THE INTENSITY OF CHANGE

As the second anniversary of the Dodd-Frank law nears, the mortgage lending industry is still struggling with understanding what has changed.

By Leonard Ryan

Change is a loaded word. To some, it is a call of hope; a promise of new beginnings or righted wrongs. Yet change also carries a stigma of fear and trepidation. Change can be costly, and as the second anniversary of the Dodd-Frank law nears, the mortgage lending industry is still struggling with understanding what has changed – and the new intensity of changes to come.

When the Dodd-Frank bill passed into law in 2010, bankers and lenders knew it would take time to pass the nearly 400 new individual rules established by the law. But the rate of passage has been incredibly slow, leaving many lenders unsure of exactly what the changes will look like and what the new regulations will require.

What should lenders do? The first step is to understand the most pressing changes in compliance issues. Once lenders grasp the new rules they must operate under, they can substantially reduce the burden of proving compliance, by taking advantage of automated tools to simplify the process of compiling information and reporting to regulatory agencies.

Where does this leave lenders? Not surprisingly, the shadow cast by these pending regulations is causing lending institutions quite a bit of stress. Since 2009, QuestSoft has surveyed lenders, banks and credit unions on their top compliance concerns, and the results point to lenders always having to adjust to new challenges each year. Yet, even as some compliance concerns rise and fall, there are a few constants in mortgage compliance.

Although the exact questions change each year to account for the addition of new regulations, there is a steady theme to lenders' compliance concerns. The Real Estate Settlement Procedures Act (RESPA) has consistently remained one of the top concerns for lenders, but this year dropped to fourth due to the law not facing any major changes in the immediate future.

HMDA/fair lending and disclosure regulations also remain a top concern for lenders across the years. This year, disclosures top the list, due to the upcoming deadline for a ruling on a new GFE/TILA Disclosure.

The first step in adjusting to regulatory change is to understand the priorities of the CFPB. On their website, the CFPB describes its mission as threefold:

>>> "Educate: An informed consumer is the first line of defense against abusive practices.

>>> "Study: The consumer bureau gathers and analyzes available information to better understand consumers, financial service providers, and consumer financial markets.

>>> "Enforce: Like a neighborhood cop on the beat, the CFPB supervises banks, credit unions, and other financial companies, and we will enforce Federal consumer financial laws."

The CFPB has drawn up a set of targets for the remainder of 2012 and of particular interest are a handful of mortgage-focused regulations due to be finalized or proposed before the end of the year.

Unsurprisingly, the most urgent of these changes also coincide with lenders' most significant concerns in the survey. These are the new rules and processes that will have to be faced sooner rather than later. First up will be the Truth in Lending Act (TILA)/Real Estate Settlement Protection Act (RESPA) Mortgage Disclosure Integration, which is scheduled for final rule announcement on July 21.

Next up in the change pipeline is the definition of Qualified Mortgage (QM). As of right now, the CFPB has indicated that a ruling on QM will not come until after the November election.

In this year's survey by QuestSoft, 81 percent of the nearly 400 lenders surveyed reported that upcoming changes to mortgage disclosures ranked a medium or high concern, and 63 percent cited QM as a high or medium concern. This falls in line with past results that indicate the highest causes of stress are usually the next rule revision scheduled to impact the industry.

As the next major rule to be announced, lenders are paying close attention to disclosures. The CPFB has announced that it still intends to release a ruling on a new disclosure that combine the requirements of RESPA and TILA by July 21, the date mandated by law under Dodd/Frank (one year after the bureau's launch). The CFPB has been testing various prototype disclosures, making the forms available for public comment on its website.

The challenge facing the CFPB is that Dodd-Frank requires the new disclosure forms integrate both RESPA and TILA -- two related, but different steps in the loan workflow.

RESPA's purpose is to ensure that consumers receive accurate information about the cost of closing the mortgage. TILA, on the other hand, discloses the cost of the actual mortgage credit being offered – interest rate, terms of payment, points paid down, among other items.

Once the CFPB announces the format of the disclosure, lenders will have until the implementation date to build the new forms into their disclosure workflow. Depending on the specifics, compliance checks may also need to be revised to ensure all fees, interest rates and other payments fall within the standards set by the regulations.

Of course, the problem with all of this is that other state and federal regulations still, in essence, require the industry to break out and maintain the old system of specific fees. So fundamentally you will have the same or more work on the back end of your loan software and more education on the front end until borrowers feel comfortable with the new combined disclosure.

