MORTGAGE Compliance Magazine

Encompassing Regulatory Compliance, Risk Management & Operational Excellence in Mortgage Banking

May 2019

WITHOUT A RISK CONTROL FRAMEWORK, IT ALL FALLS

Alternative Home Financing
page 24

QUALITY CONTROL GUIDE
PAGE 13

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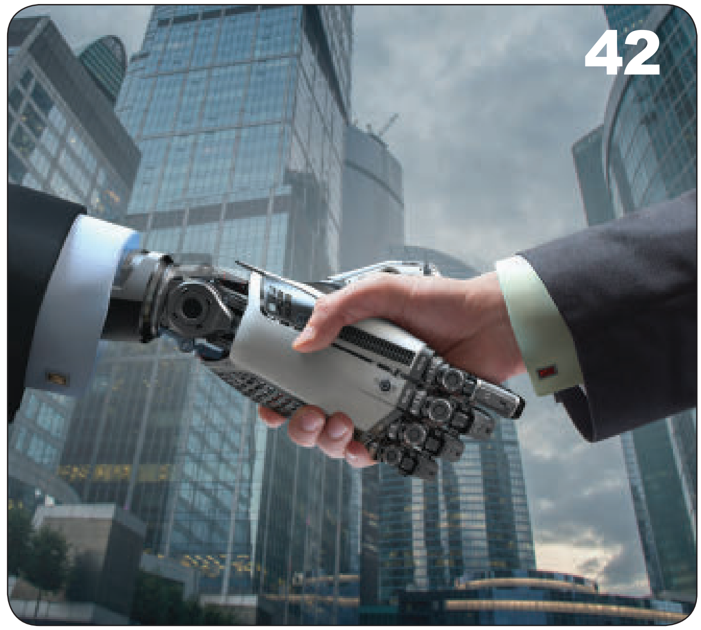
CONTENTS

Cover Story

Features

Mortgage Servicing Compliance



Departments

LEGAL ISSUES AND REGULATIONS: THE MORE THINGS CHANGE. . .

Typically that cliché is completed with, "the more they stay the same." When it comes to legal issues and regulatory matters for the mortgage industry, however, the adage should read, "The more things change, the more challenging it is to comply."

Things definitely do not stay the same as more regulations are constantly changed or added, and compliance does become more challenging. Hence, thousands of industry professionals will gather in New Orleans on May 5 through 8 at the MBA's Legal Issues and Regulatory Compliance Conference to discuss how the most recent regulatory changes are affecting their business and how to handle the latest compliance challenges.

If you can't make it to the Big Easy but you want to know the latest legal and regulatory developments, look no further than this issue of Mortgage Compliance Magazine. This issue is packed with industry experts orating on such hot regulatory topics as implementing a strong quality management process (Steve Spies of Fannie Mae) how Fannie Mae is handling the uncertainty of mortgage loans made to DACA immigrants (James Brody of Johnston Thomas Law Firm); the growing popularity of AI in regulatory compliance (Chitra Dorai of Atasii.com) regulatory considerations for alternative home financing programs (James Milano of Weiner Brodsky Kider) what happens when alternative data and fair lending collide (Jonice Gray Tucker and Caroline Stapleton of Buckly LLP); and, compliance considerations for any lender thinking about making non-QM loans (Colgate Selden of PromonTech).

What are some of the legal issues and regulations you find most challenging in your day-to-day operations? Drop us a line and let us know. Contact us on social media (facebook.com/mortgagecompliancemagazine) or via the email address below.

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Mortgage Compliance Magazine welcomes your feedback. If you have comments, questions, criticisms, praise, or information to share with us and our readers, please write us at info@MortgageComplianceMagazine.Com.

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2019

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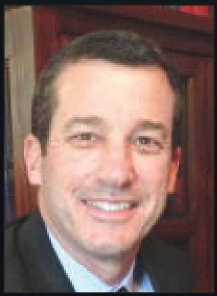
FRAMEWORK:

A risk control framework in the life of a loan Quality life-of-loan model

BY STEVE SPIES



Steve Spies

Implementing a strong quality management process will help ensure you're getting the most from your quality control (QC) program. A good place to start is by looking at your company's risk management procedures and culture. Unless the culture of the entire organization is committed to it, no QC program will be effective.

In this installment we lay out what a culture of quality looks like. It will come as no surprise that if the CEO is not passionately committed to quality, then any attempts to build a culture of quality will be in vain. Therefore, as the graphic points out, hold the CEO accountable for quality and the rest will fall into space. Build this operational discipline first before tackling the nine control points on the framework that will be highlighted in future issues.

The Risk Control Framework graphic (opposite page) traces the mortgage loan process from first customer contact to a comprehensive post-closing analysis and action plan to improve the quality of future loans with nine critical control points in the QC life cycle:

1. Validating Application Data [Internal/Third-Party Data and Fraud Tools]
2. Underwriting and Eligibility
3. Appraisal and Collateral Assessment

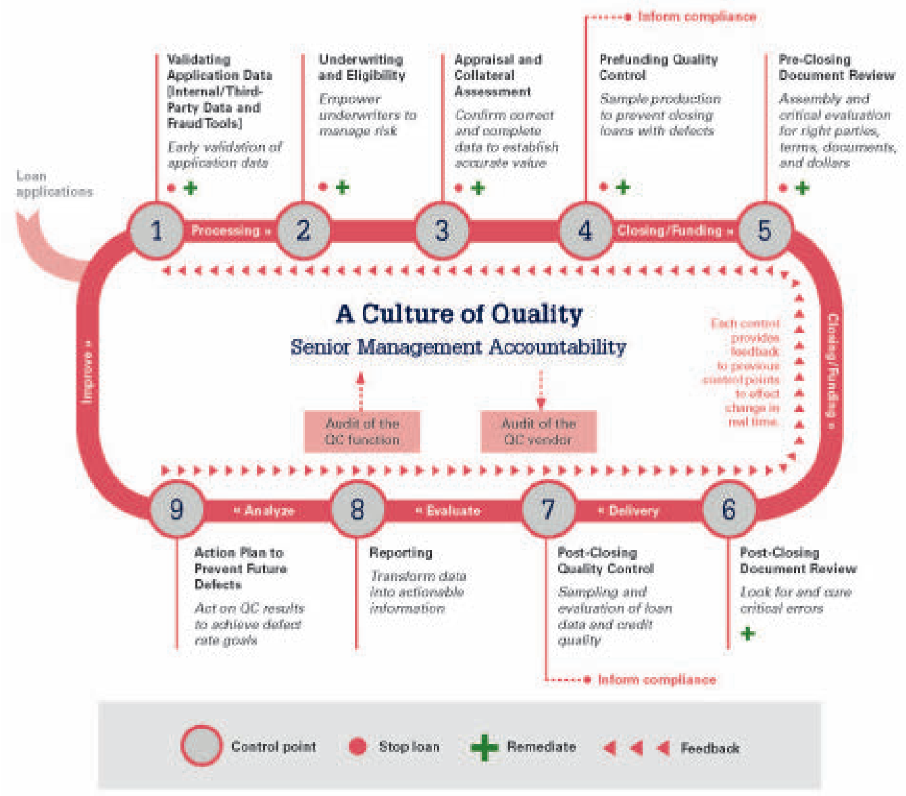
4. Prefunding Quality Control
5. Pre-Closing Document Review
6. Post-Closing Document Review
7. Post-Closing Quality Control
8. Reporting
9. Action Plan to Prevent Future Defects

Some of these control points are managed by QC personnel and some by operations personnel. Regardless of the person completing the reviews and checks, lenders that have these or similar controls in place will ensure active management of loan quality. The control points will be discussed in more detail in future articles, following this review of some foundational principles for good risk management.

Good procedures and a strong risk management culture will also provide a clear and accessible escalation process when staff or management have concerns. In *Beyond the Guide*, we provide ideas on how to reach maximum effectiveness for each control point.

- **Good Data –** The lack of a robust control process for verifying file data is a common gap in QC programs. Control point #1 focuses on ways to confirm the accuracy of loan data.
- **Continuous Feedback for Improvement –** The QC process should drive a continuous feedback loop that results in improvement to the origination process. A strong culture of quality will motivate those who first touch the loan to focus on the accuracy of information in the file. While a rigorous prefunding QC process should become the lender's most powerful tool over time, the cornerstone of an effective QC program is an accurate process for measuring, analyzing, and reporting on loan quality. The organization can determine the need for action only if standards are in place to identify a defect. The lender must empower staff to stop a loan from processing or closing when a significant defect is found; otherwise, the QC program will lack "teeth" and not be effective.

QC RISK CONTROL FRAMEWORK



- **Document Control –** Fannie Mae has observed a widespread lack of control in the management of file documents. A lender's failure to either obtain all required documents to support an underwriting decision or to maintain copies of those documents in the loan file has led to a significant number of QC findings. We cannot over-emphasize the need to implement processes and require accountability to ensure that all documents are obtained before closing and properly stored for later retrieval. Compliance activities also have a critical role in a QC program. Given the targeted and specific nature of compliance reviews, ▷

they are not addressed in *Beyond the Guide*, which focuses on manufacturing quality.

A loan file with a missing document is like a jigsaw puzzle with a missing piece. Get more ideas on how to reduce missing docs.

- **Taking Action –** At each control point, the lender should assess the accuracy of loan information and, if a defect exists, take action. In our own internal QC processes and in our industry observations, we've seen that organizations with a disciplined approach to remediation of defects and errors have demonstrated the best performance related to loan quality. Enforcing a discipline related to tracking, monitoring, and testing action plans builds in a continuous improvement loop and helps these risk organizations have lower level of defects that are sustainable over longer time periods.

Identify the defect ➪
Cure the loan-level defect ➪
Address the root cause

Finally, once all the QC components are correctly implemented, the lender should be able to transition from concern about the "cost of quality" to appreciation for the "return on quality."

Steve Spies is Fannie Mae's Vice President of Loan Quality. He leads their Loan Quality Center which conducts over 100 thousand loan level quality control reviews every year. His role also includes developing, implementing and monitoring Loan Quality standards, as well as oversight for lender quality control effectiveness. Steve conceived and co-authored Fannie Mae's Beyond the Guide, highlighted in the April and subsequent issues.

QUALITY CONTROL

QC GUIDE

QUALITY CONTROL

MORTGAGE Compliance
Magazine

QUALITY CONTROL GUIDE

CORPORATE PROFILE

Since 1983, Adfitech, Inc. has been the go-to source for premier post-closing and pre-funding quality control services for more than five hundred mortgage lenders, banks, and credit unions throughout the United States. Located in the heartland of America, Adfitech, Inc. is known for concierge-level service in delivering trustworthy results, expert regulatory oversight, and improving overall loan quality for the clients we serve. Adfitech, Inc.'s online reporting and rebuttal platform is the easiest, most transparent online rebuttal process the industry has to offer. Our simple per-file pricing eliminates the need for long-term and minimum contracts, enabling Adfitech, Inc. to operate as your company's full-service quality control partner. For more information or to schedule a demo, please visit us at www.adfitech.com.

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BUSINESS SERVICES & PRODUCTS

Performing oversight from application to payoff, Adfitech, Inc. offers review service products to meet every need. Post closing Quality Control that meets the requirements of Fannie Mae, Freddie Mac, FHA and VA, as well as, Non-QM/ATR products. Pre-Funding Quality Control to review the accuracy and quality of the loan application and approval before funding. Mortgage Fulfillment to handle the delivery of a complete closed loan file to an investor or collateral package to custodian with imaging and/or file storage options. Servicing Quality Control Reviews consisting of several distinct QC programs based on the areas of servicing in which you wish to identify and control operational risk. Mortgage Due Diligence that is rating agency reviewed and offers Pre-Securitization, Private Transfer, and NPL / RPL reviews.

KEY BENEFITS & VALUE

Experience Counts! With 35 years of service, Adfitech, Inc. is committed to providing timely response to all inquires as well as proactive solutions in order to meet client specific demands. Our innovative approach to client satisfaction allows us to remain agile in an ever-changing industry as we continually work to exceed expectations of our partners. With no long-term or minimum contracts and competitive and simple per-file pricing, Adfitech, Inc. gives your company a full-service quality control department as well as a variable-price solution based on your company's production volume.

CORPORATE PROFILE

More than one in three of the nation's top lenders and servicers, as well as over half of the top 20 mortgage lenders, choose ARMCO (ACES Risk Management) as their risk management software provider. The leader in enterprise financial risk management solutions, ARMCO offers an array of quality control and compliance technology, including ACES, its award-winning auditing platform.

Every ARMCO client benefits from our hands-on consultative approach that leverages the company's decades of industry expertise. ARMCO's free services include the quarterly ARMCO Mortgage QC Industry Trends Report and the Compliance Newshub, an online credit and compliance resource library.

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BUSINESS SERVICES & PRODUCTS

ARMCO's product line includes loan quality enterprise software, services, data and analytics. Its flagship product, ACES Audit Technology™, has set the bar for user-definability in its category. It is used at virtually every point in the mortgage lifecycle, as well as for a wide range of risk-prone business operations outside traditional mortgage origination and servicing. ARMCO's consultative approach to customer relationships leverages 25 years of mortgage risk intel.

KEY BENEFITS & VALUE

ARMCO clients benefit from our robust profit-enhancing tools and our Client Success team of experts who are constantly ensuring each client reach their goals, bring value to their organization and deliver ROI. Among the long list of awards we have earned throughout the years are MBA Tech All Star, HousingWire Top Tech 100, HousingWire Vanguard and HousingWire Insiders.

QUALITY CONTROL GUIDE

The Compliance Shop LLC
Compliance Management Systems | Auditing | Education | Consulting

CORPORATE PROFILE

As originating loans becomes more difficult and federal agencies are slow to give clear answers to new regulations, you need to protect your business, your loan officers and yourself. We are dedicated to helping mortgage brokers, mini-correspondents, correspondent lenders, and small banks of all sizes comply with regulations, manage risk, and seamlessly integrate compliance into day-to-day operations. With a combination of technology and one-on-one training, we will ensure you, your business and your employees and are in full compliance. With our secure website, your employees can log on 24/7 from their home, office, or tablet and take training modules, upload files, get answers to questions, and access your company's QC policy.

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BUSINESS SERVICES & PRODUCTS

TCS's product line includes a complete customizable Compliance Management System (CMS), for brokers, mini-correspondents, and correspondent lenders. The CMS includes a complete QC Policy, LO Comp Policy, Online Training Modules for entire staff that meet or exceed SAFE Act rules, and a full Social Media Review to ensure compliance. Additional services include: Post Closing QC File Reviews, Prefunding Loan Reviews, AML/BSA Reviews, Federal and State Regulatory Reviews, HMDA Reports, and Audit Preparation.

KEY BENEFITS & VALUE

We work closely with all the state regulators, so we always know what the state hot buttons are. The importance of maintaining a fully compliant shop cannot be overstated. Stop cutting and pasting regulations together, and start mitigating your risk With 21 years in the mortgage industry, the question isn't can I afford this service, the question you should be asking is, can I afford to not have this service?

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CORPORATE PROFILE

Indecomm is a leading provider of business services and technology for the mortgage industry, with over two decades of experience helping mortgage lenders manage their risk and quality control. Our outsourced risk management solutions bring together mortgage industry veterans and our robust next generation audit technology to provide a unique suite of solutions. When you partner with Indecomm, we become an extension of your risk management team. We start by discussing your goals, workflow, and needs. Feedback and recommendations are then provided to ensure best practices are followed to render delivery of quality loan files to your investors.

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BUSINESS SERVICES & PRODUCTS

AuditGenius™ is Indecomm's next generation SaaS solution for loan audits and mortgage risk management, leveraging technology to enable automation and simplify the loan audit process for effective risk management. AuditGenius™ automates document identification and indexing, then compares data across the loan file to identify exceptions. This allows you to focus on areas that need attention rather than the whole loan file, dramatically increasing your efficiency thus reducing the cost of audits.

