclosures on the forms could be a time-consuming and challenging process, and courts will likely have to resolve the uncertainty.

TILA-RESPA Integrated Disclosures (Industry Readiness)

- Starting last fall, CFPB leaders have emphasized that although the new disclosure forms are not required until August 1, 2015, mortgage lenders “should already be working on the new rule and getting ready now.”
- Significant changes to business operations and technology platforms will require close collaboration with third-party service providers.
- The GSEs have released the Uniform Closing Dataset, which leverages and maps to Mortgage Industry Standards Maintenance Organization (MISMO) data standards, to help implement the Closing Disclosure. The MISMO Origination Working Group created a corresponding dataset for the Loan Estimate.
- Director Cordray is showing little sympathy for companies that may be behind the curve — even while some legislators and industry trade groups are urging the CFPB to exercise restraint in its enforcement come August 1, 2015.

TILA-RESPA Integrated Disclosures (Challenges and Expectations)

- Other Challenges come August 1:
 - For an application taken on July 31, lenders will have to use the old forms until the end of closing, even if that happens in October. For applications taken in August, lenders have to use the new forms and systems, which means all lenders will have to run the same systems side-by-side, which could be a major logistical issue.
- CFPB's Expectations for Compliance:
 - Policies, procedures and training should be updated to ensure that employees fully understand the changes prior to the effective dates.
 - Transaction testing will not take place until after the effective date of the rule and enough time has passed to allow for an adequate sample of transactions.
 - Most of the Title XIV rules took effect in January 2014 and the CFPB commenced examinations for compliance four months after the effective date.



RESPA - Kickbacks

- RESPA prohibits giving a “fee, kickback, or thing of value” in exchange for a referral of business related to a real-estate-settlement service (12 C.F.R. § 1024.14(b)).
 - Two-thirds of the Bureau’s mortgage originations enforcement cases have concerned kickbacks.
 - In January 2015, the CFPB and the Maryland Attorney General took action against two large banks (and a former employee and his wife) for an alleged marketing-services-kickback scheme with a title company.
 - The title company allegedly gave the banks’ loan officers cash, marketing materials, and consumer information in exchange for business referrals.
- Emphasizes the challenges with, and importance of, adequate employee monitoring and compliance management systems.



Loan Originator Compensation

- Regulation Z prohibits a loan originator from receiving compensation based, directly or indirectly, on the terms of a consumer credit transaction secured by a dwelling (12 C.F.R. § 1026.36(d)(1)).
 - A loan originator includes administrative staff and branch managers who, for compensation or other monetary gain, or in expectation of compensation or other monetary gain, arrange, negotiate, or otherwise obtain an extension of consumer credit for another person.
- One of the CFPB's Top Supervisory and Enforcement Priorities:
 - Franklin Loan's alleged practice of incentivizing loan officers to upcharge consumers by paying quarterly bonuses based, in part, on the interest rates of loans they originated (November 2014).
 - Castle & Cooke's alleged practice of giving loan officers bonuses that varied based on the interest rate of the loans they offered to consumers (November 2013).

Loan Originator Compensation (cont.)

- Last week, the CFPB released its latest “Supervisory Highlights” report outlining legal violations uncovered by the Bureau’s examiners.
 - CFPB examiners found that some loan originators illegally received compensation based on the terms of the loan.
 - In one or more examinations, examiners found that branch managers were loan originators *and* owners of related marketing services entities. Supervision found instances of improperly allocated expenses on branch income statements which resulted in marketing services entities receiving income based on the profitability of retail loans originated by branch managers. Consequently, branch managers, as owners of the marketing services entities, received compensation based on the terms of transactions originated by the branch managers themselves.
- Retaining Records of Compensation:
 - Requirement for creditors to retain evidence of compliance, such as payroll records.



