What mortgage servicing rules apply to me?
Sorting out the scope and impact of the new mortgage servicing regulations

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Confronted with the reality of mortgage servicing rules related to the Dodd-Frank Act, some mortgage servicing companies hope they can fly under the regulatory radar rather than comply. They typically ask, “What mortgage servicing regulations apply to me?” The answer: some of them, in the short run. However, the reality is that, in the long run, probably all of them eventually will apply.

That’s not the answer that mortgage servicers want. However, our view reflects the unvarnished reality of the interlocking rules now in place through the Consumer Financial Protection Bureau (CFPB), the Federal Deposit Insurance Corporation (FDIC) and the Office of the Comptroller of the Currency (OCC), among other agencies.

The new CFPB rules became effective this January, so their implementation and impact are still shaping up. Mortgage servicers of all sizes should pay close attention to them, based on the regulatory actions and negative media coverage aimed at such servicers who are already subject to similar rules. If they ignore the rules, mortgage servicers will create significant reputational, operational and financial risk for themselves. After the turmoil of the financial crisis, no prudent management wants that.

The nine key areas

Briefly, the CFPB amended Regulation X (Real Estate Settlement Procedures Act (RESPA)) and Regulation Z (Truth-In-Lending Act (TILA)) to implement provisions of the Dodd-Frank Act regarding mortgage loan servicing. These new rules, covering nine major areas, are the government’s response to widespread abuses and calls for enhanced disclosures to consumers. The nine areas are:

- Periodic billing statements
- Interest rate adjustment notices for ARMs
- Payment crediting and payoff statements
- Force-placed insurance
- Error resolution and information requests
- General servicing policies, procedures and requirements
• Early intervention with delinquent borrowers
• Continuity of contact with delinquent borrowers
• Loan mitigation procedures

Generally, the 2013 amendments to RESPA apply to closed-end federally related mortgages. Federally related mortgages means any loan secured by a first or subordinate lien on a residential property, including one-to-four unit properties, manufactured housing and reverse mortgages.

Exemptions? Possible, but . . .

Questions arise when mortgage servicers read the regulations for passages that exempt them from some rules. A small servicer, which is exempt from certain new rules, services fewer than 5,000 mortgage loans and only services mortgage loans that the firm or an affiliate owns or originated. Firms that service loans for others do not qualify. Such exemptions include:

• Periodic billing statements
• General servicing policies, procedures and requirements
• Early intervention with delinquent borrowers
• Continuity of contact with delinquent borrowers

On the other hand, small servicers are prohibited from making the first notice or filing required for a foreclosure process, unless a borrower is more than 120 days delinquent. Additionally, they cannot make the first notice or filing, move for foreclosure judgment or order of sale, or conduct a foreclosure sale, when a borrower is performing pursuant to the terms of a loss mitigation agreement. Thus, while small servicers are exempt from some aspects of loss mitigation, they must still comply with consumer protection rules.

In addition, if you only service open-end mortgage loans, you are generally exempt from the new mortgage servicing rules. If you only service reverse mortgages, you are exempt from the following:

• General servicing policies, procedures and requirements
• Early intervention with delinquent borrowers
• Continuity of contact with delinquent borrowers
• Loan mitigation procedures

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1 Except loans on property of 25 acres or more, business-purpose loans, temporary financing and loans secured by vacant land.
2 The loan is (i) made by any lender that is either regulated by or whose deposits are insured by any agency of the federal government; (ii) insured, guaranteed, supplemented, or assisted by the Department of Housing and Urban Development (HUD) or under a program administered by HUD; (iii) sold to FNMA, GNMA or FHLMC; (iv) made by a creditor, as defined by section 103(g) of the Consumer Credit Protection Act, that makes or invests in residential real estate loans (including single-family and multifamily residential property) aggregating more than $1,000,000 per year (but does not include any agency or instrumentality of any State); or home equity conversion mortgage (reverse mortgages)
3 Applicable CFPB mortgage servicing rules are (a) prompt payment and crediting; (b) force-placed insurance; (c) error resolution; (d) general servicing policies and procedures and requirements; (e) early intervention with delinquent borrowers; (f) continuity of contact with borrowers; and (g) loss mitigation procedures.
Small mortgage servicers will often reason that, given they are well below the threshold, they need not focus on new-rule compliance until they exceed the 5,000 limit. Our view: The overlapping nature of regulations from different agencies makes this a short-sighted approach that misunderstands the CFPB's purpose. The CFPB aims to identify practices that violate Dodd-Frank mortgage rules or that increase the risk of consumer harm. In addressing practices that heighten the risk of consumer harm, the CFPB also looks for violations under regulations from other agencies:

- Electronic Funds Transfer Act
- Fair Debt Collection Practices Act
- Homeowners Protection Act
- Fair Credit Reporting Act
- Gramm-Leach-Bliley Act/Privacy of Consumer Financial Information
- Equal Credit Opportunity Act
- Unfair, Deceptive, and Abusive Acts or Practices

The CFPB may also enforce certain rules of the Federal Trade Commission.