KEY BENEFITS & VALUE

Indecomm offers Quality Control solutions for every step of the loan process to ensure delivery of quality loan files to your investors, including: Initial Package Submission Audit, Pre-Funding Quality Assurance, Pre-Closing Audit, Post-Closing Quality Control, Compliance Audit, Pre-Delivery Audit, HMDA review and AuditGenius™, Indecomm's proprietary audit technology that provides a real-time view of files, with business intelligence, reports and dashboards.

QUALITY CONTROL GUIDE

CORPORATE PROFILE

Quality Mortgage Services, LLC (QMS) is a well-established leader of mortgage quality control audit solutions and proprietary mortgage auditing software, MARS (Mortgage Analyst Review Software). With over 20 years of experience and specialized knowledge in the mortgage banking industry, QMS is a boutique risk management and mortgage quality control solutions company that provides full service mortgage loan analysis results for banks, credit unions, lenders, brokers and housing authorities.

QMS is a proven industry partner, with a dedicated commitment to our clients. The QMS vow is to shine in customer service, responsiveness, support and flexibility.

KEY PERSONNEL & CONTACT INFORMATION

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BUSINESS SERVICES & PRODUCTS

QMS delivers reports and analytical tools that assist clients in assessing loan quality and maintaining organizational compliance. Our audit reviews are in line with agency requirements and QC services include: Post-Closing, Pre-Funding, Federal Regulatory, Pre-Purchase/Due Diligence, Early Payment Default, Denials, Servicing, Repurchase Defense, HMDA, Anti-money Laundering and MERS® audits. Additionally, QMS offers a secure reverification platform, QCVerify, and our MARS QC software can be leased to manage QC efforts inhouse.

KEY BENEFITS & VALUE

Audits, QC plans and verification solutions that meet today's organizational compliance needs…. We guarantee 4-6-week report delivery. At QMS we are progressive in nature, committed to service, and always evolve to better assist our clients in meeting industry requirements and their unique needs. All solutions are competitively priced and supported by our MARS software, providing transparency to every phase of the quality control process.

CORPORATE PROFILE

Quest Advisors, Inc. is a leader in the mortgage quality assurance industry, providing expert services, including QC audits, federal and state regulatory compliance reviews, consulting and other quality control offerings to mortgage lenders and servicers. Our customized solutions provide clients with options for streamlining their mortgage quality and compliance processes to favorably influence profitability. Since our inception in 1995, we have partnered with our clients to improve their loan quality as they navigate within the ever-changing mortgage environment. We work closely with our clients to communicate key changes and to provide valuable advisory support in a variety of quality and compliance areas.

We tailor our services to our clients' needs and provide advanced portal-based technology featuring real-time results and reporting. Through the shifting landscape and challenges of the mortgage industry, we have been a stable force for nearly 25 years. Reach out to www.questadvisors.com for a superior quality assurance experience.

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BUSINESS SERVICES & PRODUCTS

Quest provides a wide variety of mortgage quality assurance services including, but not limited to: Post Closing QC Reviews, Prefunding Loan Reviews, Adverse/Denied Loan Reviews, Early Payment Default Reviews, Federal Regulatory and State Compliance Reviews, Audits (Servicing, Branch, Operational, AML/BSA), QC Plans and General Consulting.

KEY BENEFITS & VALUE

Quest is entering its 25th year in business. We work closing with clients on all aspects of their quality assurance programs and strongly believe that with the proper guidance and support, Quality Assurance can be a profit center rather than a cost center. Our longevity and expertise in the mortgage industry separates us from others, and we welcome the opportunity to show you how we partner with our clients in their Quest for Quality.

QUALITY CONTROL GUIDE

REGULATORY Solutions

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BUSINESS SERVICES & PRODUCTS

Pre-Funding QC • Post-Closing QC • Servicing QC
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Our pre-funding and post-closing loan review process meets and exceeds agency requirements and includes a complete analysis of credit, collateral, closing and compliance. Pre-funding reviews are performed in 24 hours allowing you to identify and reduce errors before closing. Our servicing reviews cover all facets of servicing. We specialize in HMDA scrubs and have developed proprietary software which allows us to scrub your HMDA with accuracy and efficiency.

KEY BENEFITS & VALUE

We work with clients nationwide. Use us on a monthly basis or for overflow during peak months. Our online communications portal allows clients to interact and communicate with us electronically throughout the review process. Reports are easy to read and can be customized for your needs. Management is easily accessible to respond to your quality control and compliance questions.

CORPORATE PROFILE

Regulatory Solutions is an industry leader in mortgage quality control and lending compliance. Our growth has propelled us into one of the premiere mortgage quality control service providers in the country. Our management team has over a century of combined experience in the banking, mortgage lending, and investment industries and includes former bank regulatory examiners, compliance officers, experienced mortgage loan quality control and audit professionals, underwriters, and attorneys.

Regulatory Solutions has been a Certified Women's Business Enterprise since 2012.

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BUSINESS SERVICES & PRODUCTS

TENA's audit services and SecondLook software provide the information required for early detection of aberrations along with tools to mitigate them. SecondLook can be licensed by firms that perform QC in-house and TENA's outsource audit divisions provide a variety of quality control audit services, including:

• Pre-funding • Post-closing • Servicing • Consumer loan origination • Consumer loan servicing • TENA Web Services • Compliance • Loss Mitigation • Foreclosure • MERS

KEY BENEFITS & VALUE

- Dedicated expert support representatives for each client.
- Flexible and scalable QC services will meet the needs of all types of lenders and servicers.
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- SSAE-16/SOC 2 compliant.
- An array of prebuilt and customizable reports are available to meet each client's unique business requirements.
- Customized Selection Methodologies.

CORPORATE PROFILE

For over 37 years, TENA has provided accurate audits and strong customer support to over 700 lenders and servicers nationwide. TENA prides itself on its ability to adapt to the fast-paced and constantly changing lending industry.

TENA's knowledgeable staff is available to answer client questions about many different aspects of the mortgage and consumer lending and servicing processes. TENA strives for excellence when it comes to supporting its customers and ensuring all their questions are answered and their expectations are exceeded.

THOUGHT LEADER

Remember to Comply with these Requirements When Designing New Marketing, Websites, or Technologies

Garris Horn PLLC

Richard Horn, Managing Member
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Whether your company is a new Fintech start-up or an existing mortgage lender, if it is creating new technology, mobile apps, tinkering with its advertising in the mortgage market, or finding new business partners, you may be asking how you can improve the consumer experience, or speed up the application process?

But there are important questions your company should also ask to prevent legal risk, such as whether and when it collects information that triggers requirements under federal laws, such as TRID, RESPA, HMDA, or ECOA? Or how can you balance a simple borrower experience with these federal consumer protection laws?

These are important questions because there are many federal laws that apply to your company's marketing and application process. Many of these laws have not kept pace with technological advancements and can insert themselves in the process in unintuitive ways, putting up roadblocks to the efficiencies and consumer-friendly workflow you are trying to achieve. Violations can result in administrative penalties and borrower lawsuits. We will briefly discuss just two of the laws here, but there are many.

1. TRID. The TILA-RESPA integrated disclosure rule (the "TRID" rule) requires a lender or mortgage broker to provide a Loan Estimate (or "LE") within three business days after receipt of a consumer's "application," which is only these six items: (1) name; (2) income; (3) social security number to obtain a credit report; (4) property address; (5) estimated property value; and (6) desired loan amount. Requiring any other information from a consumer before providing an LE, or failure to provide a timely LE after obtaining these six items, can be a violation.

The rule also prohibits imposing fees, except a bona fide and reasonable credit report fee, before the consumer receives the LE and indicates an "intent to proceed" to the lender. In addition, the rule requires a specific disclaimer to appear on the top of any consumer-specific estimates of loan terms and costs.

2. RESPA Section 8. Many new entrants to the mortgage and real estate markets do not realize that RESPA greatly restricts the ability to enter into referral arrangements with other players in the market, which may be commonplace in other industries.

Section 8 of RESPA generally prohibits payments of kickbacks or any "thing of value" in exchange for referrals of settlement service business. Section 8 is drafted very broadly, and it has not been updated in decades. Especially considering the fast pace of technological changes, this prohibition may have uncertain applicability to many new types of relationships in the industry.

There are some exemptions from this prohibition that companies may utilize, such as for marketing services agreements ("MSAs") or affiliated business arrangements. But there are very specific criteria companies must meet to satisfy these exceptions. If your company has or desires any arrangements or joint ventures with other players in the real estate or mortgage industry in which referrals are made, it should obtain legal counsel to ensure it is compliant with RESPA.

This is only a very brief summary of two federal laws that apply to marketing and the application process. There are many other federal and state law requirements that may apply.

Please contact me if you would like Garris Horn PLLC, a new "virtual" financial services law firm, to advise your company regarding its marketing or application process.

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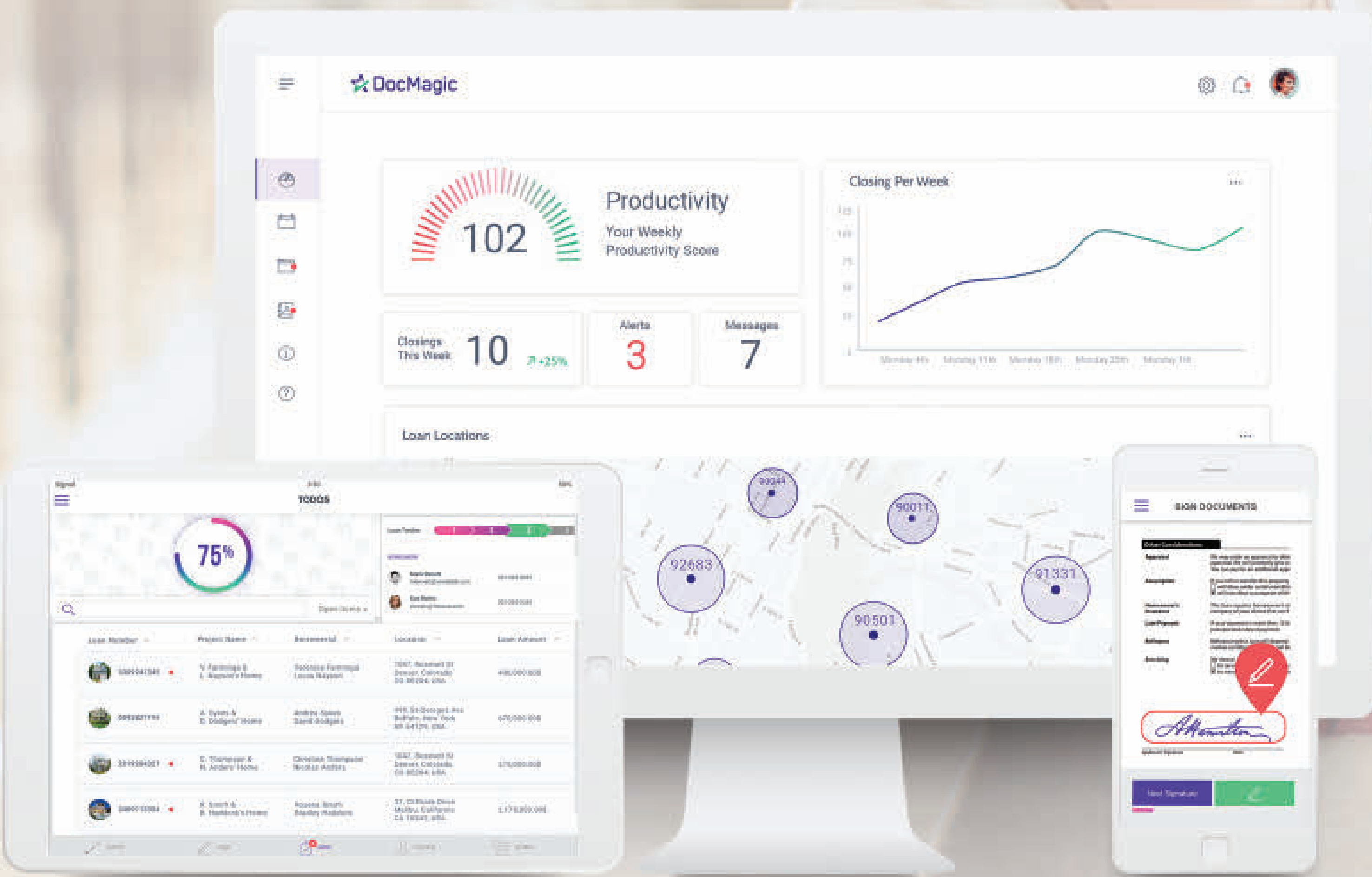

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FANNIE MAE BACKS "DREAMERS"

BY JAMES BRODY

James Brody

As early as the second half of 2018, lenders started becoming very concerned about the DACA status of potential borrowers.

Over this last year, there appears to have been an unannounced shift in the various agency requirements for DACA [Deferred Action for Childhood Arrivals] Visa Status borrowers. DACA status is a Visa status that was offered to children who were brought to the U.S. illegally by their parents and who have now been here for the majority of their lives. Many of these "children," also known as Dreamers, have lived in the U.S. for many years and are now well into their adulthood. As these Dreamers are technically in the U.S. illegally, DACA was created as a way for the Dreamers to obtain a Visa status that would allow them to work in the U.S. despite their immigration status, at least until Congress is able to come to an agreement on what to do with this particular segment of the population. Under DACA, Dreamers are protected from deportation and given a work permit.

As early as the second half of 2018, lenders started becoming very concerned about the DACA status of potential borrowers. In a letter to FHA Commissioner Brian Montgomery, the Mortgage Bankers Association (MBA) noted the uncertainty of the DACA program and how lenders were particularly hesitant to offer mortgages to individuals with deferred status and expired renewals. The MBA pointed out that the Handbook contains three categorizations of non-U.S. citizen residency status, including lawful permanent resident aliens, non-permanent resident aliens, and non-U.S. citizens without lawful residency. As a result, the MBA recommended HUD provide clear guidance as to which category DACA participants should fall.

Thereafter, in February 2019, the status of Dreamers was thrust into the limelight of national media outlets, as a political bargaining chip, which only served to exacerbate the great uncertainty that those affected persons had with regard to their home buying options.

The most common argument that has been made as to why DACA borrowers were not eligible for mortgage financing has been because the guidelines of the FHA as well as those of Fannie Mae and Freddie Mac, state that a U.S. citizen borrower must be legally present in the United States. Investors following FHA guidelines would argue that because DACA does not confer a Lawful Permanent Residence Status, according to the USCIS definitions, DACA borrowers are not eligible for mortgage financing. Namely, these individuals are considered temporary residents, which fall under non-U.S. citizens without lawful residency in the U.S. and are not eligible for FHA insuring at this time.

HUD stated in a recent letter that it has a "... longstanding policy regarding eligibility for non-U.S. citizens without lawful residency. Those policies have not been altered." According to HUD's letter, "... non-U.S. citizens without lawful residency in the U.S. are not eligible for FHA-insured mortgages." This claim comes despite the fact that according to the U.S. Citizenship and Immigration Services (UCIS) office within the Department of Homeland Security (DHS), DACA recipients are still able to renew their grant of deferred action under DACA, although the agency is not accepting new requests.

Fortunately for Dreamers, this interpretation is wrong and Fannie Mae is stating that loud and clear. On March 26, 2019, Fannie Mae issued a clarification stating, "[w]e have a longstanding policy on eligibility for non-U.S. citizen borrowers. Fannie Mae purchases and securitizes mortgages to non-citizens who are lawful permanent or non-permanent residents of the United States under the same terms available to U.S. citizens." Further, Fannie Mae went onto state that it is not changing its existing policies. Rather, the purpose of issuing the bulletin was to provide "additional guidance to help lenders determine eligibility for non-U.S. citizen borrowers" in response to customer feedback on the issue.