Loss Mitigation – Implementation Issues

- Consumers continue to identify “problems when unable to pay” as a consistent mortgage servicing complaint.
- The CFPB has scrutinized implementation issues in the roll out of the 2013 Mortgage Servicing rules, including:
 - Interpretation by many servicers of the Early Intervention requirements (*but not the CFPB*) as requiring *one* effort at live contact and *one* written solicitation.
 - Appropriate scope of the exemption from Early Intervention for certain borrowers due to bankruptcy and FDCPA protections.
 - Customer experience under the new rules both in terms of incomplete and complete applications.
 - Cause of delays in the loss mitigation process, particularly as to third party information not in the borrower’s control.
 - Effectiveness of the new rules in preventing foreclosures, including whether foreclosure counsel is effectively advocating for delays to the sale where a complete loss mitigation application has been received.

Loss Mitigation - CFPB Proposed Rule Changes

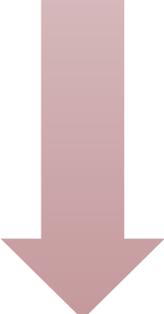
- Early Intervention rules have been modified to require *repeated* live contact and *repeated* written solicitations.
- Certain higher risk populations are no longer exempt from early intervention.
 - New rules require written solicitation of borrowers in bankruptcy and borrowers who have invoked their FDCPA protections.
- Additional new obligations are expected of servicers.
 - Requirement to set the date for returning all required borrower documents in a way “that will maximize the individual borrower’s protections” (based on milestones).
 - Express obligation to promptly identify and request third party information.
 - Enforcement of dual-tracking prohibition by requiring the servicer to take reasonable steps to delay the sale; if such steps are not taken, the servicer must dismiss the foreclosure proceeding to avoid the sale.
- New disclosures to borrowers
 - A notice stating the date the application became complete. As of such date, dual-track protections must be provided, even if ultimately additional information is needed.
 - A notice when the servicer is unable to obtain third-party information within the 30-day evaluation period.



Loss Mitigation - Enforcement Actions



Increasingly,
processing
errors are
viewed as a
harm



- December 2013
 - Servicer allegedly committed robo-signing and charged unauthorized fees. Further alleged failure to honor trial modifications that were agreed upon by previous servicers. The servicer misled consumers about alternatives to foreclosure and denied loan modifications for eligible homeowners.
-
- June 17, 2014
 - Servicer allegedly committed robo-signing, failed to promptly and accurately apply payments, and charged unauthorized fees. Further, the servicer allegedly failed to provide accurate information about loan modifications and other loss mitigation services, failed to properly process borrowers' applications and calculate their eligibility for loan modifications, and provided misleading reasons for denying loan modifications.
-
- September 2014
 - Servicer allegedly took excessive time to process borrowers' applications for loss mitigation relief; failed to tell borrowers when their applications were incomplete; denied loan modifications to qualified borrowers; and delayed finalizing permanent loan modifications.

Source: See CFPB Newsroom, summary of enforcement actions, <http://www.consumerfinance.gov/newsroom/?topic=enforcement>.

Note: We have not included the enforcement actions by the CFPB and/or FTC related to debt-relief scams that charged upfront fees to borrowers and made false promises regarding the agency's ability to prevent a foreclosure.



Loss Mitigation - Conclusion

- Tightly proscriptive regulations on timing of each step of the loss mitigation process and required disclosures.
 - Customer protection is the focus.
 - Burdens on servicers may be underestimated.
 - Comments from servicers may not sway the CFPB away from the proposed regulations, in light of its public commentary and outreach efforts.
- A robust systems approach to compliance is particularly critical.
 - Under CFPB guidance, transferor and transferee have shared responsibility for loss mitigation requirements at time of service transfer.
 - For banks and non-banks who are evolving to these new expectations there is a critical need for business, compliance, and internal audit to share in a comprehensive and holistic approach.



CFPB Servicing Transfer Bulletin

Both the Transferor & Transferee are expected to develop a servicing transfer process that ensures data integrity and the accurate transfer of all loan-level information upon boarding.

