Annual Regulatory Round-Up: Invaluable Tips for Maintaining Compliance in 2019 and Beyond

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Johnston Thomas is a full suite boutique law firm, which amongst other practices such as real estate and commercial litigation, has a nationally recognized Mortgage Banking Group ("MBG"). With an experienced team of mortgage banking lawyers (including senior litigation attorneys, former in-house General Counsel and in-house Compliance Counsel from a well-known bank and mortgage company, etc.), certified fraud examiner(s) and forensic underwriter(s), and an extremely competent support staff, all of whom are dedicated to aggressively and competently serving the needs of our valued clientele, Johnston Thomas' MBG is known all across the country for the experience and results that it brings to the areas of regulatory compliance, mortgage banking litigation, and a broad range of mitigation services.

Amongst the many legal services Johnston Thomas offers the mortgage banking industry (e.g., brokers, lenders, servicers, vendors and more), such include, but are in no way limited to, as follows:

- Mortgage Repurchase and Make-Whole Indemnification Litigation and Mitigation (e.g., Secondary Market Investors, Agencies, Bankruptcy Trustees, etc.);
- Mortgage Industry Litigation (e.g., Servicer and Sub-Servicer Disputes, 3rd Party Fraud Recovery, CPL and Title Policy Actions, Appraiser E&O Claims, Loan Officer Actions, LOS Disputes, etc.);
- Mortgage Repurchase and Make-Whole Alternative Dispute Resolution (e.g., Arbitration, Mediation, etc.);
- Regulatory Compliance, Administrative and Business Services (e.g., Mock Audits, LO Compensation, MSAs, Licensing, CA Dep't of Business Oversight, HUD Review Board, etc.); and
- Transactional Matters (e.g., Drafting and Negotiating Broker and Correspondent Loan Purchase Agreements, Mergers & Acquisitions, etc.).

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James W. Brody, Esq.

As the Chairman of the Mortgage Banking Practice Group, Mr. Brody actively manages all the complex mortgage banking litigation, mitigation, and compliance matters for Johnston Thomas and its diverse clientele.

Being one of the founding and managing attorneys for his prior mortgage banking firm, as well as having practiced law for close to 20 years, with nearly 15 of those years being spent in the mortgage banking industry, Mr. Brody has been instrumental in the firm's development and in its continued success.

Mr. Brody has successfully resolved hundreds of mitigation and litigation cases that involve complex mortgage fraud schemes, as well as large-scale repurchase and/or make-whole disputes, in connection with loans that were securitized and/or sold to third parties (e.g., Lehman Bros., Aurora, FNMA, Freddie Mac, ResCap, RMBS Trusts, CitiMortgage, JPMorgan Chase, and more).

Mr. Brody's experience centers on those legal issues that arise during and through loan originations, loan purchase sales, loan securitizations, foreclosures, bankruptcies, and repurchase and indemnification claims.

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AGENDA

I. The Digital Mortgage Platform

II. Non-QM Products

III. Loan Officer Compensation

IV. Fair Lending

V. State Regulations & Enforcement

Part I:

The Digital Mortgage Platform

Digital Mortgage Platform – Overview

- The "Digital Mortgage", "Digital Platform", and "Digital Transformation" are common industry catch phrases rising in popularity.
- No single industry-wide accepted definition.
- Ranges from simple on-line completion of application form, to fully digital experience of application to closing all completed on-line and electronically.
- Embrace of digital mortgage products is increasing quickly and substantially, including a spike in eNote usage.

Digital Mortgage Platform – Compliance & Risk

- Risks will vary based upon the specifics of your digital platform.

- E-SIGN Requirements:
  - Provide clear and conspicuous statement on consumer's rights - how to consent and withdraw consent, system requirements, etc.
  - Must be able to evidence consumer *affirmatively* consented *prior* to receiving disclosures

- Record Retention Requirements:
  - State and federal regulations governing record retention timelines apply.
  - TIP: If possible, obtain and retain the full esign audit log from your vendor at loan completion.

Digital Mortgage Platform – Marketing & Advertising

- Proper license disclosures are required on all website and electronic marketing campaigns.
- Electronic marketing campaigns are still subject to proper Opt-Out or Opt-In regulations.
- As the lender and licensee, you retain the risk when using third party vendors, including CRM tools.
- Advertising on Social Media platforms can be very effective, but is also subject to regulatory scrutiny, including recent UDAAP and Fair Lending concerns.

Part II:

Non-QM Products

Non-QM Products – Overview

- The Non-QM secondary market has experienced a significant expansion recently.
- Non-QM loans *do not* provide the Safe Harbor for compliance with the Ability-to-Repay (ATR) rule that QM loans do.
- Non-QM loans are not necessarily "sub-prime" or "high risk" products.
- Non-QM product characteristics can vary widely – from higher DTI ratios to Interest Only options to Bank Statement qualification.