If those criteria are met, the borrower's loan is eligible to be purchased by Fannie Mae. To be more specific on the matter, Fannie Mae provided four example scenarios, with one of those scenarios specifically dealing with DACA borrowers. If the Fannie Mae listed criteria are met, Fannie Mae considers that Dreamer's mortgage to be eligible for purchase. However, Fannie Mae did include the caveat that "(l)enders retain discretion as individual borrower situations differ." For underwriting decisions, "(l)enders can continue to decide what type of documentation is appropriate and what can be retained as part of the loan file to show that a borrower is legally present." Of course, recognizing the reality of the situation, Fannie Mae added that with all its policies, subsequent changes to the law and its application "may cause us to reevaluate our policy on this matter prospectively."

Pete Mills, Senior Vice President of Member Engagement and Residential Policy with the MBA, noted that the Fact Sheet says that Fannie Mae "will not seek a loan repurchase solely based on a change in the borrower's immigration status after closing." Mills added that the MBA expects Freddie Mac will follow shortly and that the MBA will continue to urge FHA to follow the same framework.

The bottom line is that without clear and definitive information from HUD and the FHA about whether they are backing DACA mortgages, both investors such as Fannie Mae and lenders are taking matters into their own hands to ensure the mortgages they originate will have a buyer when it is all said and done. To assist in making these types of decisions, there are a few things a lender should consider.

The first thing a lender should do is gather information from their investor outlets regarding this issue. This due diligence will not only assist lenders in their policy-making process, but it may also provide them with documented evidence that they followed proper protocol in attempting to get an answer. Once the lenders have gathered the information, then the executive teams will need to consider the consequences of offering or not offering mortgage loans to DACA status borrowers.

Next, lenders should seek out their legal counsel's opinions, as they will need to be able to defend their thought process. Legal risks that each ▷

lender will now have to consider include dealing with the False Claims Act and fair lending practices. For instance, will the decision of whether to offer mortgages with DACA Visa Status affect the fair lending risk of investors? This is an area where good legal advice is highly recommended.

In seeking the advice of counsel, lenders should also conduct some of their own due diligence in researching what other competing lenders are offering or not offering. If everyone else offers DACA status loans and you do not, then the question will always be "why"? When dealing with disparate treatment concerns, which is part of your counsel's fair lending analysis, the advice will likely be that lenders should always ensure their guidelines and policy reference only criteria that would not be considered discriminatory on a prohibited basis.

So, while HUD and investors are touting processes are status quo, lenders should review policies and processes to ensure their own practices remain compliant while the agencies continue to determine where that status quo actually is.

https://www.housingwire.com/articles/48374-hud-to-lenders-we-are-not-denying-mortgages-to-daca-dreamers

https://www.mba.org/mba-newslinks/2018/july/mba-newslink-friday-7-20-18/mba-asks-fha-for-additional-clarity-guidance-on-fha-handbook

https://www.uscis.gov/archive/frequently-asked-questions

James Brody is the Chairman of the Mortgage Banking Practice Group. His 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. He can be reached at jbrody@johnstonthomas.com.

Making the Appropriate Selection Regarding Anti-Deficiency Laws on the Closing Disclosure and Arizona Anti-Deficiency Laws

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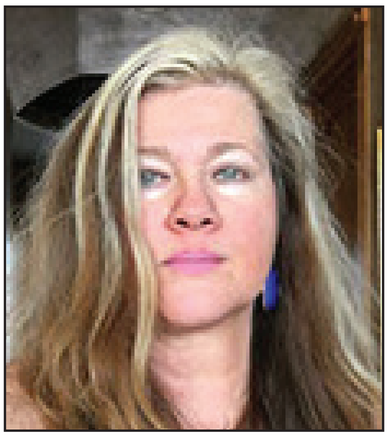

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The lender is required to advise the borrower in the Closing Disclosure whether anti-deficiency protection exists under applicable state law if there should be a foreclosure. Reg. Z § 1026.38(p)(3). State anti-deficiency laws provide certain protections to a borrower from a lender pursuing a judgment for the amount by which the sums due under the loan exceed the value of the property following foreclosure. As set forth in the Model Form below, the lender must select one of two boxes on the CD in the "Liability after Foreclosure" section. The lender must choose either (1) there "may" be anti-deficiency protection; and (2) there is "not" anti-deficiency protection.

The regulation and Official Interpretations direct the lender to make this choice after analyzing the applicable state law. Reg. Z § 1026.38(p)(3). The Official Interpretations add that if the state law provides "any type of protection," other than a statute of limitations, then the regulation requires a statement that state law "may" protect the consumer from liability for the unpaid balance.[1] Therefore, the lender must make this selection based upon a thorough analysis and understanding of state law.

In Arizona, the anti-deficiency laws are complex. An analysis of whether anti-deficiency protection applies to an Arizona loan requires consideration of various statutes and court decisions. The answer depends upon several factors such as whether a non-judicial or judicial foreclosure is done, the type of property and the size of the property involved and whether the loan is considered "purchase money" under the statutes and court decisions. See, for example, A.R.S. §§ 33-814 and 33-739. Whether the loan is considered "purchase money" is the subject of many Arizona Court of Appeals and Arizona Supreme Court decisions and depends upon factors such as the purpose of the loan, whether the loan was a refinance transaction and the purposes for the refinance, whether there was a "cash out" transaction, whether the loan was a construction loan or for the purpose of home improvement, whether a house was constructed, whether a builder is the borrower and other issues. There are factual scenarios in which anti-deficiency protection clearly does *not* apply.

Because there are scenarios in Arizona in which anti-deficiency protection clearly does not apply, the lender cannot have a policy of always selecting the "may" box. If the lender chooses the "may" box, and a court subsequently rules that there was no anti-deficiency protection, there may be adverse consequences to the lender. The CFPB or other regulator may cite a violation of the regulation and a UDAAP/unfair, deceptive or abusive act or practice. The borrower may assert a claim for damages based upon the argument that checking the "may" box was a misrepresentation by the lender upon which the borrower relied to his detriment in accepting the loan. Ultimately, the best practice is to have a thorough understanding of the anti-deficiency laws of all states in which loans are originated, and in Arizona, to make a case-by-case analysis whether anti-deficiency protection exists for each loan.

Liability after Foreclosure

If your lender forecloses on this property and the foreclosure does not cover the amount of unpaid balance on this loan,

☒ state law may protect you from liability for the unpaid balance. If you refinance or take on any additional debt on this property, you may lose this protection and have to pay any debt remaining even after foreclosure. You may want to consult a lawyer for more information.

☐ state law does not protect you from liability for the unpaid balance.

Carolyn Goldman is a member of Goldman & Zwillinger PLLC in Scottsdale, Arizona. She acts as an Arizona Responsible Individual, advises regarding compliance issues and is a litigator.

[1] The Small Entity Compliance Guide 2.0 confirms that the lender fulfills this obligation by checking the box on the CD. Liability after Foreclosure, Comment 38(p)(3)-1.

REGULATORY CONSIDERATIONS FOR ALTERNATIVE HOME FINANCING PROGRAMS

BY JIM MILANO


Jim Milano

The importance of categorizing a program's legal structure is to identify which set of laws will apply and, thus, which regulatory issues should be considered.

With mortgage volume down and margins compressed, lenders may be looking for other programs to offer in order to enhance their own mortgage loan offerings or augment company revenue. Since the financial crisis, many alternative home finance and home equity access programs have entered the home finance market. This article addresses some of those programs and gives a brief overview of the regulatory considerations for offering and partnering with such programs.

It is often said that lawyers like to "think in boxes." That is to say, lawyers like to categorize information into segments in order to better analyze information. In looking at alternative home finance and home equity access programs, one of the initial questions to ask is "what box does it fit into?" Basically, a program could fit into one of four "boxes": 1) a loan, 2) an investment, 3) a purchase, or 4) a lease. Some programs could be a combination of these categories, such as a lease with an option to purchase.

The importance of categorizing a program's legal structure is to identify which set of laws will apply and, thus, which regulatory issues should be considered.

Description of Types of Programs

Equity Access or Purchase Money Augmentation Programs

There are several different alternative home finance or equity access programs available to homeowners in the marketplace today. The programs can broadly be categorized as purchase transactions (or more appropriately, options to purchase), sale-leasebacks, equity share contracts and leases with an option to purchase. Below is a description of a few of the features of some of those programs.

OPTION TO PURCHASE PROGRAMS

Under one type of option program, an investor either makes an investment in a consumer's home or augments the purchase price of the home under a tax-deferred investment of cash in exchange for a share of the home's future appreciation. Some programs have an advance limit, such as up to the lesser of $200,000 or 15 percent of a home's value. Other programs' advance limits are higher.

Typically, there is a transaction fee of a couple of percentage points, an appraisal fee, and an escrow fee that is deducted from the homeowner's funds. The investor uses a deed of trust and memorandum ▻

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of option that is recorded in the county recorder's office. Some of these programs are offered with both owner-occupied and investment properties, and can take a second or even a third lien position. For those programs that allow investor properties, the homeowner does not have to live in the home, but under some programs there is a penalty imposed at the end of the term if the property was not a rental at the beginning of the agreement.

Under these types of programs, the investor normally is not added to the title of the property at the outset of the transaction, although contractually it is contemplated that the investor will go on title at the exercise date of the option. The homeowner maintains possession, occupancy, and control over the home. The homeowner also remains responsible for all the costs of homeownership, and the investor has no responsibility for property taxes, insurance, or homeowner association fees in connection with the home. The investor is named an additional named insured on the homeowner insurance policy.

The homeowner can remodel the home, but there are limits on adding additional debt to the home to pay for remodeling or for other purposes, and the investor will share in any increase in property value due to remodeling changes. Some programs provide an adjustment in value of the home in favor of the homeowner for such remodeling or additions to the property.

There are no monthly payments under these option contracts, and no interest is charged to the homeowner in return for the investor's investment. The investor obtains its return by sharing in the appreciation, sometimes up to a set cap, but also stands to lose if the value of the home depreciates during the term of the option.

The homeowner can "unwind" the option prior to the end of its term and "re-purchase" his or her equity any time during the term, which term can range from 10 years under some programs, or up to 30 years under others. Typically, a homeowner will unwind the option by use of a refinance loan or a home equity loan. If the homeowner sells the home, the investor will share in the sales proceeds at the rate of the specified investor's investment percentage, typically in the range of between 25 to 40 percent of the home's price appreciation. There are no pre-payment penalties with most programs; however, some programs require an "early termination fee" for contracts that are un-wound in the first three to five years of the option contract.

Thus, under these option programs, the investor achieves its return on investment when one of the following events occurs, and the homeowner can elect any one of these options at any time during the term of the contract without penalty:

- The homeowner chooses to unwind the option and "buy out" the investor based on the appraised fair market value of the home at that time;
- The homeowner chooses to finance out the investor with a HELOC, home equity loan, or reverse mortgage based on the appraised fair market value of the home at that time;
- The homeowner sells the home; in which case, the investor shares in the sales proceeds based on its investment percentage, and, at the homeowner's option, the investor may be paid off directly from the sale's closing escrow; or
- The end of the term is reached, in which case, the investor shares in the sales proceeds based on its investment percentage based on the appraised fair market value of the home at the end of the term. In this case, also, at the homeowner's option, the investor may be paid off directly from the sale's closing escrow the homeowner repays the investor.

Under one program, the ending (final) home value at the maturity of the option contract is determined not based on the actual value of the home, but on the Case-Shiller Home Price Index. Further, under some programs, the homeowner agrees to pay back to the investor the investor's original investment amount plus a predetermined percentage of the home's appreciation, usually between 25 to 40 percent. If there is an event of default, the investor can exercise the option and initiate a sale process.

LEASE WITH AN OPTION TO PURCHASE

Under some types of lease-to-own financing programs, a provider arranges with a local government or non-profit agency to purchase a home, the provider finances the home on behalf of the agency, and the home is leased to the consumer. These programs typically include an assumable 30-year mortgage, with a fixed interest rate that the consumer can qualify to assume when ready, under which the consumer takes over the remaining payments. Such programs afford a consumer with the ability to live in a home that the consumer wishes to own while building equity for its purchase in the future.

Under one such program, the provider approves payments to a maximum of 50 percent of the consumer's gross household income less other debt obligations, or 38 percent, whichever is less.

There is no down payment and low move-in costs, with the lowest purchase option price starting at 1 percent over the home's cost, plus an underwriting fee. A consumer must also pay the typical home purchase costs, including a home inspection and an appraisal, if the negotiated home price does not match the appraised value.

The consumer's monthly payment is fixed, and only goes up during the lease if the property taxes, homeowners insurance, homeowner's dues, or other similar costs increase. Additionally, the provider credits a portion of the consumer's on-time monthly lease payments toward the ultimate assumption of the loan and corresponding purchase of the home. The consumer can purchase the home at any time, regardless of the lease term.

If after the first two years of the lease the consumer wants to move out of the home, prior to the lease ending, the consumer can provide 60 days' notice and the provider will work with the consumer to assist them in their move. If the consumer wishes to move out of the home during the first two years of the lease, the provider will assist in finding a sub-tenant for a small fee. If the new occupant qualifies, they can be a substitute for the consumer and the consumer will be released from the lease obligations.

At the end of the lease, the consumer has the option to buy, sell, trade in, or move out of the home without penalty. If the consumer needs more time, it may be possible to extend the lease term, which is initially a term of two to five years.

SALE-LEASE BACK PROGRAMS

Sales leaseback programs provide homeowners an opportunity to sell their homes for cash while remaining in the home. Under one such program, a provider makes a purchase offer, and the homeowner receives money, less any lien balances on the home and realtor fees. Some programs impose no minimum home equity requirements, but do require the homeowner to have the ability to pay rent under the lease. Some providers charge a closing fee, which is typically a percentage of the value of the home, such as 2 percent, along with traditional closing costs.

The lease automatically renews if the homeowner remains in good standing. Under these programs, the rental rate is typically based on the market rent for similar homes in the homeowner's region. Normally, a lease has a 12-month term, and can be renewed for up to five years. Rent is based on current market rates, and rent typically increases annually by the greater of 2.5 percent or the CPI. Under some programs, an appraiser is used to determine a fair market rental rate by considering local rental properties that have similar characteristics to the homeowner's home, such as square footage, general condition, and number of bedrooms and bathrooms.

The responsibilities of owning the home, such as property taxes, HOA fees, or expenses associated with repairs required as a result of normal wear and tear pass to the lease provider, but the homeowner is responsible for basic maintenance like lawn care, snow removal, and appliance repairs.

A consumer also has the option to repurchase their home if they decide they want to own it again, and some programs allow the consumer to control the timing, asking price, and even the listing agent. Under some programs, if the consumer wants to repurchase the home within the first year, they must pay the amount funded in the initial home purchase, plus a percentage, such as 5 percent. Each subsequent year the re-purchase price can increase. Under one program, the annual increase after the first year is 2.5 percent per year.

If the consumer wants to move, several program providers will assist with placing the home on the market, and once the home is sold, after certain fees, the consumer is allowed to keep the remainder of the equity in the home if the value of the home has increased.

If the consumer defaults on their rent, providers will afford the consumer with a notice and opportunity to cure. If a resolution is not reached, such defaults can result in the consumer being evicted. Under some programs, however, if the consumer is evicted and the home sold, a consumer may still receive some or most of the equity in the ▹

property after the provider has recovered unpaid rent, the selling costs, and any legal fees associated with the eviction.

SHARED APPRECIATION CONTRACTS

Another alternative to debt financing is a program that allows a consumer to augment the purchase price of a home or access their home equity under a co-investment contract whereby an investor invests in the consumer's home. Some of these programs, while evidenced by a note and security instrument, are structured as an investment contract and not a loan, and have no monthly payments or interest charges. Like option contracts described above, the cost to the consumer is based on the home's future appreciated value. Unlike the option or sale-leaseback programs, however, the investor does not take an ownership stake in the home and does not share in ownership of the home. Thus, these types of programs do not contemplate a sale of the home.

