

# ACUIA Region 3 Meeting

**September 24, 2014**

**Mortgage Servicing Compliance**

**Best Practices and Current Events  
(What Are We Seeing, What Are You Seeing)**

# Objective and Theme

- Provide you with information that will help your credit union comply with the residential mortgage servicing regulations
- An assortment of practical principles-based compliance tips and insights
  - Based on what we/regulators are seeing
  - Only a few technical details
- Goal – you pick up a few nuggets to enhance your policies and procedures

# Introductions

- Jim McClanahan
  - Director, Financial Consulting Group
- Sean McDonald
  - Director, Financial Consulting Group
- Specialize in mortgage servicing and other consumer regulatory compliance
  - Financial services organizations, such as banks, mortgage companies, **credit unions**, nonbank servicers

# Agenda

- Who, what and why
  - Setting the stage
- How
  - Best offense is a good defense
  - Substance over form
- Where and when
  - Hot and risky (not risqué) topics
  - What puts you on a regulator's radar?
  - What is being seen by us and regulators?
- In closing
  - Your compliance role and responsibilities

# Setting the stage

- What topic are we talking about?
- Why is this a conference topic?
- To whom is this topic relevant?
- Who is my regulator?
- What regulations apply to me?
- What are some good reference materials?

# What topic are we talking about?

- Mortgage servicing rules and regulations
  - RESPA (Regulation X)
  - TILA (Regulation Z)
- Significant amendments effective January 10
  - Current focus of the regulators

# Why is this a meeting topic?

- A. CFPB is fining organizations and damaging their reputations
- B. Other regulators, including NCUA, OCC, FDIC, are following the CFPB's lead
- C. Compliance is a profit center
- D. Happy hour doesn't start until 5pm

The CFPB has blazed a trail and set a tone that has emboldened the NCUA and state regulators

# Does internal audit have a role in compliance?

What percentage of your auditing time is devoted to testing mortgage servicing compliance?

- A. 5% or less
- B. 5-10%
- C. More than 10%
- D. Too much
- E. Not enough

How much time do you think this area merits?



# Who is my regulator?

- Technically
  - CFPB if >\$10 billion
  - NCUA, if federally chartered
  - State, if state chartered
- Reality
  - All regulators are adopting the same attitude and approach
  - CFPB is even partnering with other regulators
- CFPB = NCUA/State
  - CUNA article

# What regulations apply to me?

## Exemptions related to TILA and RESPA – *McGladrey White Paper*


- Small servicer

Owner of Loan	Servicer of Loan	Partial Exemptions
Yes	Yes	Yes, if servicing <5,001 loans
No	Yes	No, <u>CU</u> - servicing for others
Yes	No	No, <u>third-party</u> - servicing for others

- Closed-end versus open-end loan
- Principal residence versus non-principal residence
- Reverse mortgages, timeshares, certain ARMS, fixed rate loans with coupon books

# What are some good reference materials?

Some helpful guidance:

- CFPB Publications
  - Small Entity Compliance Guide
    - November 27, 2013
  - Mortgage Servicing Rules Coverage Chart
    - July 23, 2014
  - Supervision and Examination Manual
    - Part II.A – Compliance Management System
  - Supervisory Highlights
    - Fall 2012, Winter and Summer 2013, Spring 2014
- NCUA Regulatory Alerts
  - Summaries of January 10, 2014 regulations
    - 14-RA-03 TILA
    - 14-RA-04 RESPA
  -  Compliance Self Assessment Guide – **out of date**

How do you stay up to date?

# Best offense is a good defense

- What is a compliance management system (CMS) and why is an effective CMS important?
- What are the essential elements of an effective CMS?

# What is a CMS and why important?

- Compliance management system
  - The whole enchilada - policies, operating procedures, control procedures, software, documents, people
- Regulator's first stop
- Sets the tone
  - Quality and content of the CMS reflects CU's attitude toward compliance
    - Priority or perfunctory
    - Spirit or letter
- Your defense – written, detailed, complete
- Art, not a science; principles-based

What does your internal audit group do with respect to a CMS?

# What are essential elements of effective CMS?

- Every CFPB report touts benefits of CMS
- Effective CMS has four independent control components (Sup Hi Summer 2013)
  - Board and management oversight
  - Compliance program
  - Consumer complaint management program
  - Independent compliance audit

# What are essential elements of effective CMS?

- Complete coverage (Sup Hi Fall 2012)
  - Internal controls and oversight
  - Communication and training
  - Internal monitoring
  - Consumer complaint response
  - Independent testing and audit
  - Third-party service provider oversight
  - Recordkeeping
  - Product development and business acquisition
  - Marketing practices

# Substance over form

- Practical attributes of an effective CMS
  - Compliance culture
  - Good faith effort
  - **Observability**
  - Accountability
  - Analysis and **remediation**
  - **Vendor management**
- Over-arching: Risk-based
  - Tailor to size of organization, complexity of operations



# Compliance culture

- Board visibility and support
  - Standing Board meeting agenda item
  - Frequent written and oral communications
  - Support compliance by adhering to consequences
- Spirit
  - Consumer interface
    - Clarity of written communications
- Compliance separate from operations
  - Chief compliance officer position
  - Wears only one hat

# Good faith effort

- Many of the regulations require interpretation before implementation
  - Oral complaints
  - Data requested by borrower
  - ABA letter to CFPB requesting clarifications (7/29/14)
- Take a position
  - Adopt a policy you feel is reasonable
- Make it defensible
  - Demonstrate prudence, good faith effort
    - Debate among knowledgeable parties
    - Document the thought process
- Document, communicate, and follow the policy
  - Promotes consistency across organization

# Observability

- Procedures should leave a trail and be testable
  - Monitoring reports
  - Checklists
    - GAO report on CFPB civil penalty fund (6/26/14)
      - Discretionary use of funds
  - Questions and answers
  - Findings
  - Action plans
  - Decisions and reasons

What % of your findings are related to documentation?

