

Mortgage Mash-Up: Regulatory Reform Here and Now

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**As consumer protection
grows ever more complex, only
technology can keep pace.**

In 1974, the “personal computer” was just a metal box with lights and switches—a toy for geeks and engineers. To do anything more complicated than basic math, you needed a machine that filled an entire room and cost upward of \$100,000. Meanwhile, on Capitol Hill, back in 1974 lawmakers had just finished crafting the Real Estate Settlement Procedures Act (RESPA), the country’s great hope for finally understanding where all the money really goes when you get a mortgage.  Needless to say, technology has been in a state of constant change since then, growing exponentially more powerful over the past 35 years. On the other hand, the most significant change to RESPA’s disclosure rules since its 1974 enactment just took effect on Jan. 1 of this year.  Reform had been in the works for nearly a decade, but it was the mortgage meltdown and subsequent credit crisis that ultimately gave regulators the evidence they needed to make the case that a 35-year-old RESPA clearly wasn’t a cure-all in its current form.  The new RESPA reform completely changed the two key disclosures that must be given on virtually every mortgage transaction—the Good Faith Estimate (GFE) and the Department of Housing and Urban Development (HUD) Settlement Statement (HUD-1/1A). Despite drastic changes, regulators gave the mortgage industry just a little more than a year to adapt to the sweeping new RESPA reform. Without today’s technology, that pace of change would be unthinkable.  That would just be an interesting anecdote, were it not for the fact that RESPA is only one example of the kind of regulatory changes the mortgage industry is seeing in this new era of consumer protection—an era in which regulators are keenly aware of available technology. Now the mortgage industry has little choice but to rely on

automation in order to navigate the ever-changing regulatory landscape.

Consumer protection speeds ahead

With the dust still settling on RESPA reform, all eyes have now turned to the Consumer Financial Protection Agency Act of 2009 (CFPA). The act first appeared in mid-summer 2009, following the release of the Obama administration's ambitious blueprint for reforming financial services.

Since then, the idea of creating a new Consumer Financial Protection Agency has found its way into both houses of the U.S. Congress, including in a consumer-protection bill proposed by Rep. Barney Frank (D-Massachusetts) and more recently in a larger financial regulatory reform bill passed by the House. It also was included in Senate Banking Committee Chairman Christopher Dodd's (D-Connecticut) initial package of legislative proposals to reform the financial system (see sidebar).

As of early December 2009, it was not clear what the future holds for CFPA-related legislation in Congress. While the House has passed it, the Senate has not yet acted on the measure. Although it may be two years before the hypothetical new federal

uber-agency consolidates its authority and issues regulations, the road ahead for mortgage industry professionals already is filled with unprecedented compliance challenges.

In fact, critics of the proposed agency say that a new consumer-protection agency may no longer be necessary in the mortgage space, if only because of the flood of new mortgage-centric laws and regulations that have already been enacted during the last two years. Moreover, the CFPA legislation that has emerged at this point sets forth broad purposes and guidelines, while leaving much of the details to the new agency. It is not clear what approach the new agency would adopt in regulating mortgages.

Most financial institutions are familiar with the methods federal and state agencies traditionally employ, in particular requiring consumer disclosures and imposing tighter restrictions on certain "higher-cost" and "higher-risk" mortgages. A consumer financial protection agency that springs from current proposals could simply add to the current set of federal, state and municipal requirements lenders must face. It could also act more broadly by prohibiting particular mortgage products or mortgage terms and practices altogether.

Certainly one question on the industry's mind is why Congress sees the need now to enact a radical new approach to the regulation of consumer financial services and residential mortgage loans. It is true that Congress has already enacted a number of laws aimed at mortgage reform, including the Mortgage Disclosure Improvement Act of 2008 (MDIA), the Housing and Economic Recovery Act of 2008 (HERA) and the Helping Families Save Their Homes Act of 2009. Other federal regulators and state regulators with authority over mortgage lending have also bounded forward to enact sweeping new regulations and guidelines.

Within the last two years, the Federal Reserve Board has

been very active, putting new rules in place to implement the MDIA as passed by Congress, in addition to amending new rules aimed at unfair or deceptive practices. The Fed issued the final amendments to the Truth in Lending Act (TILA) regulations or "Regulation Z" in the *Federal Register* on July 30, 2008. Changes included the addition of a new and restricted class of "higher-priced mortgages," new restrictions on advertising mortgage loan terms and limitations on the ordering and use of appraisals.

Not stopping to take a breather, on July 23, 2009, the Fed proposed additional comprehensive changes to disclosures and limitations on mortgage lending practices. These latest proposals weigh in at almost 400 pages in the *Federal Register*. The comment period was scheduled to end in late December 2009, and there is every expectation that the Fed will finalize expansive amendments to Regulation Z soon.

Regulators and law-enforcement officials have paid close attention to residential mortgage appraisal practices in recent times. The most notable example is that of the Home Valuation Code of Conduct (HVCC). The HVCC came into being as a result of a settlement agreement between New York Attorney General

Andrew Cuomo and the government-sponsored enterprises (GSEs) Fannie Mae and Freddie Mac.