However, similar to the option contracts, there are no monthly payments. One such program allows a consumer to augment their down payment for the purchase of a home or convert up to 20 percent of their home equity into cash. However, the ultimate amount the homeowner may access is based on any mortgage loan on or to be placed on the property, the homeowner's credit profile and other factors determined by the investor, such as expected home price appreciation. There may be various origination and other fees associated with these programs.

In exchange for an investment, the investor is generally entitled to repayment of their investment, plus a pre-agreed upon portion of the appreciation value of the consumer's home, upon the occurrence of a terminating event, which includes when the consumer sells the home, prepays the contract, or passes away. If the home price has increased, the investor will share in the appreciation of the home. If the home price has gone down, the investor may absorb a share of the loss.

REVERSE MORTGAGES

In addition to the above non-debt-based equity access programs, a loan (debt) based program that allows homeowners either to purchase a home or access the equity in their home are reverse mortgages. Since the financial crisis until approximately a year ago, the FHA-insured Home Equity Conversion Mortgage (or HECM) program has been the predominate reverse mortgage program in the marketplace. However, more recently, several non-FHA-insured reverse mortgage programs have been introduced and soon may overtake the HECM program on a dollar volume basis. These reverse mortgage programs will be the subject of a future article.

Legal Considerations

Sale vs. Loan

One risk for option programs is the risk that the program will be recharacterized as a loan. The risk of recharacterization as a loan includes having state mortgage lending licensing and other mortgage requirements apply, as well as fee or interest rate limits under state law. In analyzing any program, one must determine into which "box" it most appropriately fits.

In analyzing whether a transaction is a sale versus a loan, where a real estate transaction claims on its face to be a sale, a sale and lease back, or a conditional sale, the typical threshold question a court will address is whether the transaction was meant simply as security for a preexisting or contemporaneous debt.

Courts generally have taken the position that where there is no prior or contemporaneous debt, there can be no equitable mortgage, and where there is a prior or contemporaneous debt between the parties, the transaction is likely to be a mortgage. There is a presumption in favor of such a finding once sufficient evidence has overcome the presumption that an instrument is in substance what it purports to be on its face.

Upon satisfying itself of the existence of a prior or contemporaneous debt between the parties, before a court will exercise its equitable powers in recharacterizing a purported sale as an equitable mortgage or loan, it reviews the entirety of circumstances surrounding an agreement, including parol evidence, according to these factors: (1) the intentions of the parties; (2) the adequacy of consideration; (3) the retention of possession by the grantor; and (4) the satisfaction or survival of the debt. No single factor is dispositive, and because the introduction of parol evidence contradicting the terms of a written agreement is in derogation of the general rule against such, such evidence must be strictly construed. Further, no subsequent debt or occurrence can change the nature of the agreement, whether a sale or mortgage, as that agreement's nature is fixed at the time of its creation. In actually deciding equitable mortgage cases, courts often consider the financial position of the seller, or equitable mortgagor, at the time the transaction was consummated, as the relative bargaining strength of the parties is an animating force behind the equitable mortgage doctrine. Where a court fails to find an equitable mortgage, it appears neither state nor federal lending laws, including state usury laws, will apply.

An option program should be analyzed under the above criteria in order to assure that the option program is a precursor to a purchase transaction and not a loan.

Lease Issues

One legal risk of a lease transaction is recharacterization as a sale or a loan. If the rental payments equate to fair market rental value and not a purchase price that would be paid under an installment sales contract, then it is more likely not to be recharacterized as a sale or loan. Another "stress point" is allocating which party, the landlord or tenant, is responsible for real estate taxes and property insurance. The landlord should remain responsible for these items in order to reflect a true lease. Some lease programs offer an option to purchase. Such features will not cause a risk of recharacterization as long as rental payments equate to a fair market rental value and the option payment for purchase is not nominally low.

Securities and Tax Issues

While a discussion of securities and tax issues is beyond the scope of this article, the shared appreciation contracts discussed above are not designed to be loans. However, such contracts also are not typically structured as real estate purchase or option to purchase contracts. Therefore, one should consider what legal and regulatory regime such contracts fit under. The applicability of these laws may turn on whether the property is the home of the consumer and owner occupied, and/or whether the return to the investor is based on the appreciation of the home, or some external measurement, such as a home price appreciation index.

Regulatory Considerations

For mortgage companies that wish to become involved in or partner with these alternative home purchase or home equity access programs, the first question is whether the mortgage company will offer these products or merely partner with companies that offer these alternative programs. If alternative finance companies allow third party participation and the mortgage company will offer such programs as an originator, it must consider whether additional regulatory approvals and other requirements will apply. If a mortgage company will partner with alternative finance companies, it must consider which regulatory issues might apply.

Licensing

For the shared appreciation contracts, some companies reportedly plan to offer such programs under mortgage lending licenses. For the option contracts, the alternative home equity access companies typically hold realtor licenses. However, if mortgage companies will partner with and refer contracts, mortgage companies must consider whether they also need state realtor licenses. In some states, merely acting as a finder for a real estate contract, even for compensation, does not rise to the level of licensable realtor activity.

Nonetheless, if a mortgage company will only ▻

offer mortgage loans alongside such alternative home purchase or home equity access contracts, the mortgage company may nonetheless want to know what laws will apply to its business partner. In addition to state laws issues on real estate and leases, federal consumer credit laws might also be considered.

Federal "Alphabet Soup"

One of the hallmarks of such federal laws as the federal Truth-in-Lending Act (and Regulation Z), the Equal Credit Opportunity Act (and Regulation B), the Real Estate Settlement Procedures Act (and Regulation X), and the Home Mortgage Disclosure Act (and Regulation C) is that credit must be involved.

Under TILA, for instance, "credit" is defined as "the right granted by a creditor to a debtor to defer payment of debt or to incur debt and defer its payment." Under ECOA, a "creditor" means any person who regularly extends, renews, or continues credit; any person who regularly arranges for the extension, renewal, or continuation of credit; or any assignee of an original creditor who participates in the decision to extend, renew, or continue credit. "Credit" is defined as the right granted by a creditor to a debtor to defer payment of debt or to incur debt and defer its payment or to purchase property or services and defer payment therefor.

RESPA applies to "federally related mortgage loans" offered by "creditors." Creditor is defined with reference to TILA, which describes such term in part as a person who both (1) regularly extends consumer credit which is payable by agreement in more than four installments or for which the payment of a finance charge is or may be required, and (2) is the person to whom the debt arising from the consumer credit transaction is initially payable on the face of the evidence of indebtedness. Under RESPA, there is a "cooperative broker" exclusion from the anti-kickback (or referral) provisions; however, such an exception should only need to come into play if a federally related mortgage loan is involved in the first place.

Arguably, if the underlying alternative contracts are not "credit," then some of these federal "alphabet soup" laws would not apply.

However, other federal laws might apply to alternative home equity access programs.

Fair Housing Act

For instance, the federal fair housing laws apply not only to the offer and granting of credit to purchase homes, but also to the sale and rental of homes. In offering or partnering with providers of alternative home equity access programs, mortgage lenders should be cognizant of these laws and regulations not only in their own operations, but also those of its business partners.

FCRA

Further, some companies that offer alternative home equity access programs order credit reports on homeowners as part of the origination and offering of such programs. Of course, in doing so, the federal Fair Credit Reporting Act would apply.

CONCLUSION

With mortgage volume down and margins compressed, mortgage lenders may wish to look into other programs in order to enhance their operations. Alternative home finance and equity access programs may be one such viable and additional option. In considering such alternative programs, lenders may already have infrastructure in place to support such programs; however, the legal and regulatory issues outlined above are some of the items mortgage lenders should contemplate when entering into or partnering with such programs. MCM

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THOUGHT LEADER

Taming the Beast – How to Keep Mortgage Marketing Compliant in the Digital Era

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In the current operating environment, generating new business is more important than ever, which means mortgage loan originators (MLOs) are ramping up marketing to attract new borrowers and drive loan volume. However, lenders must be mindful of the marketing and advertising materials being distributed by MLOs, as both state and federal regulators continue to keep a sharp eye on how mortgage lenders market to consumers.

One of the biggest risks lenders face in this area is running afoul of Fair Lending regulations and the Unfair, Deceptive, or Abusive Acts or Practices Act (UDAAP). With the rise of digital marketing strategies and social media use, it is now easier than ever for businesses to zero in on their target audiences using sophisticated analytical models. For other, less regulated industries, this is a good thing. Unfortunately for the mortgage industry, regulators tend to view targeted marketing campaigns as discriminatory in nature rather than a savvy business development strategy.

Even if lenders' intentions are noble (after all, who doesn't want to increase access to homeownership for minorities, Millennials, and other underserved groups), the disparate impact litmus test still puts these efforts on the wrong side of Fair Lending laws. Case in point – HUD is pursuing Facebook for discriminatory advertising practices and has compelled Facebook to make immediate changes regarding how real estate companies can target marketing on the Facebook paid advertising platform.

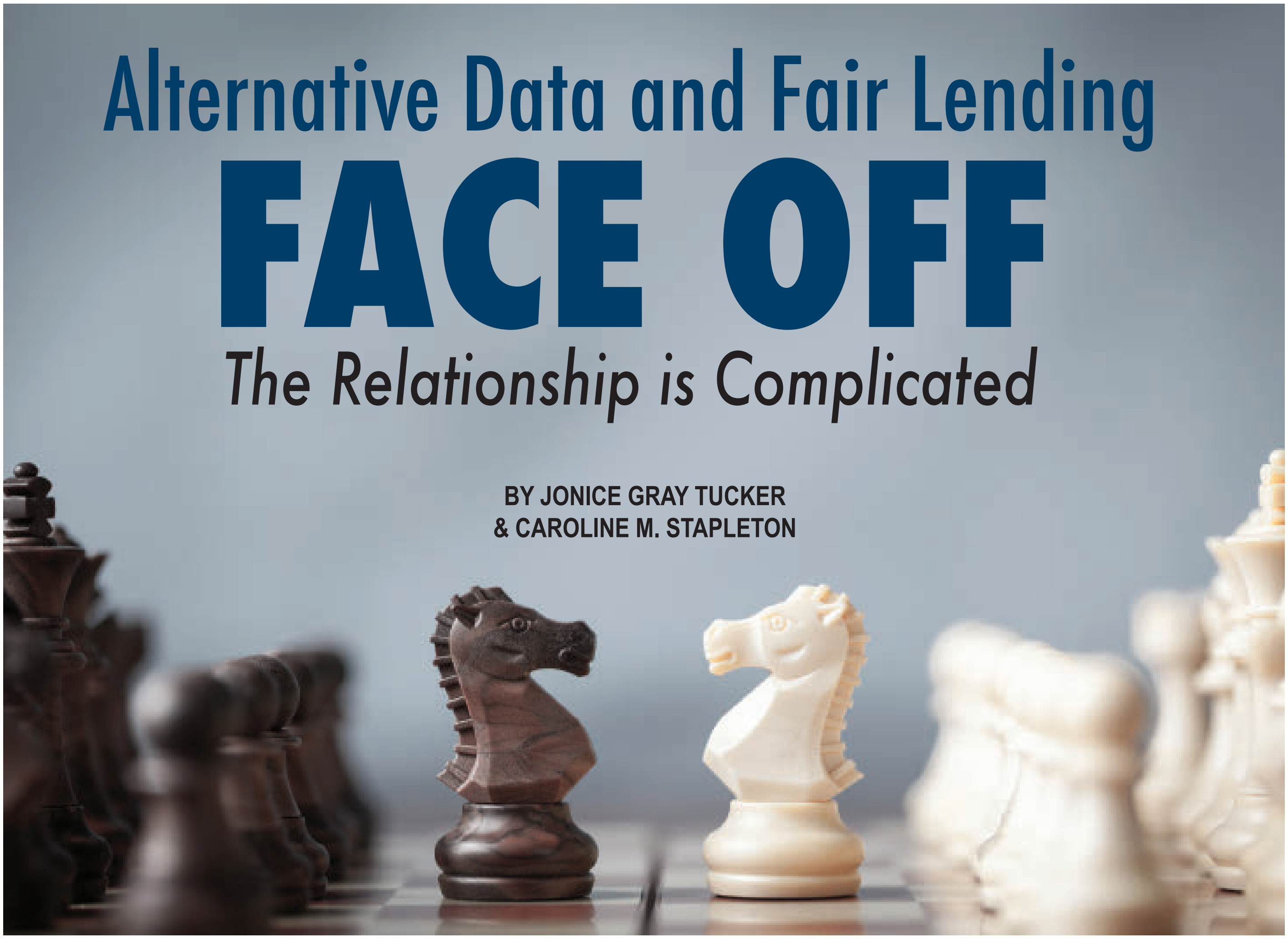
Furthermore, the vast majority of mortgage marketing aimed at consumers happens at the branch and MLO level. When one factors in the speed and reach of social media in particular, keeping on top of marketing and advertising compliance is a full-time endeavor that many lenders are ill-equipped to manage on their own.

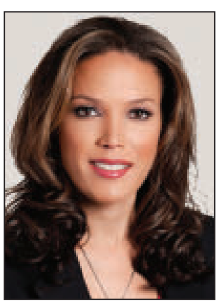
1. Whether it's in the employment contract, MLO compensation agreement or a specific social media/advertising P&P, outline do's and don'ts for advertising requirements along with contractual obligations to which the MLO must adhere.
2. Conduct on-going training and monitoring of social media and advertising, using identified violations as an opportunity to reinforce what's been previously outlined as permissible.
3. Establish an approval review process where LOs can submit unique marketing collateral for approval or leverage existing, pre-approved materials. This can be a daunting task, given that someone can easily create a Facebook, Twitter or LinkedIn account in a matter of minutes, but remember, all a regulator has to do before performing an examination is Google your name, a team name, a D/B/A name, or a MLO name from the comfort of their desk.

What's more, marketing and advertising are two of the many compliance areas covered by MQMR's Monthly Compliance On-Demand Service. For a flat, monthly fee, lenders can access MQMR's internal team of mortgage compliance experts to get answers on any and all compliance questions on an as-needed basis, including guidance on marketing, advertising, website and social media content.

With the need for new business at an all-time high, lenders simply cannot afford not to market themselves, yet the cost of a marketing compliance misstep can easily wipe out hundreds of thousands of dollars in profit via fines. Get the help you need to gain market share while staying on regulators' good side – contact us at MktCompliance@MQMResearch.com to get started.

Also, subscribe to our free bi-weekly mortgage compliance FAQ, which covers a wide range of compliance issues, and stay tuned for our next white paper on "The Seven Deadly Social Media Sins."




Jonice Gray Tucker


Caroline M. Stapleton

Thinking of getting into a relationship with alternative data? You're not alone. Use of "alternative data," a term broadly used to describe consumer information gathered from non-conventional sources, is becoming increasingly attractive to mortgage lenders, their service providers, and even consumers who lack traditional evidence of creditworthiness. In recent years, there has been a dramatic increase in access to large volumes of consumer data, much of which is being mined from digital sources. On a parallel track, technological advances have enabled companies to rely on machine learning to interpret and then use data in sophisticated models, providing a path for more efficiently using such information in business analytics.

In connection with consumer lending, alternative data may present a mechanism for enhancing loan marketing, underwriting, and pricing as well as means for opening credit markets to consumers who may not have qualified for certain financial products or services if alternative data had not been considered. However, as illustrated by the government actions and private litigation that have impacted Facebook and certain other early users of alternative data within high-powered models, use of this information may be accompanied by significant legal and compliance risks, including the possibility of violating anti-discrimination laws and laws prohibiting unfair, deceptive or abusive acts and practices. These risks are pronounced in the financial services industry, as compared to other industries insofar as such companies are regulated by tighter legal structures.