The bottom line: The CFPB has broad authority to protect consumers. That mandate means your financial institution may find itself in compliance in some areas (including CFPB rules) but may be in violation of regulations of other acts. The new mortgage servicing rules are rules-based and prescriptive, while the regulations listed above are more principle-based, specifically, the Unfair, Deceptive, and Abusive Acts or Practices (UDAAP) in the Dodd-Frank Act. By way of explanation, the principle-based regulations are subjective. Therefore, the objective of your institution's communications must align with consumer protection regulations. Your legal counsel can provide guidance on how to interpret the regulations.

The CFPB provides an example of the risks for the unwary in its Supervision and Examination Manual: “A transaction that is in technical compliance with other federal and state laws may, nevertheless, violate the prohibition against UDAAPs. For example, an advertisement may comply with TILA's requirements, but contain additional statements that are untrue or misleading, and compliance with TILA's disclosure requirements does not insulate the rest of the advertisement from the possibility of being deceptive.”

The takeaway: Even small servicers must craft their policies to comply not only with the CFPB, but also the other acts.

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4 The Bureau's purpose is set forth by Section 1021 of the Act: (a) PURPOSE.—The Bureau shall seek to implement and, where applicable, enforce Federal consumer financial law consistently for the purpose of ensuring that all consumers have access to markets for consumer financial products and services and that markets for consumer financial products and services are fair, transparent, and competitive. Federal consumer financial law Subject to the provisions of the Act, the CFPB has responsibility to implement, examine for compliance with, and enforce “Federal consumer financial law.” Those laws include, among other things, Title X itself, which prohibits unfair, deceptive, or abusive acts and practices in connection with consumer financial products and services, and the following “enumerated consumer laws” and the implementing regulations.

5 Pg 3 of the CFPB Supervision and Examination Manual, Version 2 – October 2012

The CFPB may enforce the following rules issued by the Federal Trade Commission: (i) Telemarketing Sales Rule (16 CFR Part 310); (ii) Use of Prenotification Negative Option Plans (16 CFR Part 425); (iii) Rule Concerning Cooling-Off Period for Sales Made at Homes or at Certain Other Locations (16 CFR Part 429); (iv) Preservation of Consumers' Claims and Defenses (16 CFR Part 433); (v) Credit Practices (16 CFR Part 444); (vi) Mail or Telephone Order Merchandise (16 CFR Part 435); (vii) Disclosure Requirements and Prohibitions Concerning Franchising (16 CFR Part 436); (viii) Disclosure Requirements and Prohibitions Concerning Business Opportunities (16 CFR Part 437).
What about small banks that are mortgage servicers?

Small banks, with under $10 billion in assets, argue that they are not subject to CFPB mortgage servicing rules. In one sense, that’s accurate. CFPB’s authority starts with banks with assets exceeding $10 billion, with some exceptions.

Despite the CFPB threshold, banking regulators are also focusing on consumer compliance. On Feb. 25, 2014, the FDIC released a Financial Institution Letter detailing mortgage rules related to Dodd-Frank. This Financial Institution Letter (FIL-9-2014) applies to FDIC-supervised institutions with under $1 billion in total assets. In addition to the mortgage servicing rules of RESPA and TILA, the FDIC will evaluate compliance with the following Dodd-Frank residential mortgage loan rules:

- Ability-to-Repay/Qualified Mortgage Rule
- Loan Originator Compensation Rule
- High-Cost Mortgage and Homeownership Counseling Amendments Rule
- Higher-Priced Mortgage Loan Escrow and Appraisal Rules
- Equal Credit Opportunity Act Appraisal Rule

The FDIC expects institutions to be familiar with the mortgage rules’ requirements and have a plan for implementing them during the initial examinations for compliance with the new regulations. Implementation plans should contain clear timeframes and benchmarks for making the necessary changes to compliance management systems and relevant programs.

These new FDIC regulations bring banks at the $1 billion asset level into the servicer rule sphere. In March 2014, the OCC adopted examination procedures reflecting the RESPA and TILA amendments. Under TILA, the goals of the examinations are:

- Evaluate the quality of the compliance management system and how much reliance can be placed on it, including internal controls and procedures
- Determine compliance with TILA
- Assess ability to initiate corrective actions when the compliance management system fails to identify violations of laws or regulations
- Determine if the institution will be required to make adjustments to consumer accounts under the restitution provisions of TILA

For RESPA, the examinations seek to determine:

- Existence of policies and procedures for compliance with RESPA
- If the institution engages in any practices prohibited by RESPA
- That all required disclosures are compliant with RESPA, completed and provided to borrowers within required time periods
- That the institution submits to borrowers required initial and annual escrow account statements, are accurate and compliant with escrow account arrangements
- That the institution is responding to borrower error notices and borrower inquiries for information relating to the servicing of their mortgage loans
- That the institution is providing proper notices to borrowers before assessing charges or force placed insurance and refunding necessary charges and fees
- That the institution complies with record management requirements
- That the institution is following early intervention and continuity of contact requirements
- That the institution complies with loss mitigation procedures
Focusing on consumer compliance, regulators are now basing their examinations and enforcement strategies on CFPB rules, as well as accounting for UDAAP. Proactive mortgage servicers are addressing compliance both on a rules-based approach and on a broad and principle-based approach. This combination of rules and principles reflects the shift in the supervisory philosophy toward consumer protection. The UDAAP provision under Dodd-Frank Act is an example of a broad regulatory provision and the CFPB’s principle-based approach to consumer compliance may require financial institutions to rethink their compliance management system.