# Accountability

- Job descriptions
  - Compliance responsibilities and necessary skills
- Performance evaluations
  - Compliance metrics
    - Hard to measure
    - Absence of noncompliance
  - Corrective actions
    - Meaningful consequences
      - Change behavior
    - Root cause(s) - remedial training?
  - Balance against performance metrics
    - Based on volume
    - Based on outcome
  - Demonstrated enforcement
- FINRA action against Wedbush Securities
  - Cited performance metrics that motivated noncompliance

Do your procedures include review of performance evaluations?

# Analysis and remediation

- Findings result in corrections
  - Written findings
  - Root cause analyses
    - Document thought process
    - Address systemic versus isolated, especially if automated
  - Written action plans
  - Documented completion of action plans
- Originating from monitoring, auditing, complaints
  - Complaint management

How diligent are you about requiring action plans and monitoring timely fulfillment of action plans?

# Vendor management

- Principles-based guidance
    - CFPB Bulletin 2012-03
      - Service Providers (4/13/12)
    - OCC Bulletin 2013-29
      - Risk Management Guidance (10/30/13)
    - Federal Reserve Publication
      - Guidance on Managing Outsourcing Risk (12/5/13)
  - Three components
    - Upfront due diligence, written contract provisions
    - Offsite regular monitoring – via dashboards
    - Onsite periodic testing
  - Don't forget sub-servicers!
  - Numerous enforcement actions resulting from vendor noncompliance
    - You are held responsible for vendor noncompliance
- Does internal audit conduct periodic testing or monitor testing?

# Hot and risky topics

- Vendor management
- Servicing transfers
  - CFPB Bulletin 2014-01 (8/19/14)
    - Submission to CFPB of written plans for managing risks (at least 5,000 loans)
  - OCC Bulletin 2014-37 (8/4/2014)
    - Debt sales - Information to be transferred
- Force-placed insurance
- Fee arrangements with affiliates
- Servicemembers Civil Relief Act
- Borrower complaints management
- Loss mitigation, in general
- Private mortgage insurance release

# On the radar

Will you be examined?

- Size
- Growth
- Complaints
- Servicing transfers
- Number of loans in default (“high touch”)
- Nature of products
  - Short-term loans, student loans, credit cards, add-ons (e.g., insurance, overdraft)
- Prior regulatory exam results
- Eventually
- Bad luck

Have your exams started to encompass new TILA/RESPA?



# What is being seen by us and regulators?

- Our discussions with servicers and performance of services, has revealed:
  - Failure to meet timing deadlines
  - Inaccurate facts and amounts in borrower communications and court filings
  - Unclear or inadequate documentation of servicer actions, decisions, and reasoning
  - Unsupported interpretations of the rules in the servicer's favor
  - Vague explanations in borrower communications – denials (original and appeal), complaint resolution
  - Anxiety over vendor management
- Mainly compliance with loss mitigation rules

# What is being seen by us and regulators?

- Lessons from recent CFPB enforcement actions
  - **You are responsible for vendor noncompliance**
    - Numerous actions
    - Not good enough to tell vendor to fix things
      - First Investors: consumer credit reporting (8/20)
  - **Lots of UDAAP** – fees, advertising, collections, discrimination, add-ons
    - USA Discounters: upfront SCRA fee (8/14)
    - Amerisave Mortgage: false advertising-unavailable interest rates (8/12)
    - Rome Finance: false advertising- terms (7/24)
    - ACE Cash Express: collection-false threats, harassing calls (7/10)
    - GE Capital: discrimination-credit card terms; false marketing: credit card add-on products (6/19)
  - If a fee is “split”, a service must be rendered by all splitters
    - Stonebridge Title Services: illegal kickbacks to nonemployees (6/12)
  - If the CFPB provides a template, follow it exactly
    - Realty South: steering borrowers to an affiliate (5/28)
  - **Suntrust**: applying payments, unauthorized fees, improper denial of mods, robo-signed foreclosure documents, dual-tracked (6/17)

How does internal audit test for UDAAP?

# Your role and responsibilities

- Internal audit
  - Stay current
  - Risk-based approach
  - Compliance management system
  - Complete coverage
    - Board/management compliance
    - Performance evaluations
  - Remediation
  - Evaluate compliance culture
    - Spirit over letter

## Power comes from being understood.<sup>SM</sup>

When you trust the advice you're getting, you know your next move is the right move. That's what you can expect from McGladrey. That's the power of being understood.

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