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A Spur or a Burr? CFPB Issues New Exam Procedures and *Supervisory Highlights* on Mortgage Servicing

For those who thought that the Consumer Financial Protection Bureau (CFPB) may be getting bored with US mortgage loan servicing as it turns its attention to arbitration clauses, payday lending and other non-mortgage consumer credit issues, no such luck. On June 22, 2016, the CFPB released a "special edition" of its *Supervisory Highlights*[1] focused on examinations of mortgage servicers between January 2014 and April 2016. It also released its third update to the mortgage servicing chapter of the *CFPB Supervision and Examination Manual*.[2] In a press release, the CFPB reported that these releases are intended to "spur industry in its general compliance with CFPB rules."[3]

Yet, by raising issues regarding the sufficiency of servicers' technology systems, the specter of material increases in technology investments to ensure compliance with the CFPB's complex and prescriptive rules is likely to leave a burr in the sides of servicers for which the cost to service perhaps just went up. "Mortgage servicers can't hide behind their bad computer systems or outdated technology," stated CFPB Director Richard Cordray, and the *Supervisory Highlights* notes that the CFPB will increasingly focus on information technology systems in examinations.

In retrospect, one wonders whether the CFPB sufficiently vetted the anticipated costs of compliance with the servicing regulations. Section 1022(b)(2) of the Dodd-Frank Act requires the CFPB to consider, among other factors, "the impact of proposed rules on covered persons" before finalizing proposed regulations. Yet the Section 1022(b)(2) analysis in the servicing regulations mentions technology costs in only a few places. Perhaps the CFPB should have considered the cost of replacing, enhancing or modifying these so-called bad computer systems or outdated technology before imposing extensive new regulations that it knew or should have known might be difficult to implement without considerable cost.

The *Supervisory Highlights* describes numerous practices that CFPB examiners found to be violations of the federal consumer financial law. The updated mortgage servicing chapter of the *CFPB Supervision and Examination Manual* offers insight into the CFPB's focus when it examines servicers. In particular, mortgage servicers should note the CFPB's emphasis on the following areas.

Loss Mitigation

The CFPB reported that loss mitigation is a significant focus because of the risk that weak compliance programs can lead to inadequate customer support, errors with account transfers and possibly wrongful foreclosure. In its special edition of its *Supervisory Highlights*, the CFPB enumerated a litany of practices that examiners found to be violations:

Loss Mitigation Acknowledgement Letters. The CFPB found that servicers failed to comply with the requirement to send an acknowledgement letter within five days of receiving a borrower's loss mitigation application.[4] In addition, the CFPB found that one or more[5] servicers foreclosed on borrowers before the deadline passed for submitting missing documents even though the acknowledgement letters represented that the servicer would not foreclose on borrowers before that deadline passed. The CFPB found the representations to be deceptive regardless of whether the mortgage servicing rules otherwise permitted the servicers to foreclose. The *Supervisory Highlights* report cited numerous other problems with the acknowledgement letters, including requests that borrowers submit documents that were not necessary to evaluate loss mitigation eligibility as well as requests that borrowers submit documents that they had already submitted.

Loss Mitigation Offer Letters. The CFPB also uncovered problems related to loss mitigation offer letters. For example, *one or more* servicers sent loss mitigation offer letters with response deadlines that had already passed or were about to pass by the time the borrower received the letters.

Trial Modification Periods. In addition, the CFPB found that *one or more* servicers failed to convert trial modifications to permanent modifications after borrowers successfully completed trial modifications. This practice is unfair, according to the *Supervisory Highlights* report, because the delay harmed borrowers who accrued interest under a higher rate than they would have under a permanent modification.

