Preparing for CFPB Servicing Exams

Avoiding Common Mistakes with Servicing Transfers and Private Mortgage Insurance

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As many servicers learned in June 2016, when the Consumer Financial Protection Bureau (CFPB) published the Supervisory Highlights Mortgage Servicing Special Edition Issue 11, there are continued common weaknesses within the servicing industry. Despite improvements in many areas of servicing in the last few years, servicers are discovering that they still may need to make adjustments in a number of areas to meet regulatory requirements and be better prepared for CFPB exams.

These areas include loss mitigation, servicing transfers, and failure to maintain adequate document retention procedures. Other factors the CFPB will consider are “the strength of compliance management systems, the existence of other regulatory actions, findings from our prior examinations, servicing transfer activity, the number, severity and trends of consumer complaints, as well as input from housing counselors and other stakeholders about institutional performance based on their experience.” Compliance with regulations becomes particularly problematic for servicers with outdated and deficient servicing technology.

As a result of our work with servicers, we are also seeing that the requirements pertaining to private mortgage insurance (PMI), especially cancellations and terminations, are not well understood or implemented. While not mentioned in the supervisory highlights, this is an additional challenge to get right.

BEST PRACTICES FOR SERVICING TRANSFERS

Servicing transfers, as stated by the CFPB, are anticipated to be a key focus area for exams, and all servicers will want to be as prepared as possible. Several different types of situations are considered servicing transfers in the CFPB Mortgage Servicing Transfer Bulletin 2014-01 (issued August 19, 2014):

- The mortgage owner may sell the rights to service the loan, called the Mortgage Servicing Rights (MSR), separately from the note ownership;
- The owner of the loan or MSR may, rather than servicing the loan itself, hire a vendor—typically called a sub-servicer—to take on the servicing duties;
- Servicing transfers may also occur through whole loan servicing transfers or whole loan portfolio transfers, rather than through sales of MSR; and
- Servicing responsibility is transferred within a company from the origination platform to the servicing platform.

Comprehensive policies and procedures should be implemented for the various scenarios that can occur in the transfer of servicing. The ultimate objective should be to eliminate any servicing interruptions to the borrower as well as ensure transparency occurs from the servicer's perspective. Many consumer-focused regulations apply to the servicing transfer process and are embedded in the CFPB's examination procedures; all of these must be considered.

- Regulation X – RESPA (Real Estate Settlement Procedures Act), which includes:
  - required notice of servicing transfer,
  - error resolution procedures and requests for information,
  - general servicing policies/procedures and record retention requirements; and
  - required notice of changes in the escrow account requirements resulting from a transfer of servicing.
- Regulation V –Fair Debt Collection Practices Act (FDCPA), which addresses requirements of Notice of Debt and Disputed Debts from both the transferor and the new servicer perspectives.
- Fair Credit Reporting Act – prohibits providing information to a consumer reporting agency that servicer has reasonable cause to believe is inaccurate.
- Regulation E – Electronic Funds Transfer Act pertaining to preauthorized electronic transfer payments.
- Regulation Z – Truth-in-Lending includes the requirement for providing the borrower a loan ownership transfer notice should the servicer also acquire the legal title to the debt obligation.
- UDAAP – Unfair, Deceptive or Abusive Acts or Practices which can result from not only non-compliance with the above regulatory requirements, but also from any practice considered to harm the consumer.

Successful transfers occur when the process is communicated and properly coordinated with both entities involved. Best practices within the industry typically include:

- Establishing internal planning meetings with representatives from each servicing function involved in the transfer process and commonly referred to as the Conversion Team (personnel from IT, payment processing, escrow, foreclosure, loss mitigation, bankruptcy, legal, etc.).
- Ensuring contracts and service level agreements between the transferor and the new servicer specify key requirements for data and documents to be transferred as well as delivery timelines.
- Performing pre-transfer scrubs of data and supporting documents to identify any discrepancies requiring corrective action prior to the date of the actual transfer. The data involved in servicing transfers can often exceed 275 data fields per loan.
- Maintaining ongoing communication between the transferor and new servicer during pre- and post-conversion phases. Identifying responsible parties for all transfer processes is critical to the success of the transfer. Escalation procedures should be clarified to ensure that appropriate parties have been identified to resolve any critical pending issues impacting a successful transfer.
- Ensuring that the transferor properly notifies all third parties utilized for various roles related to the loans to be transferred including:
  - Default services providers including, for example, foreclosure attorneys as well as bankruptcy attorneys and trustees,
  - REO realtors and management companies,
  - other third party vendors including all homeowner/flood insurance providers, VA, FHA, USDA, private mortgage providers, MERS, flood tracking companies, tax collection agencies and tax service providers.
- Establishing a post-conversion quality assurance process in which any outstanding issues continue to receive high priority in order to mitigate any borrower impact (e.g. incorrect loan data converted; pending documents not yet received).
- Conducting a “post-mortem” review at the conclusion of each servicing transfer, to identify key successes of the transfer as well as any required revisions to the transfer process that could result in updating existing procedures or enhanced training opportunities.

COMPREHENSIVE POLICIES AND PROCEDURES SHOULD BE IMPLEMENTED FOR THE VARIOUS SCENARIOS THAT CAN OCCUR IN THE TRANSFER OF SERVICING.

Depending upon the complexity and size of the servicing portfolio(s) to be transferred, various challenges exist if the process is not carefully planned and executed. Eliminating as many roadblocks as possible early on in the planning phase can lead to a smoother transfer benefiting both the borrower and the servicer. Since servicing transfers have been identified by the CFPB as a targeted focus area for future examinations, demonstrating comprehensive procedures are in place and have been validated will only benefit the servicer in the eyes of the regulators.