Non-QM Products – Risks & Compliance

- Selling Non-QM products on the secondary market subjects the lender to Repurchase Risk that may be different than QM loans.
- Disclosure requirements can vary depending on product specifics and state by state regulations.
- Enhanced training is recommended for all staff
  - Train LOs on the product waterfalls to prevent steering borrowers to higher cost products
  - Underwriters may not be accustomed to assessing risk on Non-QM loans
- Regulators tend to focus on Non-QM products during Exams.

Part III:

Loan Officer Compensation

LO Compensation Rule - Review

- Prohibits compensation based on loan terms, or a proxy for loan terms, other than loan amount.

- Defining "Proxy of a Loan Term"
  - Consistently varies with a term or terms of the transaction over a significant number of transactions.
  - LO has the ability, directly or indirectly, to add, drop, or change the factor when originating the transaction.

- Prohibits compensation from both the consumer and another person.

LO Compensation Rule – "Safe Harbor"

Compensation paid or received based on the below "Safe Harbor" methods will be deemed to not be based on a transaction term or proxy for a transaction term:

- LO's overall volume – either total dollar amount of credit extended or total number of transactions originated;
- Loan term performance of the LO's loans;
- Hourly pay rate based on actual number of hours worked;
- Loans made to new customers versus existing customers
- A "flat-fee" structure paid for every loan originated
- The percentage of the LO's applications that close
- Quality of the LO's files submitted to the creditor

LO Compensation Rule
Permissible v. Non-Permissible Structures

Permissible	Non-Permissible

▪ Plans that vary by Loan Officer
▪ Toggle between Borrower and Lender Paid
▪ Plans that provide for a minimum and maximum compensation per transaction
  ▪ 1.25% of loan amount, with minimum of $1,000 and maximum of $5,500 earned per loan
▪ Sign-on bonuses as well as initial guarantees
▪ "Pick a Plan" structures
▪ Periodic plan changes
  ▪ Prospective only; changes no more frequently than quarterly
	▪ Varying compensation by loan product
	  ▪ E.g. FHA v. Conv.; CRA v. Non-CRA
	▪ Sliding scale percentages by buckets
	  ▪ E.g. 1% for loans > $250,000, 1.5% for loans $150,000 to $250,000, 2.5% for loans < $150,000
	▪ Varying compensation based on Sold v. Retained/Portfolio
	▪ Compensation Pools

LO Compensation Rule
The "Gray" Areas

The following plan elements may be permissible in certain circumstances, but extra caution is warranted before implementing:

- Varying compensation by state: This is not expressly prohibited, but can raise concerns regarding Fair Lending and Proxies.
- Reducing compensation to cover fees or cures: It is permissible to reduce compensation to cover rate lock extension fees or tolerance violation *in very specific situations* that are a result of *unforeseen* changes.

The following plan elements are questionable practices that should be avoided as a best practice:

- EPO/EPD/Quality clawback: Compensation should be set in advance, and these clawback provisions can violate state employment and wage laws.
- Paying differently for Purchase v. Refinance: Rule does not provide an express carve out, may be considered a proxy for a term, or bundle of terms.

Part IV:

Fair Lending

Fair Lending - Overview

- Fair Lending is governed by multiple federal regulations which prohibit unlawful discrimination, including the following:

Equal Credit Opportunity Act		Fair Housing Act	
▪ Race	▪ Religion	▪ Race or color	▪ National Origin
▪ National Origin	▪ Sex	▪ Religion	▪ Sex
▪ Marital Status	▪ Age	▪ Familial Status	▪ Handicap
▪ Income derived from any public assistance program			
▪ Exercising rights under the Consumer Credit Protection Act			

- The Home Mortgage Disclosure Act ("HMDA") requires lenders to disclose information about applicants, including race, ethnicity, gender.
- Many states have added protected factors to their anti-discrimination laws, such as sexual orientation.
- Fair Lending violations can be unintentional, resulting in disparate treatment or impact.

Effective Fair Lending Programs

An effective Fair Lending program should be tailored to the size and complexity of the lender's operation, and can consist of:

- Comprehensive Fair Lending training for all staff
- Published clear underwriting guidelines that ensure consistent eligibility criteria for all applicants.
- "Two To Say No" second review of underwriting denials.
- Complaint tracking and monitoring.
- Established monitoring program
  - Pricing and Underwriting exception reviews
  - Credit QC monitoring, including loan declinations
  - Matched Pair analysis
- Whistleblower hotline or confidential reporting mechanism.