Managing fair and responsible lending risk on this new frontier is anything but straightforward, particularly given that many seemingly neutral data points may, in fact, be proxies for a protected characteristic or membership within a class of consumers who may be especially vulnerable. For this reason, mortgage lenders thinking of leveraging alternative data first should carefully consider the potential implications on fair and responsible lending compliance, and take steps to mitigate the applicable risks. As we discuss below, relationship between lenders and alternative data can be complicated.

ARE REGULATORS OPEN TO RELATIONSHIPS WITH ALTERNATIVE DATA?

The use of alternative data has implications for regulatory compliance under a variety of consumer protection statutes and regulations. These include the Fair Housing Act (FHA), Equal Credit Opportunity Act (ECOA), the prohibitions on unfair, deceptive, and/or abusive acts and practices (UDAAP/UDAP) in the Federal Trade Commission Act (FTC Act) and the Consumer Financial Protection Act (CFPA), and state corollaries to these laws. Specifically, alternative data may trigger risk in connection with compliance with these laws because it is being used to change the way consumer lenders market, underwrite, and price loans, with the potential for unintended discriminatory or unfair impacts on protected, or otherwise vulnerable populations.

The use of alternative data has implications for regulatory compliance under a variety of consumer protection statutes and regulations.

Fortunately, regulators acknowledge that alternative data, when used properly, can benefit consumers, including populations protected by fair and responsible lending laws. In connection with a request for information (RFI) on alternative data in 2017, the Consumer Financial Protection Bureau (CFPB) said that using alternative data could provide access to credit to consumers with insufficient credit histories.[1] According to the CFPB, "[t]his problem disproportionately impacts consumers who are Black or Hispanic, and people who live in low-income neighborhoods."[2] The significant potential benefit of expanded access to credit through the use of alternative data also was recognized in a Government Accountability Office (GAO) report in December 2018.[3]

Simultaneously, however, regulators have raised concerns about the potential for fair lending violations arising from the use of data from non-traditional sources. For example, the 2017 CFPB RFI asked for public input on whether there are "specific challenges or uncertainties that market participants face in complying with ECOA and Regulation B with respect to the use of alternative data or modeling techniques."[4] Similarly, the Board of Governors of the Federal Reserve System (Federal Reserve) issued a newsletter in 2017 that noted the potential for new data to serve as a proxy for a protected characteristic, resulting in a situation where "some data may not appear correlated with race or national origin when used alone but may be highly correlated with prohibited characteristics when evaluated in conjunction with other fields."[5]

Moreover, in a particularly notable recent development, the New York Department of Financial Services NYDFS) weighed in on the risks of using alternative data in life insurance underwriting. The agency issued guidance that could be a potential harbinger of the agency's expectations for lenders. The guidance contains a discussion of issues that should be considered to mitigate potential differential treatment, including ensuring there is "a valid explanation or rationale for the differential treatment of similarly situated applicants" arising from the use of external data sources.[6] The NYDFS also advocates for transparency in consumer disclosures where there has been use of external data sources, noting that the failure to adequately disclosure material elements of an "accelerated or algorithmic underwriting process, and the external data sources upon which it relies" could be an unfair practice. ▻

BAD MARRIAGES CAN LEAD TO GOVERNMENT ACTION AND PRIVATE LITIGATION

On March 28, 2019, the Department of Housing and Urban Development (HUD) filed a formal charge of discrimination against Facebook alleging multiple violations of the FHA.[7] HUD's theory of discrimination is predicated on Facebook's alleged use of user data gathered from its own social media platform to customize advertisements for housing-related services, including ads for mortgage loans. In some instances, this customization was requested by advertisers, while in other instances Facebook's algorithm limited the audience receiving the advertisement without the advertiser's knowledge. HUD alleges that these practices resulted in some advertisements being shown to Facebook users based on their sex and/or other data serving as proxies for protected characteristics, such as a user's location, religious dress, or use of a service animal.[8]

HUD's notice of charges is the latest in a string of similar discrimination allegations arising from Facebook's use of alternative data brought by state actors, advocacy groups, and private litigants.[9] In July 2018, Facebook settled allegations by the Washington Attorney General that the company's advertising platform permitted "ethic affinity targeting" that violated the state's prohibitions on unfair acts and practices and discrimination based on protected class status.[10] The settlement required Facebook to make improvements to its advertising platform, including no longer providing tools that could be used to discriminate based on race, creed, color, national origin, veteran or military status, sexual orientation, or disability status.[11] Similarly, in March 2019, the ACLU and its co-plaintiffs reached a settlement with Facebook requiring it to implement limitations on advertisement targeting options, perform additional reviews of advertisements, and engage in future studies on the potential for unintended biases in Facebook's algorithmic modeling.[12]

The recent Facebook cases are seminal because they bring the intersection of alternative data, modeling, and alleged discrimination in housing to the forefront for the industry.

The recent Facebook cases are seminal for financial institutions because they bring the intersection of alternative data, modeling, and alleged discrimination in housing to the forefront for the financial services industry. Prior matters involving Facebook had focused on alleged discrimination in marketing and employment practices at non-financial institutions, because lenders have been hesitant to use such data for fear it will produce outcomes that violate fair lending laws and regulations. However, as alternative data becomes more ubiquitous in other industries, we can expect that lenders seeking to innovate and expand consumer access may begin incorporating it into their own marketing, underwriting, and pricing strategies. As this transition occurs, financial institutions can expect to see increased regulatory scrutiny, especially where use of alternative data in mortgage and other consumer lending transactions holds the potential to result in unfavorable treatment of, or impact on, consumers protected under the FHA, ECOA, and state anti-discrimination laws and/or vulnerable populations subject to UDAAP protection under the FTC Act, CFPA, and similar state laws.

PREVENTING AN UNHAPPY SEPARATION: A FEW BEST PRACTICES

The advent of our digital society means that alternative data is here to stay. The question mortgage lenders face is how to use it to their advantage without running afoul of fair lending and other consumer protection laws. The GAO report recognized that regulators have yet to provide meaningful official guidance on the use of alternative data in credit transactions,[13] but we offer the following pre-marriage counseling for those seeking a healthy and happy relationship with alternative data:

- Develop clear policies, procedures, and training regarding the use of alternative data, including required protocols for approval of the nature and way in which data is used.

- Involve compliance and legal in the development and use of new data sets and models.
- Understand external data sources, validate integrity, and confirm that a third party did not use prohibited criteria in its creation. Consider in particular whether the data could be a close proxy for membership in a protected class. If so, are there other data points that could be used in lieu of those that may be viewed as proxies?
- Ensure the data has a clear nexus with an applicant's creditworthiness. According to the Federal Reserve, "[g]enerally, the more speculative the nexus with creditworthiness, the higher the fair lending risk."[14]
- Test the data, and the interaction between attributes being run through models to evaluate potential for negative repercussions for members of protected classes or other vulnerable population.[15] If they exist, evaluate the business justification for continuing to use data or a model that generates different outcomes for otherwise similarly-situated applicants.
- Perform initial and ongoing validation of models using alternative data.
- If using of a new source of data, a new type of data, or a new model, consider a pilot before -full launch of the new program or practice.
- Consider whether adverse actions resulting from the use of alternative data should include information about the data used and the source of the information.

While the practices described above can help in this effort, the best defense against a potential fair lending or consumer protection claim is being proactive by implementing compliance measures in advance of a product's launch, and continuing with these measures throughout its lifecycle. This requires comprehensive analysis and application of tried and true compliance management principles modified to mitigate risk on this new frontier. Best wishes for a happy union. MCM

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END NOTES

1 Press Release, "CFPB Explores Impact of Alternative Data on Credit Access for Consumers Who Are Credit Invisible" (Feb. 16, 2017), available at https://www.consumerfinance.gov/about-us/newsroom/cfpb-explores-impact-alternative-data-credit-access-consumers-who-are-credit-invisible/.

2 Id.

3 "Financial Technology: Agencies Should Provide Clarification on Lenders' Use of Alternative Data," GAO-19-111 ("GAO Report"), at *2 (Dec. 2018).

4 Request for Information Regarding Use of Alternative Data and Modeling Techniques in the Credit Process, 82 Fed. Reg. 11183, 11190 (Feb. 21, 2017).

5 Federal Reserve System, Consumer Compliance Outlook ("Federal Reserve Newsletter"), 2d issue (2017).

6 NYDFS Insurance Circular Letter No. 1, "Use of External Consumer Data and Information Sources in Underwriting for Life Insurance" (Jan. 18, 2019).

7 HUD v. Facebook, Inc., FHEO No. 01-18-0323-8 (Mar. 18, 2019) (citing violations of 42 U.S.C. § 3604(a)–(c)).

8 Id., at *4.

9 See e.g. NFHA v. Facebook (alleging that Facebook made it possible for housing advertisers to exclude certain home seekers from seeing their ads on a protected basis); Mobley v. Facebook (alleging that Facebook allowed businesses to target individuals for housing opportunities, among other things, in a manner that discriminates against certain races); Communication Workers of America v. T-Mobile US (claiming that employers, including T-Mobile, Amazon.com, Cox Communications, and Cox Media Group routinely exclude older workers from receiving employment and recruitment ads on Facebook, thereby denying older works job opportunities).

10 In re Facebook, Case No. 18-2-18287-5, at *1–3 (Jul. 24, 2018).

11 Press Release, "AG Ferguson Investigation Leads to Facebook Making Nationwide Changes to Prohibit Discriminatory Advertisements on its Platform" (Jul. 24, 2018), available at https://www.atg.wa.gov/news/news-releases/ag-ferguson-investigation-leads-facebook-making-nationwide-changes-prohibit.

12 Press Release, "Facebook Agrees to Sweeping Reforms to Curb Discriminatory and Targeting Practices" (Mar. 29, 2019), available at https://www.aclu.org/news/facebook-agrees-sweeping-reforms-curb-discriminatory-ad-targeting-practices/

13 GAO Report, at *45–46.

14 Federal Reserve Newsletter.

15 Id.

Thinking About Joining the Non-QM Queue?

Here are Some Compliance Considerations to Keep in Mind

BY COLGATE SELDEN

Colgate Selden

Today, non-QM lending is widely viewed as one of the few growth areas left in the market and one that is attracting more lenders and issuers.

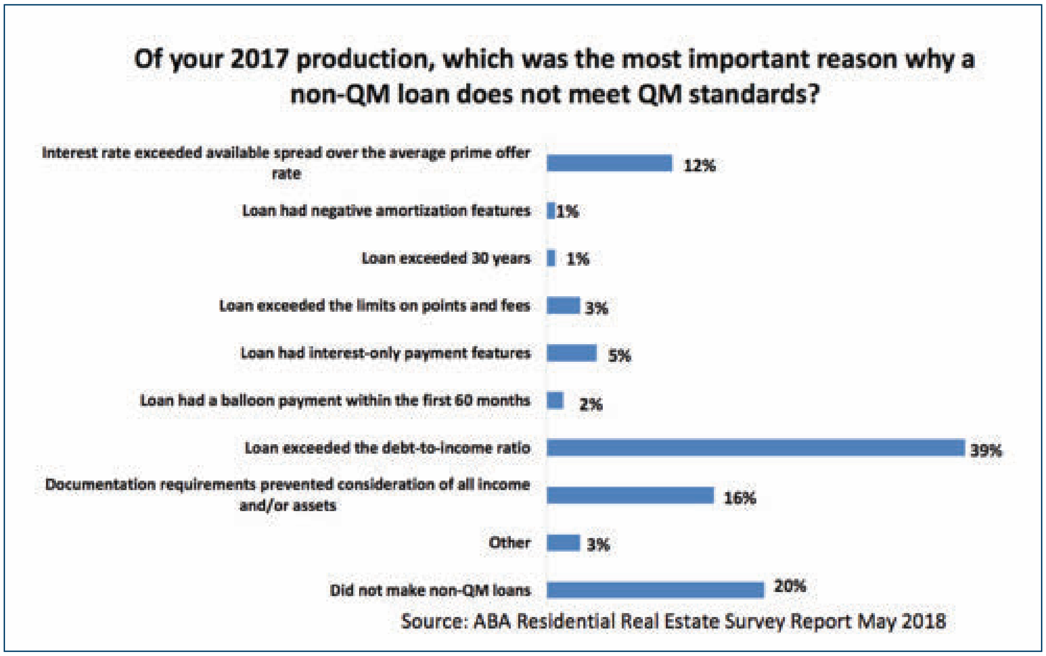
A few years ago, only a handful of intrepid originators, aggregators, investors, and issuers were actively participating in non-QM lending. The rest of the market watched from the sidelines, convinced non-QM lending brought significant potential liability, was hard to learn and easy to get wrong, or was not worth the effort when there was an abundance of refinance business to be done.

Several years of declining volume and intense margin compression on traditional loans, combined with a newly-receptive investor community, are changing the market's perception of non-QM lending.

Today, non-QM lending is widely viewed as one of the few growth areas left in the market and one that is attracting more lenders and issuers. Overall, this is good news for previously underserved market segments: the 16 million self-employed consumers in the U.S., the millions of borrowers who have been repairing their credit since the mortgage crash, and even the aging cohort of baby boomers who are sitting on nearly $30 trillion in assets.

Last year, Nomura estimated non-QM lending volume could grow to more than $100 billion within 10 years. Other observers have since suggested the addressable market for non-QM products could be as high as $200 billon. Increasingly, non-QM securitizations are becoming a growing part of the private-label RMBS market. S&P expects non-QM securitizations to double in 2019 from $10 billion to $20 billion.

Recent changes in banking law have made it easier for mid-size and smaller banks to originate products that used to fall into the non-QM category. And, new investors and different approaches to due diligence are helping banks and originators get more comfortable with non-QM. But, despite the growing acceptance and interest in non-QM, there are challenges inherent in the product, particularly the increased risk of buybacks, due to underwriting defects and real compliance issues that remain.



WHAT MAKES A LOAN NON-QM?

Generally speaking, a first mortgage can be classified as non-QM for several reasons: a debt-to-income (DTI) ratio above 43 percent; an interest only (IO) or balloon structure; rates and fees above three percent; or, the use of alternative documents in its underwriting. Adjacent products, such as expanded credit, asset depletion, and some fix-and-flip loans are usually included in the non-QM category. Non-QM loans, similar to their QM counterparts, must include a determination of the borrower's ability to repay (ATR).

For the past five years, the "GSE patch" (QM safe harbor for loans eligible for purchase by Fannie Mae or Freddie Mac) has allowed lenders to avoid non-QM classifications on high DTI loans and, to date, more than 54 percent of the GSEs' purchases exceed the 43-percent threshold. The patch, however, is an option only while the GSEs remain in conservatorship and is set to expire in 2021, regardless of GSE conservatorship status.

In 2018, the Economic Growth, Regulatory Relief, and Consumer Protection Act changed the non-QM playing field for banks with assets below $10 billion. Now far more mortgages, regardless of compliance with Appendix Q of the ATR rule, DTI and credit characteristics, can be deemed QM loans, if the bank holds them in portfolio.

It's still too early to determine whether this new option makes non-QM lending more attractive to banks, but it certainly gives community banks more permanent leeway in originating products that used to be portfolio staples before the mortgage market downturn and subsequent recession. Similarly, it should help them serve the mortgage needs of high-net worth, retired, and self-employed customers who had been disadvantaged by QM rules. A strong case can be made that broader relationships with these customers put banks in a better position to make credit decisions with alternative documents like checking accounts, credit cards, auto loans, etc.

Prudent bankers that want to take advantage of the new portfolio lending option will most likely want to originate products that could eventually be sold to non-QM issuers. This means staying abreast with the evolving private non-QM market category, its guidelines, and this market's zero-tolerance approach to compliance.