Loss Mitigation Denial Letters. Examiners also found that *at least one* servicer listed incorrect reasons for denying loss mitigation options in its loss mitigation denial letters.[6] In other cases, servicers did not state with specificity a borrower's right to appeal a denial and instead included a generic statement that, under certain circumstances, a borrower may have a right to appeal.[7]

Complaints

The new mortgage servicing chapter of the *CFPB Supervision and Examination Manual* includes an enhanced section on consumer complaints that explains that examiners will evaluate whether servicers have an adequate process to identify and escalate certain inquiries and complaints. Examiners will also review whether servicers have an adequate process to achieve an expedited resolution for borrowers who are facing imminent foreclosure. The *CFPB Supervision and Examination Manual* explains that an adequate process may include a dedicated phone line that connects borrowers directly to a live representative.

Servicing Transfers

Protecting consumers from harm due to mortgage servicing transfers has long been a focus of the CFPB. In a press release, the CFPB stated that "transferring loans during the loan modification process heightens risks to consumers, including the risk that documents and information might not be accurately transferred to the new servicer."[8] The special edition of the *Supervisory Highlights* details many compliance problems related to the transfer of servicing rights. For example, the CFPB noted that incompatibilities between servicer platforms led to transferee servicers failing to honor in-place loss mitigation. In addition, the updated chapter on mortgage servicing in the *CFPB Supervision and Examination Manual* emphasizes servicing transfers by directing examiners to evaluate mortgage servicing rules that were not previously included in the section on servicing transfers: requirements related to error resolution procedures,[9] information requests[10] and record retention.[11]

The Government Accountability Office (GAO) released a report on nonbank mortgage servicers in March 2016. The report noted that transfers of mortgage servicing rights have increased since the financial crisis and problems with transfers may be exacerbated by the "immature operational systems" of some nonbank mortgage servicers.[12]

Compliance Management System

In addition to enhancing the sections on complaints and servicing transfers, the CFPB introduced a section dedicated to servicers' compliance management systems in the *CFPB Supervision and Examination Manual*'s mortgage servicing chapter. The section instructs examiners to review the servicer's overall compliance management system and, in particular, the entity's service provider oversight and record retention policies and procedures.

With respect to service provider oversight, the *CFPB Supervision and Examination Manual* references the CFPB's expectation that supervised banks and nonbanks oversee their business relationship with service providers in a manner that ensures compliance with federal consumer financial law.[13] Further, the CFPB notes that, in some cases, mortgage servicers may be legally responsible for the activities of their service providers. The *CFPB Supervision and Examination Manual* directs examiners to review policies, procedures and complaints related to service providers as well as copies of agreements between servicers and their service providers. In particular, examiners will assess servicers' compliance with the Regulation X requirements to develop policies and procedures to access and provide timely and accurate information[14] as well as policies and procedures to facilitate oversight of and compliance by servicer providers.

The special edition of the *Supervisory Highlights* also draws attention to the requirement that servicers maintain policies and procedures reasonably designed to achieve specific objectives[15] and notes that some servicers did not have policies and procedures to promptly identify and facilitate communication with the successor in interest of a deceased borrower, identify with specificity all loss mitigation options for which a borrower may be eligible, and identify necessary documents or information that may not have been transferred and obtain such documents from a transferor servicer, among other things.

Fair Lending

The CFPB also announced that it has examined mortgage servicers' fair lending compliance using the Equal Credit Opportunity Act (ECOA) Baseline Modules in the *CFPB Supervision and Examination Manual*. The ECOA servicing module focuses on whether and how well a servicer's compliance management system identifies and manages fair lending risk. Among other things, the CFPB has evaluated whether servicers provide fair lending training to their staff, whether and how servicers address the needs of consumers with Limited English Proficiency, how servicers handle loss mitigation and whether servicers perform fair lending monitoring of their servicing activities. Based on these reviews and other inputs to its prioritization process, the CFPB has decided to conduct more comprehensive ECOA Targeted Reviews of mortgage servicers this year. Servicers therefore should consider evaluating their compliance management systems to ensure that they adequately address fair lending risk.