Common servicing transfer challenges that have been reported by various servicers include:

- The prior servicer (transferor) not providing all critical documents included in the transfer. These required documents should be described in specific rather than general terms. This becomes particularly important when describing "payment history." Several servicers only provide the last two years of payment history. In many instances, prior years are maintained in archived data bases that are difficult to access. A possible solution would be for the new servicer to state in the request that "total or complete borrower payment history" is required rather than stating "payment history" as this may assist in receiving more complete documentation. Incompatibilities between servicer platforms have resulted in failing to identify and service performing or pending loss mitigation arrangements after the "in-flight" loans have been transferred. The term "in-flight" is commonly used to describe the servicing status of loans that are in the process of being transferred.
- Loans in foreclosure or bankruptcy are not always properly flagged in the transfer resulting in potential consumer harm.
- The process for labeling, formatting and indexing documents varies by servicer and often the servicer that received the transferred loan files cannot easily identify and retrieve the needed documents.
- Loans for which servicing has been transferred numerous times can present multiple challenges in receiving documentation that may have originated with the initial servicer. Depending upon the document in question, this can result in the new servicer never obtaining the document to support certain loan characteristics (PMI, prior loss mitigation efforts, force-placed insurance, etc.).

PRIVATE MORTGAGE INSURANCE - GETTING IT RIGHT

Our observations have been that the cancellation and termination of PMI has been a frequent regulatory violation for servicers and sub-servicers. These rules can be found in the Homeowners Protection Act of 1998 (HPA). Prior to the HPA, there was no federal law that provided borrowers with a right to cancel their mortgage insurance. Furthermore, there were no uniform state requirements specifying when a mortgagor may request the cancellation of PMI. The CFPB Bulletin 2015-03 issued August 4, 2015, explains the HPA requirements and provides examples that either violate the HPA or may result in noncompliance. It should be noted that the HPA regulations use the term "mortgagor" while the CFPB uses the term "borrower."

Under the HPA requirements, a mortgagor may submit a written request to the servicer to cancel PMI "when the principal balance of the mortgage is first scheduled to reach 80 percent of the 'original value' of the property (regardless of the outstanding balance)" or "the date on which the principal balance of the mortgage reaches 80 percent of the 'original value' of the property based on actual payments." In addition to reaching 80 percent loan-to-value (LTV), if the mortgagor requests cancellation, there are other requirements such as a good payment history, the loan must be current, the loan must not have been subjected to a subordinated lien, and the value of the property has not declined below the original value.

The HPA also requires automatic termination of PMI when the principal balance of the mortgage is first scheduled to reach 78 percent of the original value of the collateral if the loan is current. Automatic termination of the PMI is required even if the current value has declined below the original value.

"Automatic termination" should not be confused with "borrower requested termination/cancellation." Under borrower initiated cancellation, the borrower can make additional unscheduled principal payments to "advance" the cancellation date. However, under the "automatic termination," the "termination date" is determined at origination and can never be advanced by making additional un- ➲

scheduled principal payments. This is an important distinction. An "automatic termination date" does not change just because the borrower made more payments than required; however, the "cancellation date" for a borrower initiated request can change with additional principal payments.

Servicers need to understand the interpretation of "good payment history." The HPA does not comment on outstanding late charges. Servicers need to be sure they are not requiring outstanding late charges to be paid as part of their definition of good payment history or being current on the loan.

The HPA applies to a one unit principal residence of the borrower. If a servicer is allowing borrower requested cancellations on second homes, this should be reflected in the servicer's policies.

Another common area of confusion is the differences between the investor requirements for termination of PMI and the HPA requirements. For example, many loans are owned by Fannie Mae or Freddie Mac. These investors may have guidelines that differ from HPA. The CFPB Bulletin Private Mortgage Insurance Cancellations and Terminations Bulletin 2015-03 (issued August 4, 2015), cautions servicers and sub-servicers to make sure they are not implementing requirements of an investor that may be more stringent than the PMI HPA requirements. Servicers may not look closely at the differences between these requirements and instead "merge" policies and procedures into one document without identifying the differing requirements. The CFPB has indicated this is problematic and is encouraging servicers and sub-servicers to have policies and procedures that clearly identify and separate the requirements of the HPA from investor requirements.

Some investor guidelines may allow cancellation of the PMI at a date earlier than the HPA provides for borrower requested cancellations. Servicers and sub-servicers should clearly identify the HPA policies and procedures as well as investor policies and procedures. Avoid the mistake of combining the HPA requirements with your investor requirements in your policies and procedures.

A more straightforward HPA requirement requires the servicer to provide the borrower with an annual written statement disclosing the borrower's right to PMI cancellation or termination. This annual disclosure must include an address and phone number for the consumer to contact the servicer about the ability to cancel PMI. Some servicers are neglecting to send this disclosure every year to their mortgagors with PMI; other servicers are sending out annual disclosures but forgetting to include the required contact information.

When PMI is automatically terminated, the HPA requires the borrower be notified no later than 30 days after the date of termination or cancellation that PMI has terminated and that no further PMI premiums are due. Some servicers have appropriately terminated or cancelled the PMI, but have not provided the borrowers with the notification that it has occurred nor refunded any premiums that should be reimbursed due to the termination/cancellation.

These are just a handful of the many servicing requirements that continue to cause confusion or less than adequate performance by servicers and sub-servicers. Getting it right in all areas is a huge challenge. Servicing requirements can be complex and confusing. It is critical to take the time to drill down on each of the specific requirements. Start with your policies and procedures. If your policies and procedures are lacking, it will likely be identified in future exams and could result in penalties. If servicing is being transferred to you, determine if your organization has implemented the best practices identified above. These steps will be invaluable in helping you prepare for a successful CFPB exam.

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