



Survival of the Fittest

As the industry enters post-crisis mode, there's a new phase of operational disruption on the horizon—deregulation.

By Jane Mason

As we quickly approach the 10-year mark for Fannie Mae's and Freddie Mac's conservatorship, it's difficult to surmise the extent of regulatory change that the mortgage industry has undergone, not to mention the scope of process transformation. Touching each aspect of the mortgage lifecycle, the group that crossed perhaps the most significant chasm is mortgage loan servicers, who maintained a relatively stable existence before the regulatory shake-up. Managing the onslaught of delinquencies, which quadrupled from 2007 to 2010, servicers overcame significant hindrances, including limited loss mitigation options, antiquated technology, and the absence of resources to scale. Those that have survived the past decade have done so with a pioneering spirit, perseverance, and sophisticated workflow.

Mortgage loan servicers are fairly settled at this juncture; however, as the industry enters post-crisis mode, there's a new phase of operational disruption on the horizon—deregulation. Housing research and industry reports depict a sunny picture for the future of servicing, with delinquency rates returning to pre-recession levels, servicing entities of various sizes jockeying for

servicing rights, and policies that promise to ease regulation. Upon closer look, mortgage servicers could be facing an entirely new set of obstacles, especially if unprepared for continued operational change. In a segment of the industry where profits are exceedingly thin, and the cost to service has risen year over year, managing deregulation could prove to be a monumental challenge.

Servicing requirements have and continue to vary by the investor, federal agency, and state regulator, which create inconsistencies in the options available to the delinquent borrower, as well as discrepancies in interpretation and execution of rules. Pending legislation will force servicers to reevaluate and rework existing processes, modify rules administration, and decouple systems. This process is not cost-efficient or straightforward, but without the capacity to readily conform ongoing industry change into back-office operations and workflow, the resulting operational impact could be profound. Many predict that lenders and servicers will continue to operate under current, more restrictive requirements instead of upsetting operational practices or technology systems and solutions that support these processes.

It is important for servicers to understand the breadth of potential impact from pending regulatory amendments and new legislation, as well as streamlined servicing requirements issued by the GSEs and the Consumer Financial Protection Bureau (CFPB). This background will ensure servicers are equipped to handle operational and regulatory disruption. Given the complexity of today's servicing platforms, without automated workflow and an interactive workout rules engine, servicers could face the costly prospect of altering existing systems to accommodate regulatory changes.

Coming Down the Pipeline

Significant legislation looms in the background with the regulatory change proposed through many bills submitted under the Trump administration. Although the intent is to reduce the regulatory burden, future lawmaking is vast and will touch the entire mortgage industry. The House Financial Services Committee issued a press release on January 18 outlining 15 bills that were approved by the committee to alleviate some of the current regulatory burdens. If eventu-

ally passed by the U.S. House of Representatives and the U.S. Senate, even in amended form, numerous provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act will unravel. The biggest contender in this area is H.R. 10, the Financial CHOICE Act, which despite last year's demise of the original bill on the Senate floor, will continue to exist in the background as pieces of this legislation reappear in smaller bills.

➤ *H.R. 1153, the Mortgage Choice Act of 2017*

This Act was passed on February 8, directing the CFPB to amend the Qualified Mortgage Rule (QM) under Dodd-Frank, specifically adjusting point and fee calculations that fall within the three percent cap for hazard insurance and affiliated title insurance charges. The goal is to ensure that low-to-moderate income borrowers are not adversely selected out of QM eligibility when smaller loan amounts skew allowable fees under the cap. Lenders would responsibly need to modify data and calculations used to determine QM eligibility, as well as update Loan Estimate and Closing Disclosure calculations.

Implementation of rules under the Mortgage Choice Act or any of



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the following proposed legislative bills will disrupt existing operational practices and necessitate updates to supporting technology platforms, automated solutions, and may even require manual intervention if servicers are not prepared to assimilate process changes. Workflow coupled with a workout rules engine transcends multiple facets of organizational process automation. Mortgage servicing operations that do not already have access to a workflow engine powered by business rules will find it difficult to continue to manage costs, facilitate easing regulations and remain competitive as legislation is passed and turns into rulemaking.

▼ *H.R. 125, FHA In-Person Servicing Improvement Act of 2017*

The FHA In-Person Servicing Improvement Act would establish a pilot program to improve asset handling, and retention of delinquent Federal Housing Administration (FHA) insured loans by increasing direct communication with mortgagors, to include servicer compensation for related expenses. If implemented, servicing operational changes would at a minimum involve a system for tracking associated interactions, activities, timelines, and costs.

▼ *H.R. 1264, Community Financial Institution Exemption Act*

Depository institutions and credit unions with less than \$50 billion in consolidated assets would be considered exempt from CFPB rules and regulations. In circumstances where these institutions retain servicing themselves, or under a sub-servicer arrangement, an exemption may not preclude them from being partially subjected to standard CFPB compliance. Segmenting out this type of client-based requirement is difficult on any level and is often cost prohibitive for smaller entities.

▼ *H.R. 2226, S. 2013 Portfolio Lending and Mortgage Access Act*

Amends the Truth-in-Lending Act (TILA) so that depository

institutions are not subject to suit for violating Ability-to-Repay (ATR) requirements if the lender has consistently held loans on their balance sheet and prepayment penalties comply with limitations. Additionally, an originator would not be subject to suit if the lender is a depository institution and advises of their intent to hold the loan on balance sheet. Lastly, amends TILA to consider certain mortgage loans originated and retained in portfolio by an insured depository or credit union as QM

payments made by the borrower to the wrong lender. Already riddled with exception processing, further guidance that applies to the transfer of servicing will require sophisticated communication, event and exception tracking management that will have to be automated and rules-based to ensure accuracy.

