

Regulators Turn Up Heat on Vendor Management

Increasing scrutiny creates incentive for mortgage originators to enhance internal controls

By Elizabeth McGinn and Moorari Shah

The vendor landscape for companies in the mortgage industry has shifted significantly in recent years. State and federal regulators have levied hefty and often unprecedented fines against a number of supervised institutions because of inadequate vendor-management policies and ineffective vendor oversight.

The Consumer Financial Protection Bureau (CFPB), four years old as of July, has been particularly aggressive in its enforcement activities against companies for alleged failures to ensure that tasks performed by service providers comply with applicable laws and regulations.

Equally vigilant are state regulators and the primary federal banking regulators — the Federal Reserve Board (FED) and the Office of the Comptroller of the Currency (OCC). These regulatory agencies also have demonstrated a laser-like focus in singling out companies for their lack of attentiveness to various risks presented to consumers and to financial markets when compliance responsibilities are outsourced to third-party service providers.

This era of heightened regulatory scrutiny has resulted in several new realities for institutions that rely on external vendors.

Expectations

In recent years, federal agencies such as the OCC, FED and CFPB have sought to make supervised institutions acutely aware of regulatory expectations related to vendor management. These guidance documents reveal a uniform and fundamental axiom of vendor management. Entering into outsourcing

relationships does not absolve supervised institutions of their responsibilities. They must still comply with applicable federal consumer protection and mortgage-related laws and regulations.

Many in the mortgage industry have heeded the regulators' call and wisely redoubled their efforts with respect to vendor management. At a minimum, regulators expect companies to have policies and procedures that cover vendor selection, contracts and ongoing monitoring.

In addition, regulators will generally expect to see verifiable documentation and records showing that the company has followed such policies and procedures, as well as compliance training for everyone from the board of directors and senior management down to line-level employees with clear identification of compliance roles and responsibilities.

Despite the relative speed with which many companies have adapted to this evolving regulatory environment, recent enforcement actions have nonetheless challenged traditional vendor-management paradigms, thereby establishing new realities for the mortgage industry. Several recent examples help highlight some of these important new realities.

New reality No. 1

Regulatory compliance has become a major factor when considering outsourcing and selecting vendors.

The rapid rise of large nonbank mortgage servicers in recent years has raised red flags and led to allegations of substantial

misconduct. The nation's largest nonbank servicer came under fire in December 2013, and the ensuing CFPB enforcement action provided a roadmap as to where regulators are focusing their attention. The allegations included complaints related to charging customers unauthorized fees, misleading customers about alternatives to foreclosure, denying loan modifications for eligible homeowners and sending robo-signed documents through the courts during the foreclosure process.

The 2013 action was one of many taken against servicers. These cases have resulted in hundreds of millions of dollars in fines and remediation. In terms of vendor management, mortgage lenders have had to re-calculate whether the benefits of outsourcing servicing responsibilities truly outweigh the potential for regulatory fall-out.

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Capable servicers are now routinely disqualified from consideration for new business because of a perception that they do not maintain adequate controls to ensure regulatory compliance. In a nutshell, the field of eligible servicers appears to be winnowing and consolidating under the weight of regulatory pressure. In many cases, mortgage lenders with the capacity to service loans themselves, primarily banks, have decided to perform certain servicing tasks in-house rather than take a chance on potential noncompliance by a servicer.

New reality No. 2

Examiners are expanding the traditional notion of vendors to include other third-party relationships, such as marketing partners.

The expanding definition of “vendor” also presents new challenges for relationships that have not been traditionally viewed through the prism of vendor management. Regulators have brought several enforcement actions against mortgage companies for failing to manage these relationships. Deceptive mortgage advertisements, especially ones designed to imply government backing, have been a particular point of CFPB emphasis so far this year.

A CFPB consent order announced this past April against a California-based mortgage lender, for example, encompassed activities typically performed by marketing companies — such as creating a marketing campaign that leverages a “seal of approval” to generate new business for mortgage originators. Marketing companies have made such pitches on behalf of mortgage brokers and lenders for years, often receiving a

lead-generation fee as compensation for new originations.

Going forward, these marketing arrangements are likely to be viewed as service-provider relationships, requiring brokers and originators to carefully review proposed marketing materials for compliance with deceptive advertising laws while ensuring compensation to the marketing companies does not incentivize potentially illegal conduct. Said differently, mortgage originators will likely not be able to rely on their marketing partners for assurances of legally compliant advertising materials as they may have been accustomed to doing in the past.

New reality No. 3

Many more resources for due diligence and oversight may be required to reduce compliance and enforcement risk.

Without question, the new regulatory regime has forced the mortgage industry to commit more time, capital and human resources to better vet and monitor vendors. Simply put, just about every relationship a mortgage company has with a third party may need to be re-evaluated for compliance risk. Take, for example, the relationship between a lender’s loan officers and title companies. This past January, the CFPB entered into consent orders with two of nation’s largest banks stemming from allegations that they participated in illegal marketing-services kickback schemes with a now-defunct title company.

In truth, the allegations centered around the actions of a few loan officers employed by the banks who reportedly steered homeowners to the title company — not because of cost or quality, but because the title

company provided the loan officers with free marketing services in violation of the Real Estate Settlement Procedures Act (RESPA). The services offered to the loan officers by the title company included purchasing and analyzing consumer data and generating promotional mailers branded with the banks’ logos. In return, the banks’ loan officers would refer homebuyers to the title company for closing services.

A number of similar “kickback” enforcement actions have been announced in 2015, an indication that RESPA violations represent another key focus for regulators. Worth noting, however, is that kickback arrangements can be among the hardest to ferret out in connection with vendor management. Individual loan officers can secretly enter into such arrangements without their employers being aware of the schemes. That was the case in the January enforcement actions involving the loan officers. Therefore, mortgage lenders may need to enhance surveillance measures and hire additional internal auditors, to monitor whether loan officers are steering business in directions that may potentially violate RESPA.



Strong vendor-management capabilities are now, more than ever, becoming an essential cornerstone of every mortgage-industry players’ compliance program. Given the intense regulatory scrutiny, it should come as no surprise that the new realities are causing many companies to employ enhanced vendor-management tactics to avoid aggressive enforcement actions. ■