Banks that are used to "portfolio-ing" loans or selling to the GSEs may be surprised by the rigors of the due diligence processes being used by non-QM issuers. Depending upon the asset types, it is very common for non-QM issuers to do due diligence on 100 percent of the loans in a securitization, not just a sample. At a recent industry conference, a ratings agency showed a sample due diligence exceptions report for a non-QM/non-agency private-label deal. The sample pool of 2,581 loans had three open exceptions for property, 89 for credit, and 6,805 for compliance!

While many of these exceptions were eventually cleared, the process was most likely time consuming, expensive, and painful. ▻

COMPLIANCE CONSIDERATIONS

From a compliance standpoint, a non-QM loan is generally subject to the same regulations as a QM loan, including TRID, HOEPA, Fair Lending, and state and local regulations.

Lenders participating in the private secondary market since the TRID rule effective date will most likely have better discipline for preventing TRID errors than their counterparts participating only in the GSE and FHA markets.

Incentives to review and correct errors in the private secondary market are immediate. Loans with material TRID errors can be rejected from the securitization pool, leaving the lender holding a potentially unsalable loan. Or alternatively, the loan is accepted but only with a lender guarantee or a set-aside to mitigate future devaluation from compliance losses. But, even then, only larger lenders with substantial capital and wherewithal in the marketplace are typically permitted by ratings agencies, issuers, or underwriters to use these options.

While the CFPB has promulgated TRID "clean up" rules, which have had the effect of reducing identified TRID errors, lenders entering the non-QM market must still have good controls in place and consistent compliance. TRID disclosure timing and disclosure error correction issues continue to persist, even for current, seasoned, private secondary market participants.

Additionally, there are QM (and non-QM) related ATR issues that have not yet been clarified by the CFPB and could impact loan program underwriting guidelines. Arguably, there are more issues in the QM space than in the non-QM market, given some of the vague income qualification requirements in Appendix Q and the liberal use of GSE underwriting guidelines by some lenders to meet perceived "gaps" in Appendix Q. As a practical matter, loans or loan programs intended to be QM, but with structural defects causing them to not be designated QM, may still comply with the ATR rule, without the safe harbor status.

For non-QM loans, complying with the ATR rule's eight borrower repayment factors is the only concern. ATR rule compliance can be easier to ▻

MCPAOA
MORTGAGE COMPLIANCE PROFESSIONALS
ASSOCIATION OF AMERICA

A LETTER FROM THE PRESIDENT

The Mortgage Compliance Professionals Association of America ("MCPAOA") was founded in August, 2016 to provide a forum for members to enhance their professional skills and keep up with current trends. On January 1, 2019, I took over as the President of the Association following in the steps of one of the founders, Burton Embry. Burton has distinguished himself as a judicious steward of the Association and an invaluable resource and professional in the compliance arena. I would be remiss if I did not thank him for his contribution to the Association, representing our profession at numerous trade conferences and for his personal impact on my compliance career. When I thought I was alone in some of the daily challenges in this realm, Burton quickly assured me that I am not alone and talked me off the proverbial ledge.

Most of you know me by the name "Flea". I inherited that moniker over 30 years ago when the board of the bank I worked for thought I was annoying; always bugging them to fix things, CRA responsibilities, new laws and yes, TILA is here to stay. I've been a Compliance officer for 40 years. I prefer to state I am "seasoned".

I hope you will join the organization (it's free!) www.mcpaoa.org

JOIN US for an informative conference call on May 22, 2019. The call will touch on recent activities of a very large lead generator immediately followed by an insightful presentation on the Temporary (aka Transitional) licensing effective November 24, 2019. Haydn Richards, Jr., Partner with the law firm of Bradley Arant Boult Cummings, LLP, will lead the discussion. Haydn will discuss what this new law means for the mortgage industry for registered loan originators and licensed loan originations and how the NMLS will accommodate this new status. Watch for an email announcement soon. Make sure you've joined the organization to receive the announcement. The session is FREE.

We're also planning our next member conference. More details will follow soon. Make sure you are on the mailing list to receive information. We have a lot of great topics to discuss. Plus we will be scheduling additional quarterly conference calls. Call or send me an email on the topics keeping you awake at night so we can track down the SME for future calls.

I look forward to talking, working with and generally, lending a listening ear to anyone who needs it.

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prove as a de facto matter for older non-QM loan programs with large data sets, which establish low historical default rates, so long as the lender considers and documents the eight ATR factors.

However, the ATR rule also has gray areas when it comes to non-QM loans. For example, how should a lender consider repayment factor 7 (vii) for the "consumer's monthly debt-to-income ratio or residual income" for an asset depletion loan where there is no income? The CFPB specifically contemplated certain non-dwelling asset-based loans when issuing the ATR rule but factor 7 (vii) is in direct conflict with Factor 1 (i). Factor 1 (i) of the rule provides that the creditor must consider "the consumer's current or reasonably expected income or assets, other than the value of the dwelling, including any real property attached to the dwelling, that secures the loan." If the loan is underwritten solely based on assets, there is less certainty for how to comply with factor 7 (vii).

If designed properly, asset depletion loans have strong repayment track records, especially for retirees with large asset holdings but minimal income derived from those assets or other sources of income; for instance, large quantities of treasury bond holdings without enough total yield to support DTI ratios. Borrowers plan to sell off assets on an "as needed" basis at irregular intervals to support monthly loan payments. Asset depletion loan programs often require that borrowers hold enough assets to support at least five years or more of monthly payments, depending on loan type and features. The proceeds from these types of sporadic asset sales often cannot be characterized as income. In some cases, the borrower's monthly income could be $0 with $0 residual income. In others, the borrower has an insufficient amount of monthly fixed government program income to support loan payments. In either situation, however, the borrower clearly has the ability to repay as a de facto matter given the amount and liquidity of the assets.

NEW SOLUTIONS TO BUILD CONFIDENCE AND REDUCE DEFECTS

The first generation of non-QM loans were, for the most part, super prime and fully documented. They tended to fall into the non-QM category due to their size, DTI ratio, or structure: balloons, IOs, etc. But, the products are now rapidly evolving as the industry gets more comfortable with alternative documentation (bank statement), expanded credit and rental loans. The issuers are also changing. No longer is non-QM the province of specialty aggregators, REITS and private equity players; now, insurance companies, asset managers, and major money center banks are bringing new private-label offerings, backed by non-QM assets, to market.

To help keep pace with new product options and the ever-changing underwriting guidelines, some originators, including non-depositories, banks and credit unions, are outsourcing non-QM underwriting to recognized and experienced third-party fulfillment providers for loans to be sold on the secondary market. This approach can provide comfort for the originator and the investor. Both parties are subject to TILA liability and buyback demands. By using these fulfillment providers, some less-experienced or smaller originators may find it easier to obtain approval from investors and warehouse lenders for participation in non-QM programs.

Investors, including the GSEs, are also moving loan reviews and due diligence closer to the point of sale. In the non-QM space, several active investors are using third-party underwriting fulfillment service providers to conduct pre-loan sale underwriting reviews on the non-QM loans they buy. The process is used to identify and clear conditions. Recently, larger correspondent and wholesale lenders have also begun to do bank statement income calculations for their correspondents and brokers. These initiatives, and others like them, are giving both originators and investors greater confidence to originate and purchase non-QM loans. These efforts also help to reduce the number of scratch-and-dent non-QM loans in the market.

Since the QM rule went live in 2014, the industry has been waiting for the non-QM market to fully develop. 2019 is shaping up to be the year it does. MCM

Colgate Selden is the Managing Director and Head of Regulation and Compliance for Promontory MortgagePath.

THOUGHT LEADER

A Case Study: Implementing SunriseRecon for Strategic Risk Management

Christian van Dijk, Founder

To overcome the challenges and risks of an Excel-based custodial reconciliation process, a leading regional bank recently turned to Integra Solutions. Implementing our SunriseRecon platform has increased efficiency by more than 69% and reduced the risk of write-offs and audit findings.

The Challenge

The bank's former custodial reconciliation process was mostly manual, with numerous human touchpoints and few built-in controls. The process presented multiple issues of open concern to internal and external audit partners:

- **Errors and inefficiencies:** Data was manually collected and entered, requiring many FTE hours and increasing the risk of errors.
- **Lack of visibility and controls:** Managers had no way to track analysts' progress, and there was no mechanism to "lock" submitted reconciliations to prevent further changes.
- **Limited repeatability and scalability:** Process variations across loan types made it difficult to train new FTE's and complicated the conversion of acquired loans.

The Opportunity

The bank saw the adoption of a new custodial reconciliation process as an opportunity to increase efficiency and reduce risk, with three potential areas for significant improvement:

- **Automation:** By automating data collection and data input, the bank could eliminate errors and reduce FTE hours required for multiple aspects of the process.
- **Outage resolution:** A more efficient process would give analysts more time to research and resolve outages, and to perform proactive activities like trend analysis.
- **Audit readiness:** Introducing built-in controls would streamline audit preparation, decreasing the risk of audit findings and reducing unnecessary write-offs.

The Results

Implementing SunriseRecon represented a complete transformation of a key business function and resulted in dramatic efficiency improvements across the custodial reconciliation process:

- 69% reduction in FTE hours required for the entire custodial reconciliation process
- 82% decrease in time needed for data gathering and import
- 60% reduction in time required for researching and resolving outages
- 62% decrease in hours needed to conduct quality control on a submitted reconciliation,
- 64% reduction in time required to train a new FTE

SunriseRecon automated most aspects of what had been a mostly manual process, making the process much more efficient and accurate. The application's real-time dashboards and streamlined reporting have also made it easy to proactively address potential issues and understand previously hidden operational constraints. And now that the custodial reconciliation process has been standardized across loan types, the bank is poised to grow through loan acquisition.

To learn more about how SunriseRecon can help your business overcome the challenges of custodial reconciliation, please contact Christian van Dijk, founder of Integra Solutions, at christian.vandijk@integradelivers.com or visit online at www.integradelivers.com/case-studies.

Rise of AI in Regulatory Compliance

BY CHITRA DORAI

Chitra Dorai

There is widespread confusion about exactly what AI can and cannot do.

The exciting ABCs of technology in this decade have been AI (Artificial Intelligence), Blockchain, and Cloud! AI, in particular, is igniting our imagination in terms of all the things artificially intelligent computer systems can do on our behalf, from engaging with customers and employees, delivering new insights from data analysis to automating business processes. Much has been written about the promise of AI for solving problems ranging from mundane to the profound to reimagining our work and lives.

Before describing how AI is being used to transform regulatory compliance, I like to start with a question. "What's similar between Einstein's Theory of Relativity and AI?"

The simple answer is that just like the Theory of Relativity, very few people really understand AI while most claim to! Therefore, a lot has been written and claimed about the magic of AI, the panacea for all the problems and most of it ought to be debunked. There is widespread confusion about exactly what AI can and cannot do.

WHAT IS REALLY AI?

Having spent more than three decades in AI Research and Development, there is now sufficient evidence to note that we're indeed at an inflection point of AI adoption due to a number of drivers: explosive digital data growth that makes it impossible for humans to make sense of it all with manual analysis alone; maturity of machine learning and AI algorithms (e.g., deep learning) that can analyze unstructured digital data such as text, image, and speech at scale and with accuracies comparable to human levels; and, advances in computational power (GPUs) needed to train and build data-intensive intelligent solutions.

Before we delve into how AI adoption can transform regulatory compliance, especially in the mortgage industry where lenders and servicers alike look to technology to ease their regulatory burden and reduce costs, we need to start with a basic understanding of what Machine Learning (ML) and AI can do, in order to understand their potential and how they may be used in simplifying and automating human work in risk and compliance.

MACHINE LEARNING (ML)

ML refers to a collection of statistical data analysis techniques for pattern recognition that will allow you to analyze all kinds of data, including quantitative and unstructured data such as text, speech recordings, and images to make data-driven predictions and discovery.

A well-known example of an ML-based system is face recognition. One that allows Facebook to help tag photographs that are uploaded on its site. Another example is the use of ML in a self-driving car to sense and decipher what is on the road, recognize lane markings, stop signs, etc.

Machine learning is primarily about probabilistic recognition and prediction of patterns based on past historical data.

ARTIFICIAL INTELLIGENCE (AI)

Machine learning is a subset of AI. It is just not enough to recognize patterns of what's present in data. You must take actions also based on recognition of patterns. This means that one must reason what to do, schedule, and plan what happens next.

For example, a self-driving car not only recognizes that there are markings on the road for pedestrians as it drives itself on the road, but also recognizes what or who is on the road at the crossing. Based on that, it must reason about stopping or continuing on the road, plan what needs to happen to make the stop if it decides to, and act to stop before reaching the crossing.

AI includes techniques such as knowledge representation, reasoning, planning, and scheduling to support these aspects of intelligence needed for carrying out advanced tasks.

WHAT CAN AI SYSTEMS DO?

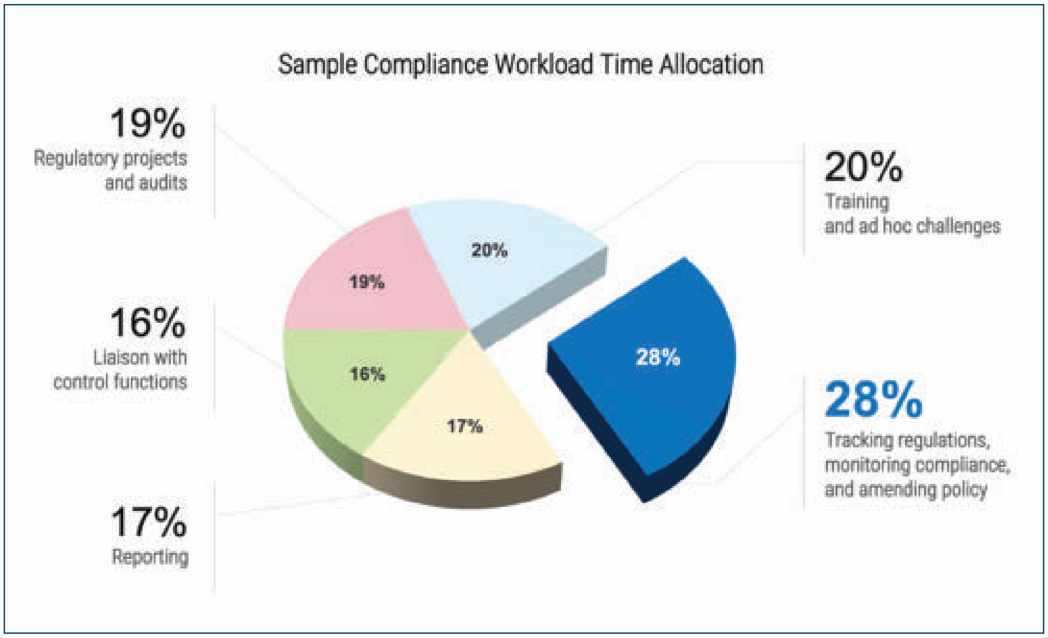
AI systems using ML techniques and knowledge representation, reasoning, etc., can process all kinds of data, understand what is in the data and having understood what is present in the data, they can reason and decide what to do with the observed patterns. For the mortgage industry, this means AI can help analyze, validate, and interpret volumes of rich data available ranging from customer data, loan documents, and appraisal notes to customer call recordings and regulatory publications; thus, transforming how work is performed in the mortgage industry from customer service, loan processing and underwriting to servicing, compliance monitoring and risk management. This also means that AI may help to automate tasks requiring analysis and insights, tasks that are beyond repetitive, 'swivel-chair' work which has been automated typically with desktop automation or Robotic process automation (RPA) technologies.

AI systems can enable ordinary people to be extraordinary. With the support of AI systems, all of us can now perform at the highest level!

RISK AND COMPLIANCE TRANSFORMED

Compliance and risk management in banking, including mortgage lending, has largely relied on people until now. Continued increase in regulatory reporting requirements are driving up risk and compliance activities in organizations, with global spending on compliance estimated to be about $270 billion a year for the banking industry. It is also leading to an unsustainable level of demand for compliance professionals hired to implement and monitor ongoing compliance. It is time for the industry to step away from adding more and more compliance staff to "check-the checkers" and adopt a more modern, technology-led approach to tackle manual processes, rising costs, and regulatory burden.