Fair Lending - Enforcement

On March 19, 2019, the OCC and Citibank N.A. entered into a Consent Order over violations of the Fair Housing Act related to its Relationship Loan Pricing (RLP) program:

- Borrowers with qualifying relationship with Citibank were eligible to receive a credit to closing costs or an interest rate reduction.
- These credits were not equally offered to all customers, adversely impacting some customers based on race, color, national origin, or sex.
- Multiple internal control failures were identified: (1) inadequate periodic reviews of the program; (2) inadequate training of staff; and (3) did not required all customers be informed of the discounts available.
- Citibank self-identified and self-reported the failures to the OCC in 2015.
- The OCC determined the conduct violated the Fair Housing Act, 42 U.S.C. Section 3601-19.
- The OCC assessed a $25 Million civil money penalty against Citibank.

Part V:

State Regulations
&
Enforcement

State Regulatory Developments

- State regulatory agencies are continuously updating their rules and regulations.
- Regulations that are not expressly under a state's mortgage lending act can still significantly impact your operation.
- California Consumer Privacy Act (January, 2020)
  - Applies to for profit entities that collect and process Personal Information (PI) of California residents and do business in CA, and meet *one* of the following criteria: (1) generate annual gross revenue in excess of $25 Million; (2) receive or share PI of more than 50,000 California Residents; or (3) derive at least 50% of its annual revenue by selling the PI.
  - PI definition is broad, including typical PII examples like SSN or Acct Number, but also drivers license, online tracking technology, and device identifiers.
  - A business must notify consumers of the PI being collected; be presented with a simple way to opt out of the selling of their PI; request a business to delete their PI; and you cannot discriminate against a consumer exercising rights under CCPA.

State Regulatory Developments, Continued

- Rhode Island Home Loan Protection Act (October, 2018)
  - RI is in the process of reformatting all banking regulations and migrating them to the Rhode Island Code of Regulations (RICR).
  - Minor changes to the Banking Regulation 3, now Home Loan Protection Act (HLPA), were made as a result of the change, mainly including deletion of all footnotes and removing appendices.
  - HLPA require the lender to provide borrowers with a disclosure identifying prohibited practices under RI law within 3 business days of application, as well as a Net Tangible Benefit disclosure prior to loan closing. Borrowers must also receive a High Cost Home Loan disclosure and a Flipping Home Loan disclosure, where applicable.
- Vermont Mortgage Commitment Letters (October, 2018)
  - The revised rule allows lenders to create two additional types of commitment letters: (1) Short Form Commitment; and (2) Reverse Mortgage Commitment
  - Short Form Commitment does not require the name and phone number of the licensed LO or NMLS ID for both lender and LO, but it must be delivered concurrently with the CD.

State Regulatory Enforcement

- Non-Bank lenders and servicers are subject to state-specific regulations, in addition to federal regulatory requirements.
- State regulatory agencies hold as much, if not more, regulatory oversight power than the CFPB.
  - As a response to the potential decrease in enforcement by the current Trump administration, many state regulators and Attorneys General publicly restated their commitment to strong oversight and enforcement.
- State agencies continue to increase their cross-communication through the likes of the CSBS, the Multi-State Mortgage Committee, and the Multi-State MSB Examination Taskforce.
- Popularity of multi-state examinations is on the rise, with at least 155 multi-state exams conducted in 2016 and 2017.

State Enforcement Actions & Settlements

- Enforcement actions are often a result of state examinations, but actions by State AGs are on the rise.
- Severity of monetary penalties may vary based on size and maturity/complexity of the lender or servicer.
- MA AG – Caliber Home Loans (April 9, 2019)
  - Caliber offered loan modifications with payments that were temporarily lowered but only covered the monthly interest due.
  - After a few years, the payments could balloon to amounts that were higher than borrowers were originally paying.
  - MA AG alleged that Caliber steered struggling homeowners into these risky modifications.
  - As part of the Settlement, Caliber is to pay $2 Million and facilitate an unknown number of modifications for borrowers.

State Enforcement Actions & Settlements, Continued

- CA DBO – Brian Joseph Decker (March 15, 2019)
  - DBO alleged that Mr. Decker did not meet the character requirements necessary to a job as an MLO due to the nature of pending lawsuits.
  - Mr. Decker was required to disclose that there was a pending financial-services related lawsuit in which he was named.
  - Mr. Decker neither admitted nor denied the allegations.
  - DBO required Mr. Decker to surrender his license and not reapply for 24 months, and pay $10,000 in investigative fees.
- MA DOB – Quicken Loans (April 20, 2018)
  - The MA DOB performed a review of Quicken's compliance with the Mortgage Lender Community Investment Standards requirements.
  - As part of the review, the DOB alleged certain data integrity errors with the company's HMDA data elements.
  - Quicken was required to pay a $250,000 monetary fine, engage a private firm to perform a compliance audit, and submit progress reports to the state.

QUESTIONS & ANSWERS

At the conclusion of this webinar please submit your questions directly to the moderator, at jbrody@johnstonthomas.com.

Johnston Thomas will be sure to follow up on all questions submitted.

Thank you for your attendance!

THANK YOU!