One of the most important items the CFPB is currently working on is a definition of the "qualified mortgage." This definition, required as part of the Dodd-

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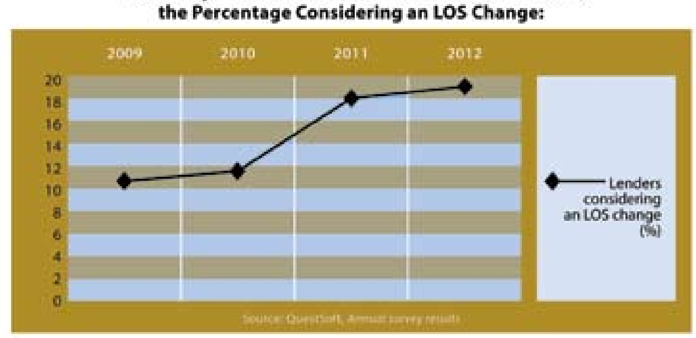

Frank law, will identify characteristics for loans that meet a certain standard of quality and low risk. The working assumption is that borrowers who meet the standards of QM have a reasonable ability to repay the loan, reducing default rates.

To be legally protected by QM, a lender would have to meet underwriting standards such as verifying income and assets. QM loans would most likely also ban terms such as interest-only payments, balloon payments or fees and points totaling more than three percent of the loan amount.

The Qualified Mortgage rule is due in January 2013; the CFPB has indicated that a ruling will not be made until after the November presidential election. However, QM has the potential to have the largest impact on future compliance processes, since the rules and guidelines for what make a compliant loan under QM could be drastically different than what is standard practice today.

While QM will still allow lenders to fund loans outside the QM definition, there will be fewer legal protections, and the costs will be much higher for non QM loans.

The third general area of compliance that has been a constant source of stress for lenders is HMDA and other fair lending regulations. Since 2010, the Federal Financial Institutions Examination Council (FFIEC) has been busy working to expand the scope of HMDA reporting. However, lenders can enjoy a short reprieve on new HMDA rules as the CFPB has indicated that these will not be officially taken up until 2013 at the earliest.

However, the CFPB has already indicated they will immediately enforce more rigorous fair lending testing in their exams. New fields, which will probably end up in the new HMDA requirements, are already being requested for exams being conducted this year. These fields include, but are not limited to, Credit Score Provider, Applicant's Credit Score, Total Lender Fees, LTV, DTI, Prepayment Penalty Months and Appraised Value.

Already, several federal banking regulators have moved forward to require a "HMDA plus" file that combines HMDA with fair lending data in preparation for banking examinations. In addition, states have been announcing reporting regulations that add fair lending data to mandated state information submissions. The LEF file format for multi-state examinations contains this and other data to quickly determine if your institution is performing undesired lending in the regulator's opinion.

It's not just the nature of these new directives that is proving challenging to lenders. It's the speed and intensity that can change a lender from a trusted provider to one that is singled out for violating any number of new regulations. Consequently, stress levels of executives and compliance personnel are at an all-time high. Gone are the days of one or two regulators calling the shots. Today there are almost 60 different agencies along with community groups that can determine the fate of your company in seconds and mandate away your personal financial future. So how does the modern banker ensure that they survive the current pendulum swing toward intense regulation?

As the saying goes, "Necessity is the mother of invention." Lenders are countering the pressures of keeping up with compliance changes by automating as much of the process as possible. The best approach is to combine this automation with well-written, established policies and procedures that provide for regular testing, analyzing and reporting of mortgage data. This provides the easiest path to staying compliant and reduces the risk of fines or buyback requests from investors.

One interesting result of the increasing importance of compliance automation is that lenders are expecting more out of their LOS when it comes to automating compliance and running reports. While compliance is not necessarily the primary reason, QuestSoft's annual survey has also shown a dramatic increase in the number of lenders looking to change their LOS. There is a universal driver; lenders need to maintain productivity but have every loan checked for compliance from the moment an originator touches a potential borrower all the way through secondary marketing and servicing.

In 2009, and 2010 the number of lenders considering replacing their LOS remained consistently around ten percent. However, last year, the percentage of lenders jumped to 17.75 percent, with a new high of 18.7 percent looking to change this year.

Outside of compliance automation and report building, another key factor may be the reduced expense of implementation and conversion offered by hosted software companies. In addition, the recent acquisitions have opened the door for lenders to evaluate their LOS and consider other platforms.

When it comes to keeping up with compliance changes, lenders should carefully consider how their LOS plans to implement these changes. Specialized compliance software is available -- through integrations with most loan originations systems -- that can automatically import loan data, apply tests and verify data prior to the closing table.

In the end, successful lenders will evolve their approach to mortgage compliance as quickly as the agencies and lawmakers change the laws. The most effective lenders educate themselves on the changing regulations and build out a policy that leverages automation. ❖

About The Author

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