Typical activities in managing regulatory compliance are about tracking high volume of regulatory change announced by oversight agencies, determining scope and materiality of published changes, identifying impacted policies, procedures, and controls within the organization, creating a holistic view of compliance requirements, and training the staff. The image below shows an informal analysis of how the ▻



compliance workload is distributed across these activities in a typical mortgage servicing unit. The reality is that limited resources, such as lawyers and risk professionals spend about 28 percent of their time engaged in "highly complex," routine tasks, such as tracking regulations in terms of what changed from the previous year or from the last release, interpreting these changes, and amending policies inside the organization, and monitoring whether the operations are compliant with these changed regulations!

How do we reduce the thousands of hours every year of tedious yet high-level manual labor and decrease costs, yet maintain high levels of regulatory compliance?

AI TO THE RESCUE

The power of natural language processing (NLP) and ML capabilities of AI are beginning to play a significant role in streamlining many manual activities in the regulatory compliance space. We have AI systems that can:

- Read through thousands of documents - regulatory policy releases, guidelines, and updates provided by different oversight agencies;
- Track updates and amendments to current regulations;
- Provide a knowledge repository with search and query-answering capabilities; and
- Map clauses of regulations to internal controls, which can be used for reporting, gap identification, and policy management.

To do this, the AI system employs advanced document parsing and NLP techniques to extract clauses, reference entities and intent from policies to extract, and rank obligations that need to be met. ML techniques are then used to establish semantic similarity patterns between obligations before and now, and to continuously learn how those obligations have been modified, dropped, etc.

AI systems are also able to discover new obligations that have appeared in the document! So, now you have an AI system that crawls through thousands of pages of policy manuals and is able to discover new policy verbiage and changes in the existing policies in a matter of minutes.

With AI, compliance officers can now monitor regulatory changes that impact their businesses faster. These AI-enabled systems can aggregate key changes in regulations for human review; thus, expediting the compliance document tracking and monitoring process. This reduces the human effort allocated to reading and interpreting huge volumes of documents and simplifies compliance review given the complexity of dealing with different jurisdictions, products, and oversight institutions.

BEYOND NLP IN RISK AND COMPLIANCE

The NLP capabilities of AI are well suited to analyzing regulatory documents and the potential is even more. Instead of doing data validation and QC with a sampled loan population, AI systems can automate and support QC reviews of every single loan in the set. They can also be applied to monitoring internal employee conduct and communication to clients, areas that have emerged as hot button issues recently.

Predictive modeling and scenario analysis are other significant AI capabilities that have emerged to provide better decision support in credit risk management and profitability forecasting in mortgage lending. Speech recognition and text analytics are further examples of advanced AI capabilities that are beginning to be used in the mortgage industry to analyze huge volumes of conversations from call recordings, chats, emails, and loan notes; thus, enhancing call quality assurance and detection of unusual customer and employee behavior for proactive mitigation of behavioral risk.

AI ADOPTION IN MORTGAGE LENDING

While the banking industry has moved fast to adopt many of the modern advances in AI, the mortgage industry must pick up its pace of embracing AI to take the strain out of managing its ever-increasing burden of regulatory obligations. Keeping in mind that AI is not a "silver bullet," it is still important for the mortgage industry to anticipate the impact of AI technology on modernizing how the business is done and to stave of the risk of being left behind in today's fintech era.

A successful way forward for a mortgage company is to plan for a well-thought out data analytics and AI program underlined by a careful, incremental approach and internal policy and guidelines to harness greater value out of the company data with responsible adoption of AI.

MCM

Dr Chitra Dorai is the Founder of Atasii.com, an AI-First Company assuring Accountability, Responsibility, and Transparency. She can be reached at dorai@atasii.com.

The Looming Threats From Today's "Improved" Mortgage Manufacturing Process

BY TOBIAS PETER

Tobias Peter

This singular focus on the underwriting process and risky product types ignores the looming threats for the industry.

For a number of years, the mortgage underwriting industry has touted both substantial improvements in the mortgage manufacturing process and the elimination of many risky product types, such as interest only, negative amortization, or balloons. While the industry believes that these changes will lastingly improve loan performance, this singular focus on the underwriting process and risky product types ignores the looming threats for the industry that come with the high risk associated with many plain vanilla loans today.

Understandably, much of the industry is not particularly focused on these lending outcomes because most of what is originated today receives the government's stamp of approval as a Qualified Mortgage (QM). And while today's low default rates may give the impression that risk is more than adequately managed, default rates are only low because of the almost seven year-long house price boom that offers troubled borrowers an escape route through refinancing or selling their home. However, when this housing cycle turns, as it eventually will, it will expose the subprime risks and unsustainable home price appreciation that have been building in the system.

Despite the absence of risky product features and an improved manufacturing process, much of what is being produced today are still high-risk, subprime-like loans. Low or no down payments, debt-to-income ratio (DTI) above 43 percent, or a credit score below 660 are common as documented by AEI's National Mortgage Risk Index (NMRI), which covers over 99 percent of agency mortgages. Often times, these risky product features are layered on top of each other in the same loan, which make them even more risky, especially when combined with a slowly amortizing 30-year loan term. According to the NMRI, in December 2018, 42 percent of all agency purchase loans were high risk. This is up from 36 percent in December 2012.

The increase in risk has been driven by misguided government housing policies: Fannie Mae and Freddie Mac (the GSEs) were allowed by their regulator, the Federal Housing Finance Agency, to again originate mortgages with a 97 percent combined loan-to-value ratio (CLTV), which have the highest likelihood of default under stress.[1] The Consumer Financial Protection Bureau (CFPB) announced the QM "Patch" in January 2013, which allowed the GSEs and the Ginnie Mae agencies to exceed the 43 percent QM DTI ratio limit.

The worst offender on risk by far is the Federal Housing Administration (FHA) as the NMRI shows. In December 2018, 60 percent of the purchase loans it insured had a DTI ratio in excess of 43 percent (it allows up to 57 percent) and an effective down payment of 98.2 percent. Virtually all FHA loans had slowly amortizing 30-year loan terms. Their median credit score was 663. To make matters worse, often times, FHA's mortgages includes down payment assistance and a seller concession raising the CLTV even further. The NMRI indicates that almost 30 percent of FHA borrowers would be expected to default under severe stress and this number is climbing every month.

But it is not just the FHA's process that manufactures risky loans. Fannie Mae, in order to meet its affordable housing goals, is increasingly competing with FHA for risky loans. While Freddie has so far been watching from the sidelines, it coincidentally missed its affordable housing goals in 2017. This shortcoming will only create more pressure for Freddie to join the rumble. If this sounds familiar, it should, because it reeks of a repeat of the 1990s and 2000s, when these three entities were engaged in a similar battle for subprime loans.

What made matters worse was that federal entities did not coordinate their policies. As the QM Patch was announced, the Federal Reserve started its third round of Quantitative Easing (QE3), which pumped massive amounts of money into the economy through purchases of mortgage backed securities. Around that time, the housing market also switched from favoring buyers to favoring sellers, in part because of the Fed's stimulus. During a seller's market, when demand outstrips supply, adding yet more demand by either bringing new borrowers into the market, equipping existing borrowers with more money to spend, or both, without changing supply will result in higher house prices. That is basic economics.

Because of continuing monetary easing and looser lending standards, today we find ourselves in yet another rip-roaring housing boom almost seven years in the making. This boom has occurred despite an improved loan manufacturing process and the elimination of risky product features. While it is true that overall housing risk is currently nowhere near the level that it was during most of the 2000s, inflation-adjusted house prices are near the level they were in 2006. Furthermore, the rate of house price appreciation during the first six years of the current boom has matched the rate of house price appreciation during the same first six years of the last boom. This is especially troubling, since we have learned the hard way that what goes up, must come down, especially when the up is inflated by misguided lending practices.

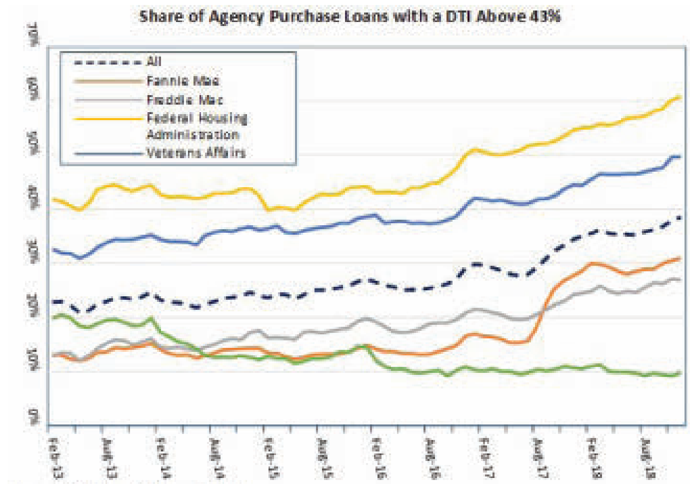
While some may argue that the level of mortgage risk is still manageable, the issue is that this risk is heavily concentrated geographically. AEI data show that lower priced, entry-level neighborhoods with high concentrations of lower-income and often minority buyers are exhibiting the highest risk levels, the tightest seller's markets, and therefore the fastest rise in house prices.[2] On the other hand, move-up neighborhoods with relatively safe lending and somewhat more supply have experienced more moderate house price increases. Coincidence? I don't think so.

When the housing cycle eventually turns, borrowers that entered the market late, and therefore took on the highest debt burdens, will be the first to default. These defaults will be heavily concentrated in neighborhoods with the greatest levels of housing risk. For lenders and guarantors heavily exposed to such borrowers and neighborhoods, the servicing costs and loan losses could be catastrophic – especially the longer the current boom continues.

And while recently many pundits have proclaimed the end of the current housing boom, this was premature. With the spring buying season in swing now, we are already seeing a pick-up in house price appreciation, especially for entry-level homes, which was to be expected. On the demand side, mortgages rates have fallen back below 4.50 percent and markets expect a more cautious Federal Reserve due to global economic headwinds and lower than expected inflation. At the same time, government agencies continue to provide more leverage month after month, especially for first-time buyers. On the supply side, data from Zillow show that despite some loosening, inventories remain very tight, mostly for entry-level buyers. Absent any significant pick-up in new construction activity, the current seller's market will likely continue. It is therefore entirely plausible that for the next year or two, the current housing boom—and the increase in risk—will continue.

To prevent major harm in the future, the government needs to take immediate action. The most obvious target is DTI ratios. According to the NMRI, Ttoday, almost 40 percent of agency purchase mortgages exceed the 43 percent QM limit. Since DTIs place a natural constraint on the amount borrowers can borrow, they act as friction on house price appreciation during periods when house prices rise faster than incomes. Therefore, the CFPB should immediately announce that the GSE QM Patch will be allowed to lapse in 2021 as scheduled. FHA should simultaneously lower its DTI limit to 50 percent.

This should be welcome news for the industry. Such a policy will create a more stable housing market by reducing lending risk and slowing the unsustainable rate of house price increases. Importantly, the downside will be smaller than expected. A lower DTI limit will not eliminate a large share of potential buyers from the market. Rather, it will force these home buyers to make trade-offs, just like households make trade-



Source: AEI National Mortgage Risk Index

offs in the grocery store. When steak becomes too expensive, instead of not eating, shoppers substitute beef for steak. Similarly, most prospective home buyers will continue to purchase homes, albeit at a slightly lower price or with a slightly higher down payment. Only a smaller fraction will continue to rent or stay put in their current home.

Government agencies have created a machinery that underwrites high risk mortgages while promoting unsustainable house price booms. The potential downfalls of such policies—as we have seen a decade ago—are simply too great for the industry to simply go along with them. While the industry has, and continues to work hard to bring the mortgage manufacturing process into the 21st century, it should also pay close attention to the quality of the lending—namely plain vanilla loan specifications such as DTIs, CLTV, loan terms, or credit scores. MCM

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END NOTES

1 See for example statement of Melvin L. Watt Director, FHFA Before the U.S. House of Representatives Committee on Financial Services on 1/27/2015 (https://www.fhfa.gov/Media/PublicAffairs/Pages/Statement-of-Melvin-L-Watt-Director-FHFA-Before-the-US-House-of-Representatives-Committee-on-Financial-Services-1272015.aspx)

2 See for example slides 16 or 22 in AEI's National Housing Market Indicators release for Q2 2018 (https://www.aei.org/publication/national-housing-market-indicators-release-for-q2-2018/)

Combating Margin Compression Through Productive Strategic Relationships

MLinc Solutions

A better way to work

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The rather dramatic decrease in lender profit margins over the past year and a half can be attributed to a variety of industry trends and market conditions occurring simultaneously. We will offer some countermeasures that can help stem the tide. More specifically, we will explore how properly constructed strategic relationships can improve overall productivity with positive short term and longer term profitability impact.

A Confluence of Factors Has Negatively Influenced Margins: A lower level of housing inventory available for sale, home affordability, interest rate volatility and homebuyer qualification issues have all contributed to a decrease in home sales and mortgage demand. Fierce competition for fewer mortgage origination opportunities has resulted in aggressive pricing and less revenue from the secondary market. Stuck with too much fixed cost and lower volumes, many lenders have struggled to remain profitable. As a result, some have left the industry while others have been acquired or restructured in a way that is removing excess mortgage origination capacity.

The Benefit of Strategic Relationships: All strategic relationships and services agreements with potential business sources should be a catalyst for collaborating to create a more efficient and compliant process, more timely closings and a better customer experience. In so doing, a lender can differentiate from other providers, brand who they are and what they do in the industry, and compete for and win more purchase business. Success with this approach can then be marketed to other potential business sources, which can drive even more volume.

Now, let's look more closely at strategies for combating margin compression for the most popular types of strategic relationships and agreements.

Affiliated Business Arrangement ("ABA"): While a mortgage ABA entity is more time-consuming to establish, the ABA has the distinct advantage of driving more origination volume. Not only does the business source ABA partner have a vested interest in the profitability of the enterprise, but the partner may also tie normal sales incentives to the use of the mortgage ABA entity. And, with the sales incentive, the mortgage ABA entity pricing can be competitive, but does not need to be under the market, to generate desired volume levels. The mortgage ABA entity should staff necessary origination functions internally, but can do so at a level of fixed cost appropriate for a minimum expected monthly volume. Turning some fixed cost into a variable, volume driven expense can help an entity better manage cost per loan. There are now very cost-effective, offshore alternatives for outsourcing technical origination, administrative and compliance tasks paired with onshore communication for optimal customer service. In addition, loan originator commissions can be set at lower, consistent "in-house business" rates, to account for the benefits to the loan originator inherent to an ABA structure.

From the standpoint of the lender ABA partner, it also becomes more productive through the funding or purchase of mortgage ABA entity loans, at appropriate levels. And the Lender ABA partner should offset internal costs by properly charging the mortgage ABA entity for any services rendered on its behalf, using a fully-costed versus incremental cost approach.

Marketing or Advertising Services Agreement ("MSA" or "ASA") and / or Office Sublease / Desk Rental: An MSA, ASA and / or Office Sublease / Desk Rental can drive volume, as well, from a better, differentiated process resulting from effective collaboration and convenience. A lender purchasing the services from the potential business source may also be able to use "in-house" loan originators at consistent, lower commission rates to handle consumer leads generated from an MSA or ASA web site. Lenders and other settlement providers can certainly improve cost structure and better manage downturns in volume by converting some fixed cost to variable expense through outsourcing, as mentioned earlier. Finally, an MSA or ASA can be one of the most cost-effective ways for a provider to advertise its services, branding itself in a real estate environment that is fertile with potential customers predisposed to need the services. And, because of regulatory pressures, participants are, in most cases, setting advertising fees below fair market value.