▼ *H.R. 3971 Community Institution Mortgage Relief Act of 2017*

Passed by the House in December of 2017, amends TILA

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eligible. Implementation under this legislation would impact ATR and QM eligibility determination, preset portfolio product guidelines, in addition to tracking and administration of portfolio loans.

▼ *H.R. 3538 Mortgage Sale Transparency Act of 2017*

Amends TILA to require notice of transfer to the borrower, liability exemption in the event of a transfer error, as well as a 90-day grace period for loan

to create a safe harbor for escrow accounts for the payment of taxes and hazard insurance on loans made by depository institutions with assets of up to \$10 billion, or where mortgages remained on a balance sheet for three years post origination. Servicers that handle 20,000 or fewer loans would be exempt from the Real Estate Settlement Procedures Act (RESPA) requirements regarding servicing and escrow account administration. Again, isolating

out servicing requirements, in particular, escrow administration, for smaller entities is often cost prohibitive for servicers that may, in turn, try to mainstream processes. Intelligent workflow allows servicers to readily customize processes for any size originator.

▼ *H.R. 4607 Comprehensive Regulatory Review Act*

Reduces the 10-year requirement to seven years for a comprehensive regulatory review of all regulations related to the insured depository institution or covered persons. These would abbreviate auditing timelines for many institutions, forcing them to hastily ensure compliance with changing regulation, investor, federal and state requirements. This scenario could be readily integrated and administered with automated workflow driven by business rules.

Impact of the GSEs

Subject to Federal Housing Finance Agency (FHFA) oversight, Fannie Mae and Freddie Mac will continue to pass on rules and guidance that modify existing operational practices. Although GSE changes typically yield updates for most industry technology platforms, implementation practices are often incomplete or just not equipped to handle operational nuances that help servicers ensure they are competitive, compliant, and cost-efficient. Both Fannie Mae and Freddie Mac updated servicing guidelines as recently as December 13, 2017, and have been diligent in making sure processes are simplified, removing duplications and streamlining methods where feasible. This trajectory will continue as the GSEs strive to meet initiatives under the Fannie Mae, Freddie Mac, and Common Securitization Solutions 2018 scorecard. This year's scorecard performance measurements include the finalization of foreclosure and short-term hardship alternatives as a part of the loss mitigation toolkit. The GSEs are responsible for developing plans



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that promote mortgage servicing market liquidity, continuing to advance the borrower experience and improving servicer efficiencies. Addressing evolving product options, including toolkit modifications, will continue to impact rules and workflow. Other modest changes recently issued by the GSEs include the capped maximum reimbursement threshold on insured loss repair inspections, the removal of requirements to report damages after an uninsured loss event, re-aligned loss event policies, and reduced loan file retention timeframes.

The Future of the CFPB

At the Consumer Financial Protection Bureau, changes in governance, administration, and oversight authority are in play. The outcome of the CFPB, amendments to the Dodd-Frank Act, and corresponding rollback of regulation could significantly test servicer operational endurance this year. There are several initiatives that fall into this basket:

- how to automate the nuances of loan payments posted

- pre- and post-bankruptcy petition;
- how to ensure accurate accounting of property tax payments from escrow accounts in scenarios where real estate property tax payments were made directly by borrowers trying to circumvent the new cap on tax payment deductions;
- and what will come of responses to CFPB Acting Director Mulvaney’s press release, announcing solicitation for “Request for Information (RFIs) seeking comment on enforcement, supervision, rulemaking, market monitoring, and education activities” of the CFPB.

Mulvaney is also considering how mortgage rule look-backs, established in Dodd-Frank to extend the CFPB authority to “modify, expand, or eliminate” rules, can be used to redefine QM, expanding loan parameters that fall under this designation, and likewise safe harbor and ATR compliance.

Last but not least, mortgage servicing guidelines introduced by the CFPB in 2014 established default parameters supporting early intervention, communication

criteria, loss mitigation processes, forced-placed insurance and borrower “assertions of error and requests for information.” Industry trade associations have suggested amending or replacing the servicing rule with new rule(s) that “preempt more restrictive state laws” to achieve better alignment and consistency between loss mitigation and foreclosure requirements set forth by states versus those of the CFPB.

Shifting MSRs

On the premise of rising interest rates and renewed consideration of mortgage servicing rights as a hedge, the handful of big bank servicers that withstood escalating regulatory burden and costs to service are now unloading servicing. The appetite for servicing is migrating toward regional banks and non-bank servicers. This environment will increase transfers of servicing and further strain servicer operational processes, as the industry strives to simultaneously digest regulatory modifications and reduced investor requirements, epitomizing the potential for regulatory

and operational disruption to stifle advancements in servicing technology and innovation.

Tech to the Rescue

Despite the servicing industry’s resiliency and growing aptitude for modernization, it is difficult to confirm that the current technical infrastructure is ready for deregulation and further disruption to operational practices. Mortgage servicers have withstood a decade of exponential regulation, the development of complex loss mitigation alternatives and fluctuating waterfall processes, not to mention enduring fines, false claim penalties, and enforcement action. In the face of this, they have either triumphed or expired from exhaustion. Survival and the capacity to prepare for post-crisis expansion will be largely contingent on flexible operational workflow and workout processes that ensure servicing system platforms and integrated solutions can handle the forthcoming decoupling and disappearance of complex business rules. Of equal importance, mortgage servicers need to be positioned to meet implementation timelines and bear the continued increase in costs to service. Whether responding to deregulation, regulation, investor changes or the ebb and flow of servicing transfers, the key to succeeding in this environment will hinge on innovative servicing workflow technology. M



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