The bottom line on penalties

In the long run, you cannot escape the consumer compliance regulatory climate. You may be exempt from some regulations but not others. After the roiling disasters in mortgage servicing during the financial crisis, CFPB and other regulators are going to exercise their power to protect consumers from financial harm due to abusive or deceptive practices, and material financial loss. Whatever your institution’s size or portfolio, if your compliance management system fails to detect, prevent or correct harm done to consumers, then you’re facing severe problems. Size will not matter.

How severe are the penalties?

**Under RESPA,** except for the policy and procedure requirements and continuity of contact, a **servicer** may face liability for:

- Actual damages
- Statutory damages up to $2,000 for an individual action or $2,000 per member of a class not to exceed the lesser of $1 million or 1 percent net worth of the servicer, upon showing a pattern of noncompliance
- Attorneys’ fees and costs

**Under TILA,** for violations of the regulations implementing TILA, a **creditor** may face liability for:

- Actual damages
- Statutory damages of up to $4,000 in an individual action or in a class action up to $1 million or 1 percent of the creditor’s net worth
- Attorneys’ fees and costs

**Under the Dodd-Frank Act,** for violations of the regulations implementing TILA and RESPA, as well as UDAAP, the CFPB can bring enforcement actions to obtain (among other things):

- For any violation of a law, rule, or final order or condition imposed in writing by the CFPB, a civil penalty may not exceed $5,000 for each day during which such violation or failure to pay continues
- For any person that recklessly engages in a violation of a federal consumer financial law, a civil penalty may not exceed $25,000 for each day during which such violation continues
- For any person that knowingly violates a federal consumer financial law, a civil penalty may not exceed $1 million for each day during which such violation continues up to $1 million for each day the violation continues
- Restitution
- Refund of moneys or return of real property
- Damages or other monetary relief (but not punitive damages)
- Costs of the CFPB in prosecuting the action
Comply or die, metaphorically speaking

Managing compliance efficiently and effectively is now more critical than ever. Size does not matter, as regulators have adopted similar approaches in enforcement strategies and examination approach. All financial institutions—not just those directly supervised by the CFPB—should follow developments and emerging issues at the CFPB. Risk management at all financial institutions is more involved, given the current regulatory environment.

CFPB cites a lack of systems for periodic monitoring and independent compliance audits as mortgage servicers’ most common weakness. To be effective, banks and mortgage servicers need to design and implement a mortgage compliance system and subject it to periodic monitoring reviews, as well as annual independent compliance audits.

At the same time, mortgage servicers should not overreact. That can happen when management looks at misleading compliance management results and interpret them as showing noncompliance in excess of requirements. That is, a small servicer may invest heavily to comply across all nine regulatory areas. If the servicer is well below the 5,000-loan level (say, 2,000), then it may be overspending. Technology vendors may leverage uncertainty and fear to sell them systems that are more complicated than they need, given their risk profile. Our message: Be aware, be realistic, but don’t go crazy.

Rather, look at your existing compliance system and test its performance. Take samples of mortgages you service and see how you are aligned with the regulations that apply.

If you find problems, the solution may involve tweaking your existing mortgage systems rather than massive changes. Look at your culture of compliance, with the training and “tone at the top” related to compliance. Do employees understand the rules and the risks of noncompliance, the dangers of cutting corners (remember robo-signing?). In our experience, severe problems at financial institutions arise not from faulty compliance management systems, but from executives who override the proper functioning of such systems.

In this environment of closer regulatory scrutiny, systems and culture must work together to monitor compliance. And forget about the false hope of exemptions to escape the tightly woven net of regulation.
What mortgage servicing regulations apply to me?

Does the owner of the loans also own the servicing rights?
- Yes (Go to A)
- No (Go to D)

Are the loans closed-end federally related mortgages as defined?
- Yes (Go to A)
- No (Go to D)

Are the loans other than on properties of 25 acres or more; or a temporary financing; or loans secured by vacant land?
- Yes (Go to A)
- No (Go to B)

Do you only service loans that you or an affiliate owns?
- Yes (Go to B)
- No (Go to C)

1. Not subject to new CFPB mortgage servicing rules
2. Subject to new CFPB mortgage servicing rules
3. Small servicer exemption available
4. Other exemptions exist for servicers who only service open-end mortgage loans and reverse mortgages

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