Technology

In its *Supervisory Highlights*, the CFPB explained that because some mortgage servicers did not properly train employees to use technology or adequately audit their technological processes, the servicers used technology in a way that harmed consumers. For example, the CFPB found that *at least one* servicer failed to send any loss mitigation acknowledgement notices to borrowers for an extended period of time because of a processing platform malfunction. Also, the CFPB found that a requirement that a servicer manually override data fields whenever a servicing platform rejected data from a transferor servicer led to delays in honoring in-flight loan modifications. The GAO also focused on the issue in its recent report on nonbank mortgage servicers. The GAO noted that challenges at some nonbank mortgage servicers are caused by overly rapid growth that has strained the servicers' operational systems.[16] The *Supervisory Highlights* note that the CFPB will increasingly focus on information technology systems in examinations.

Conclusion

In its *Supervisory Highlights*, the CFPB explained that although it observed some significant improvements by servicers, the "magnitude and persistence of compliance challenges since 2014, particularly in the areas of loss mitigation and servicing transfers, show that while the servicing market has made investments in compliance, those investments have not been sufficient across the marketplace." We expect the CFPB to continue to focus on mortgage servicing supervision and to release new mortgage servicing regulations later this summer.[17]

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Endnotes

1 Consumer Financial Protection Bureau, *Supervisory Highlights Mortgage Servicing Special Edition*, Issue 11, June 2016, available at http://www.consumerfinance.gov/data-research/research-reports/supervisory-highlights-mortgage-servicing-special-edition-issue-11/.

2 Consumer Financial Protection Bureau, *Supervision and Examination Manual*, Mortgage Servicing Section, May 2016, available at http://www.consumerfinance.gov/policy-compliance/guidance/supervision-examinations/mortgage-servicing-examination-procedures/.

3 Consumer Financial Protection Bureau Supervision Finds Mortgage Servicers' Ongoing Technological Failures and Process Breakdowns Trigger Rule Violations, June 22, 2016, available at http://www.consumerfinance.gov/about-us/newsroom/consumer-financial-protection-bureau-supervision-finds-mortgage-servicers-ongoing-technology-failures-and-process-breakdowns-trigger-rule-violations/.

4 12 C.F.R. § 1024.41(b)(2)(i)(B).

5 One wonders how widespread the issue really is when the CFPB references "one or more" servicers.

6 12 C.F.R. §. 1024.41.

7 *Id.*

8 Consumer Financial Protection Bureau Supervision Finds Mortgage Servicers' Ongoing Technological Failures and Process Breakdowns Trigger Rule Violations, June 22, 2016, available at http://www.consumerfinance.gov/about-us/newsroom/consumer-financial-protection-bureau-supervision-finds-mortgage-servicers-ongoing-technology-failures-and-process-breakdowns-trigger-rule-violations/.

9 12 C.F.R. § 1024.35.

10 12 C.F.R. § 1024.36.

11 12 C.F.R. § 1024.38(c)(1).

12 Government Accountability Office, Nonbank Mortgage Services: Existing Regulatory Oversight Could Be Strengthened, March 2016, available at: http://www.gao.gov/assets/680/675747.pdf .

13 For additional information regarding the CFPB's expectations regarding vendor oversight *see* Consumer Financial Protection Bureau, Service Providers, Bulletin 2012-03, April 13, 2012, available at http://files.consumerfinance.gov/f/201204_cfpb_bulletin_service-providers.pdf.

14 12 C.F.R. § 1024.38(a), (b)(1), (b)(3).

15 12 C.F.R. § 1024.38(a), (b).

16 Government Accountability Office, Nonbank Mortgage Services: Existing Regulatory Oversight Could Be Strengthened, March 2016, available at: http://www.gao.gov/assets/680/675747.pdf .

17 Consumer Financial Protection Bureau, Spring 2016 Rulemaking Agenda, available at http://www.consumerfinance.gov/about-us/blog/spring-2016-rulemaking-agenda/ .

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