Issue	CFPB Guidance
Servicing Contract	<ul style="list-style-type: none">• Ensure that the servicing contract requires the transferor to provide all necessary documents and information at loan boarding.
Migration Plan	<ul style="list-style-type: none">• Develop tailored transfer instructions for each deal (including description of proprietary loan modifications, proprietary system fields, document indexing, etc.).• Recognize when a servicer transfer needs to be implemented in several smaller transactions in order to ensure data quality.
Testing Protocols	<ul style="list-style-type: none">• Use specifically tailored testing protocols to evaluate the compatibility of the transferred data with the transferee's systems.
Post-Transfer Escalations	<ul style="list-style-type: none">• Transferee and transferor should have regularly scheduled calls to identify, research, and resolve loan level issues promptly.

Source: See CFPB Compliance Bulletin and Policy Guidance: Mortgage Servicing Transfers. Bulletin 2014-01 (issued August 19, 2014), as published at 79 Fed. Reg. 63,295 (October 23, 2014).



CFPB Servicing Transfer Bulletin (cont.)

The CFPB Bulletin focused extensively on servicing transfers that involve loans with “in-flight” modifications or other active loss mitigation.

Issue	CFPB Guidance
Data Migration	<ul style="list-style-type: none">Identify all loans with pending loss mitigation applications or approved loss mitigation, all loss mitigation discussions or communications with borrowers, or related borrower documents.
Continuity	<ul style="list-style-type: none">Organize effectively all loss mitigation information from the prior servicer <i>before</i> attempting communication with the borrower.
Obligations of Transferee	<ul style="list-style-type: none">Review in-flight loan modifications <i>prior to boarding</i> for documentation or underwriting issues.Do not fail to honor trial or permanent modifications until the transferee can verify documents with prior servicer; nor should the transferee approve the borrower for a less favorable permanent loan modification with inferior terms.Apply payments consistent with transferor’s loss mitigation records.

Source: See CFPB Compliance Bulletin and Policy Guidance: Mortgage Servicing Transfers. Bulletin 2014-01 (issued August 19, 2014), as published at 79 Fed. Reg. 63,295 (October 23, 2014).



Questions?

Mary Jo Johnson

Partner

+1 617 526 6750

MaryJo.Johnson@wilmerhale.com

Lisa Jack

Special Counsel

+1 617 526 6680

Lisa.Jack@wilmerhale.com

Jonathan McKernan

Counsel

+1 202 663 6803

Jonathan.McKernan@wilmerhale.com

Eamonn Moran

Counsel

+1 202 663 6638

Eamonn.Moran@wilmerhale.com

** WilmerHale has been accredited by the New York State and California State Continuing Legal Education Boards as a provider of continuing legal education. This program is being planned with the intention to offer CLE credit in California and non-transitional credit in New York. This program, therefore, is not approved for New York newly admitted attorneys. WilmerHale is not an accredited provider of Virginia CLE, but we will apply for Virginia CLE credit if requested. The type and amount of credit awarded will be determined solely by the Virginia CLE Boards. Attendees requesting CLE credit must attend the entire program.*



Wilmer Cutler Pickering Hale and Dorr LLP is a Delaware limited liability partnership. WilmerHale principal law offices: 60 State Street, Boston, Massachusetts 02109, +1 617 526 6000; 1875 Pennsylvania Avenue, NW, Washington, DC 20006, +1 202 663 6000. Our United Kingdom offices are operated under a separate Delaware limited liability partnership of solicitors and registered foreign lawyers authorized and regulated by the Solicitors Regulation Authority (SRA No. 287488). Our professional rules can be found at www.sra.org.uk/solicitors/code-of-conduct.page. A list of partners and their professional qualifications is available for inspection at our UK offices. In Beijing, we are registered to operate as a Foreign Law Firm Representative Office. This material is for general informational purposes only and does not represent our advice as to any particular set of facts; nor does it represent any undertaking to keep recipients advised of all legal developments. Prior results do not guarantee a similar outcome. © 2014 Wilmer Cutler Pickering Hale and Dorr LLP