Announced in March 2008, the settlement purported to cover only loans originated for sale to Fannie or Freddie. However, due to the market dominance of the GSEs in non-government loans, the HVCC became the industry standard. The HVCC contained safeguards intended to ensure appraiser independence, integrity of reporting of results and uniformity in the marketplace.

Due to the attention on the role of appraisals in the mortgage crisis that gave rise to the HVCC, the Fed included substantive restrictions on appraiser coercion in the Home Ownership and Equity Protection Act (HOEPA) rules issued in July 2008.

Not to be outdone, another federal agency, the Federal Trade Commission (FTC), recently exercised its authority over unfair or deceptive trade practices in the mortgage lending space, particularly against mortgage servicers. This was not without prompting from lawmakers, of course. Congress directed the FTC, in the 2009 Omnibus Appropriations Act signed by President Obama on March 11, 2009, to issue its own rules governing mortgage loans.

In response to lawmakers, on June 1, 2009, the FTC posed a series of questions to interested parties that, perhaps as a hint of what's to come, covered the entire life cycle of a mortgage loan, from advertising to servicing. The FTC also politely reminded the industry of its authority to enforce mortgage lending laws against lenders, servicers and others involved in marketing, origination and servicing of residential mortgage loans.

At the state level, regulators have been no less active than their federal counterparts. In fact, the past two years have been marked by a unique federal and state collaboration to assure that mortgage loan originators have the necessary qualifications and character to deal

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directly with consumers. And this is where the technology story starts to get interesting.

For the first time, state regulators elected to employ specific technology to help them regulate state-licensed mortgage lenders. The federal government then made things even more interesting when it wrote many of the states' processes into federal law.

Technology steps into the fray

The Conference of State Bank Supervisors (CSBS), in cooperation with the American Association of Residential Mortgage Regulators (AARMR), both based in Washington, D.C., created a technology system they called the Nationwide Mortgage Licensing System (NMLS). As the representatives for state banking and state mortgage lending regulators, the organizations wanted to provide their regulatory members with tools to better credential mortgage originators. NMLS, an online system, enabled uniform applications, background checks and license approvals for individuals who work directly with borrowers in the residential mortgage loan origination process.

At first, NMLS was simply a tool that states could use if they chose to. Some states did in fact begin to require the use of the system in 2008. Then Congress stepped forward and enacted the Secure and Fair Enforcement for Mortgage Licensing Act (SAFE Act) in July 2008.

The SAFE Act set out basic definitions for regulated activities and established standard procedures, including an expanded originator registration process for state mortgage licensees and state banks. In a big boost for technology's role in regulation, the SAFE Act included in its standard procedures the use of NMLS, which was already available by virtue of the efforts of CSBS and AARMR.

The SAFE Act "encouraged" each state to enact its own version of the federal framework by offering a choice between licensing and overseeing mortgage loan originators themselves, or giving up that right to HUD. CSBS and AARMR, working with representatives of the mortgage lending industry, promulgated a Model State Act that HUD subsequently determined was consistent with the SAFE Act. In 2008 and 2009, every state other than Minnesota enacted SAFE Act-inspired legislation that was more or less consistent with the Model State Act.

SAFE Act laws across the country began to take effect in 2009 and on into 2010, representing the culmination of an unprecedented effort by state banking and mortgage lending regulators to ensure consistency, oversight and transparency in licensing and supervision of loan originators employed by non-chartered mortgage lenders and mortgage brokers across the nation.

Importantly, the SAFE Act imposed similar registration and approval requirements on loan originators employed by insured financial institutions. HUD, rather than the states, will be responsible for creating registration rules and procedures for such loan originators. HUD is working on its implementation and issued a proposed rule in December, with final rules expected soon.

So, no matter where an individual may go to work as a mortgage loan originator, NMLS will serve as a screening and informational tool for licensing or registration. With the federal government setting the standard, state

BLUEPRINT FOR A NEW AGENCY

The idea of a Consumer Financial Protection Agency (CFPA) emerged relatively soon after the credit crisis reached its peak. Advocates, pointing to consumer products, wondered why toasters that could catch on fire are regulated by a federal agency but consumer credit is not.

The proposed Consumer Financial Protection Agency Act that emerged in the House of Representatives was established on four broad principles—namely transparency, fairness, competition and access. On Dec. 11, the House approved legislation to create a new Consumer Financial Protection Agency (CFPA) as part of a comprehensive financial industry reform bill.

The CFPA would truly be an *uber-agency*, with the authority to regulate nearly all aspects of consumer financial products and services. The legislative proposal will likely be more familiar to mortgage industry professionals than to others, because it contains many components that consumer advocates have been seeking for years—such as expanded fair lending programs and enforcement.

The proposed agency would have authority to write regulations and guidelines, oversee and examine consumer financial service providers, and enforce consumer-protection laws and regulations. The enforcement authority would span the entire bandwidth of industry participants, due in no small part to the rollback of federal pre-emption that is part of the House bill. If this legislation continues to move forward, expect more "cops on the beat" as state agencies and law-enforcement officials gain access to federally chartered institutions.

Of importance to the industry, particularly non-depository firms such as mortgage bankers and mortgage brokers, is the proposed agency's power to impose fees on financial services companies and service providers. Like existing banking agencies, the CFPA would be able to collect fees from industry participants to fund the agency and its operations. If there are concerns that heavier regulation results in higher costs to consumers, then the CFPA proposal is a one-two punch.

As of this writing, the likelihood of passage of CFPA legislation both in the House and the Senate in the near term is unknown. After all, 2010 is an election year, and the proposal is very controversial. Whether or not we see the creation of a new umbrella federal agency soon, the mortgage industry will continue to be challenged by weak economic conditions, scarcity of private capital and ever-increasing regulation.

At the end of the day, serious questions will persist about whether this ambitious proposal appropriately balances the need for effective consumer protection and the availability of credit to deserving homebuyers and homeowners.

regulators, like industry participants before them, have adopted technology in order to manage compliance.

The future of consumer protection

CSBS and AARMR have also begun to apply technology to the process of examining licensees. By applying the NMLS concept to enforcement, the organizations established Model Examination Guidelines (MEGs) in 2007. Because the two organizations represent virtually all state regulators with jurisdiction over deposit-taking institutions, non-chartered mortgage lenders and mortgage brokers, they intend to coordinate multi-state examinations of lenders and brokers that have national footprints. Under the MEGs, CSBS and AARMR have set forth guidelines and procedures for opening and conducting examinations.

Those procedures called for further use of technology—in particular by applying it to the historically time-consuming, sample-based loan audits. In what CSBS and AARMR called their “examination automation initiative,” regulators were to adopt an automated compliance system (ACS) to perform loan-level audits as part of examining licensees for compliance on all loans. In April 2008, following an eight-month evaluation process, CSBS and subsequently AARMR selected the ComplianceAnalyzer® software from Burlingame, California-based ComplianceEase® as the examination automation technology.

You might ask how more than 50 distinct jurisdictions have been able to collaborate so closely. The key so far has been the CSBS/AARMR Nationwide Cooperative Agreement for Mortgage Supervision (NCA), which was signed by all the states, as well as the District of Columbia and Puerto Rico.

The NCA enables states to more uniformly share supervisory information by empowering the Multi-State Mortgage Committee (MMC), a committee of 10 state mortgage regulators formed by AARMR and CSBS, to coordinate state supervision of the largest of the state-licensed mortgage lenders.

From a technology perspective, the MMC has begun to create consistency in examinations across the country by relying on the software as one of the foundational tools of the multi-state examination approach. With the right application of technology, state regulators have brought together the efforts of a multitude of agencies across the country to collaborate more closely than ever before.

It might have seemed like something out of a science-fiction novel when lawmakers first introduced RESPA to the world of mortgage lending in 1974, but these days lenders, too, rely on compliance technology every day. This includes conducting self-monitoring by employing an ACS to audit the terms of every loan they originate or purchase in just seconds per loan. Of course, this helps the industry stay compliant. However, it also means that consumer protections such as RESPA are implemented in a very robust and efficient way.

A comprehensive ACS is particularly adept at han-

dling multiple layers of federal, state and local consumer-protection laws, including predatory lending regulations on “high-cost” and “higher-priced” mortgage loans and, importantly, state usury, restricted fees, and late payment and prepayment penalty restrictions that vary depending on how a lender is licensed.

Technology vendors continuously monitor and update systems as new lending laws and regulations are passed, so a lender’s internal controls are always up-to-date. These systems have become increasingly important as more and more layers of regulation have come into existence.

For all of the new developments in the regulation of residential mortgage lending in recent years, the emergence of technology-driven tools and processes may be the most significant. CSBS and AARMR have built 21st-century examination protocols around automated

information tools that provide detailed data for each loan originated by a mortgage lender or mortgage broker.

If history is any guide, greater use of technology in mortgage lending compliance is inevitable. With additional layers of consumer protection forthcoming, technology may be more important than ever before, both for regulators and for lenders.

If Congress moves on CFPB legislation, perhaps we can predict what

that consumer protection will look like by referring to other activity we have seen recently. Despite inevitable opposition from the mortgage industry, we must assume that those in favor of a completely new regulatory regime see serious shortcomings even in recently enacted laws, rules and guidelines.

It is clear that proponents of a stand-alone consumer financial protection agency with the authority to rewrite the rules of consumer lending believe that current disclosure-based regimes are insufficient. It is also clear that proponents of the CFPB concept are not satisfied with existing restrictions and limitations on certain mortgage products and practices.

If the case of “high-cost” home loans under HOEPA and similar state laws is any guide, restricting specific mortgage products amounts to an outright ban on such loans. It is likely that more widespread prohibitions on loan terms and loan products are on the horizon. This means it will continue to be a complex matter to sift out what loans a lender does and does not want to make in order to remain in compliance.

With technology already successfully employed to great success by state regulators, it is easy to imagine that a newly empowered financial regulator would want to follow suit and use the best and most efficient technology at its disposal to supervise and enforce compliance. **MB**

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