Summary: Properly established strategic relationships can offer a better cost structure and process for differentiation, branding, driving volume and improving overall profitability.

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MORTGAGE Servicing Compliance

KEEPING THE PACE

A Servicer's Four Biggest Takeaways from the FHA's March 2019 Update to HB 4000.1

BY TAYLOR HILDENBRAND


Taylor Hildenbrand

Spring in Oklahoma brings many exciting things. Aside from tornadoes, freak hail storms, and bipolar weather patterns, spring brings all the runners out from their winter hiding places and out onto the sidewalks and park trails en masse. And as any runner could tell you, keeping up with "last year's pace" is usually the goal.

The FHA did something similar by issuing an update to HB 4000.1 on March 27, 2019. The primary objective was to incorporate the Mortgagee Letters (MLs) issued since December 2016, the last release of 4000.1, which, of course, includes the now-infamous PACE (Property Assessed Clean Energy) Program announcements (ML 17-06 and 17-18).

Aside from just keeping "PACE" with the 2017 and 2018 policy updates, the FHA included many other updates (i.e. changes) with significant impacts to FHA business partners. Given that these updates span the spectrum of the mortgage industry and are buried across 63+ sections and 1,031 pages, a servicing-specific summary seems appropriate. This article will race through the high points to kickstart the flurry of change implementation projects that are sure to follow given that all changes are effective immediately. Note: Content from prior MLs is effective as previously announced in the corresponding Letter.

WHAT'S NEW FOR SERVICERS IN THE LATEST VERSION OF 4000.1?

Aside from the normal ML inclusion, revisions to loss mitigation evaluations, claims' required documents and calculations, and assumption processing guidelines were announced. Other policy areas were left virtually untouched.

1. PACE REQUIREMENTS ADDED; LOAN MODIFICATION REMOVED.

All requirements in ML 17-06 are now included in-line with all other formal FHA policies. So, technically, this isn't "new." While HUD did reverse course 11 months after the release of ML 17-06, HUD never changed its mind about the servicing requirements for PACE, only that FHA would no longer endorse cases with PACE obligations starting January 2018 (ML 17-18). PACE-related requirements touch nearly all aspects of servicing, from payment application, PFS/ DIL/ CWCOT appraisals, and the Foreclosure Management Review process. Therefore, the line-level updates into 4000.1 (as denoted by the FHA in yellow highlights) are widespread and worth another look.

FHA's beloved "Loan Modification" Loss Mitigation Option is not just extinct; it's been removed from the fossil record. All mentions of this defunct workout tool have been deleted and subsequent sections have been renumbered.

2. LOSS MITIGATION GUIDANCE RE: FINANCIAL REVIEW, RESTRICTED PARTICIPATION, AND SIGNED AGREEMENTS HAVE A STRONGER BITE.

There's quite a bit of movement in this section, primarily because the FHA finally removed all mention of their traditional modification and included everything PACE-related. Aside from those "spring cleaning" exercises, the FHA made serious updates to common processes within loss mitigation. Here goes:

- **Added a step to the Evaluation of the Borrower's Financial Condition:** Servicers must now review and validate (as in "perform it and document") the borrower's financial information to determine there is no deliberate manufacturing or misrepresentation of their financial information or of their qualifying status. III.A.2.i.iii(A)(1)
- **Stronger guidance on Restricted Participation:** The FHA's not playing. You really do have to check against these criteria and retain proof prior to allowing the borrower(s) to participate in HUD's Loss Mitigation Program. There are still blanket requirements and option-specific requirements, but both have changed. III.A.2.j.ii(C)(1)
  - o FHA-HAMP
    - CAIVRS: GSA's SAM exclusion list has been replaced by CAIVRS as the required list for purposes of FHA-HAMP.
    - Unresolved delinquent Federal Debt: If the borrower has any delinquent federal non-tax debt, they're not eligible for FHA-HAMP. FHA's Origination guidance (II. A. 1. B. ii. (A) (10)) must be followed for all FHA-HAMP evaluations. The exclusion doesn't apply to the borrower's mortgage associated with the loss mitigation attempt.
  - o Program-wide (applies to all options)
    - Ownership in other FHA-insured property: There must be no ownership in other FHA-insured property, unless subject to an exception, to consider the borrower eligible. While not "new," the guideline now has clear, prominent placement.
    - Previous loan with a paid FHA Claim: No borrower can have previously been a borrower on another FHA loan where a Claim had been paid, unless the Claim was paid three years ago or more from the date of the evaluation. Certain conditions apply. ▻

- **Strict Enforcement of FHA-HAMP default status:** Servicers must ensure the loan is at least three payments down (61 days past due) at the time the modification is executed. If this doesn't happen, you can't file an incentive claim either. III.A.2.k.v(B)(1)
- **Strong language on Signed Agreements.** You must receive a signed formal forbearance agreement or TPP. The counter-signed document must be in the Claims Review File. While this isn't "new," any "repayment/ forbearance" plan greater than three months must include signatures from both parties. III.A.2.k.ii(B)

Other noteworthy changes, include:

- **Closing the loophole of "may" vs. "must" and "are" vs. "refer to" for forbearance plans.** The FHA has officially ended the quasi-debate on the optional nature of forbearance plans due to them not being incentivized. Forbearance plans are a required step in the waterfall evaluation process and an "informal/formal forbearance" by any other name is still a forbearance. III.A.2.k.ii(B)
- **Partial Claim funds can't be used to bring the new payment below the target.** Technically, this isn't new. However, it seems too many servicers have been incorrectly applying the Waterfall and this clarification is now in the Decision Point table itself. No portion of the Partial Claim funds can be used to bring the post-modified payment below what you calculated your target payment to be. This is the FHA's strongest attempt yet to enforce a long lineage of poor interpretation that took the maximum allowable partial claim amount to find the resulting PITI payment, even if it was below the "target." Always follow the Waterfall. III. A. 2. j. iii.

3. CLAIMS' REQUIRED DOCUMENT LIST IS BEEFED UP ALONG WITH CERTAIN CALCULATION CLARIFICATIONS.

The FHA has significantly updated its list of required documents for a Claims Review File (i.e. "here is the list of documents HUD expect during a claims review"). The FHA has also gone into extensive detail about how to calculate timelines, debenture interest, and other fee recovery given certain scenarios. These are very helpful clarifications to some long-lingering confusion in the claim filing protocol where one or more foreclosure timelines are missed. These clarifications may hold some financial impact and all of the FHA's yellow highlights should be thoughtfully reviewed.

- A total of 16 new documents required in the Claims Review File. IV.A.1.c.i
- New cutoff date for claiming interest on escrow advances if you missed FLD or RDT. If missed, you can only claim up to the date of the missed timeline, not the date the claim was filed, which in some cases can be a LONG time. IV.A.2.a.ii(C)(2)(a)
- Attorney fees capped to 75 percent of maximum allowable if, after first legal is filed, borrower completed a DIL, PFS, or a bankruptcy petition was filed. IV.A.2.a.ii(K)(1)(a)
- Timeframe for Debenture interest calculation on Parts C, D, and E is now much clearer for when timelines are missed. IV.A.2.a.i(A)(2)(b)(ii)
- Timeframe for debenture interest calculation for failed SFB plans revised. IV.A.2.a.i(C)(1)(c)
- Bankruptcy fees are payable according to the same restrictions as Foreclosure attorney fees. IV.A.2.a.ii(K)(1)(a)
- You can't file your claims via fax anymore. IV.A.1.a.vii(C)(2)
- Updated address to send your paper claim submission. IV.A.1.a.vii(C)(6)

4. ASSUMPTIONS SCENARIOS FORMALLY ADDRESSED.

Assumption processing is typically a manual process given that so few are done and therefore prime for error. Both of the scenarios addressed by the changes warrant special attention to ensure your team's checklists and procedures are in order.

- **Payoff Letter from Novad at completion.** Before considering the Assumption complete, you must get a "Partial Claim payoff letter" from HUD's Servicing Contractor. This pre-supposed that you've reviewed and have determined that a partial claim is on the account and you've been servicing it accordingly. III.A.3.b.v

- **Mandatory disclosure re: PACE.** Technically, this falls under PACE changes from ML 17-06, but it is eerily similar to the first bullet in that the Seller must fully disclose the PACE obligation to the buyer. This also implies that the servicer is actively reviewing to determine if a PACE lien is attached to the property in question. III.A.3.b.viii

CONCLUSION

The FHA's update helps the Department keep "pace" with common questions/ loopholes, fraud prevention, and most importantly, itself.

Incorporating it's 2017's PACE guidance and removing the mention of the defunct "modification" was a massive undertaking, but one that results in a unified document for FHA servicers to rely on. We are cautiously optimistic that quarterly updates to 4000.1 will continue.

Overall, the FHA's new guidance yields several key takeaways for the mortgage servicer's Loss Mitigation, Claims and Assumptions departments that should be thoughtfully considered. Given the immediate effective date, it looks like it's time to lace up those running shoes and pick up the pace on the change implementation!

Follow this link to the full version of 3.27.19's copy of handbook 4000.1.

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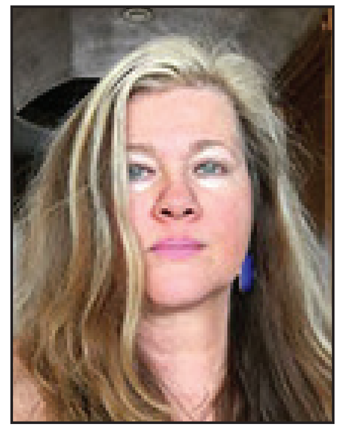

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Carolyn Goldman represents mortgage companies, banks and other businesses in regulatory compliance, complex litigation and administrative proceedings. For the past 20 years, Ms. Goldman has provided the service of acting as an Arizona "Responsible Individual (RI)," and in connection with that service, has provided legal advice regarding Arizona laws and regulations and guidance and representation in examinations by the Arizona Department of Financial Institutions (AZDFI). Ms. Goldman also represents mortgage companies, which have not retained her as their RI, and have been charged with violations of laws in administrative proceedings. Ms. Goldman has been honored to be appointed by the Superintendent of the AZDFI to its testing committees and her firm was recently appointed to the AARMR Advisory Council.

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Richard Horn is the former CFPB Senior Counsel and Special Advisor who led the TRID rule, and the design of the TRID disclosures. Richard is a founding member of Garris Horn PLLC.

Richard has extensive federal government experience from his time at the CFPB and as a Senior Attorney at the FDIC. While at the CFPB, Richard led the final TRID rule and worked on other mortgage regulatory issues. While at the FDIC, Richard worked on supervision and enforcement matters involving many different consumer finance laws, including TILA, RESPA section 8, UDAP, and fair lending. Richard advises clients of all sizes on all federal and state mortgage regulatory compliance and enforcement matters. Richard also provides on-site TRID training and compliance reviews.

Garris Horn PLLC is the next evolution of the financial services law firm. As a "virtual" law firm designed for the information age, we offer a streamlined and cost-efficient approach.

WEINER BRODSKY KIDER PC

Mitchel H. Kider
Managing Partner

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202-557-3511

In his 35 years as a practicing attorney, Mitch has represented banks, mortgage companies, residential homebuilders, real estate settlement service providers, credit card issuers, and other financial service companies in a broad range of matters. Mitch represents clients in investigations and enforcement actions before the Consumer Financial Protection Bureau, Department of Housing and Urban Development, Department of Veterans Affairs, Department of Justice, Federal Trade Commission, Ginnie Mae, Fannie Mae, Freddie Mac, and various state and local regulatory authorities and Attorneys General offices. In addition, Mitch acts as outside general counsel to smaller companies and special regulatory and litigation counsel to Fortune 500 companies.

Pepper Hamilton LLP
Attorneys at Law

John Levonick
Special Counsel

levonickj@pepperlaw.com
212-808-2758

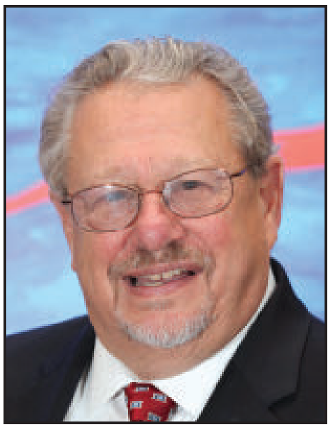
John V. Levonick is special counsel in the Financial Services Practice Group of Pepper Hamilton LLP.

Mr. Levonick's practice focuses on consumer financial services regulatory compliance and technology. Specific areas include consumer lending asset origination, servicing, and asset purchase and sale transactions; and assisting creditors, servicers, investors, and service and technology providers with regulatory issues.

Mr. Levonick also supports financial institutions and technology service providers (FinTech and RegTech) with the regulatory compliance implications of emerging technology, such as blockchain technology, artificial intelligence, machine learning, cryptocurrencies and cloud computing.

Regulatory Compliance Lawyers

These attorneys are universally recognized by their peers as setting the highest standard for the legal profession, excelling in all fields – knowledge, analytical ability, judgment, communication, and ethics.



Kenneth Markison
Of Counsel

markison@thewbkfirm.com
202-557-3530

Ken Markison recently joined the law firm of Weiner Brodsky Kider PC in Washington DC as Of Counsel in its regulatory compliance practice. His clients include lender and vendor companies, trade associations and other organizations that draw on Ken's broad experience and expertise and the strong WBK team.

Until September 30, 2017, Ken was Vice President and Regulatory Counsel of the Mortgage Bankers Association in Washington, DC. At MBA, he worked on and represented the mortgage industry on a very wide range of legal and regulatory issues. These include the Wall Street Reform and Consumer Protection Act (Dodd-Frank) and other laws governing the mortgage industry including the Real Estate Settlement Procedures Act (RESPA), Truth in Lending Act (TILA), Fair Housing Act, Home Mortgage Disclosure Act (HMDA) and the SAFE Mortgage Licensing Act.

Melissa Richards, CMB
Partner

mrichards@mayerbrown.com
415-874-4263

Melissa Richards, CMB is a California licensed attorney specializing in mortgage compliance and licensing, enforcement defense, and enterprise risk management matters. mortgage industries. Ms. Richards has almost 30 years of both General Counsel and private practice experience. Most recently, she served as the Chief Legal & Risk Officer of CMG Financial, a national mid-size independent residential mortgage banker. At CMG, she actively managed all legal, corpo-rate governance and real estate matters for the company. Ms. Richards also established the company's formal compliance, licensing, risk management and QC programs.

Ms. Richards has served in leadership for the California Mortgage Bankers Association, both as a three-term Director (1997-2006) and as its General Counsel (2002-2008). For the Mortgage Bankers Association, Ms. Richards received her CMB designation in 2009 and serves on multi-ple committees.

Phillip L. Schulman
Partner

pschulman@mayerbrown.com
202-263-3021

Phillip Schulman is a partner in Mayer Brown's Washington DC office and a member of the Consumer Financial Services group. His practice focuses on a range of matters related to real estate finance, mortgage banking and consumer finance in both the primary and secondary markets. He represents companies in the mortgage lending, title insurance and real estate industries in connection with administrative and regulatory compliance matters, including those involving the Consumer Financial Protection Bureau (CFPB), the US Department of Housing and Urban Development (HUD), the US Department of Veterans Affairs (VA), Ginnie Mae, Fannie Mae and Freddie Mac. Mr Schulman also defends False Claims Act matters before the US Department of Justice. Mr Schulman also defends False Claims Act matters before the US Department of Justice. He advises clients on matters related to approval, origination and servicing requirements under the US Federal Housing Administration's single-family loan programs.

Regulatory Compliance Lawyers

These attorneys are universally recognized by their peers as setting the highest standard for the legal profession, excelling in all fields – knowledge, analytical ability, judgment, communication, and ethics.

CLARK PARTINGTON
ATTORNEYS AT LAW

Anastasia D. Stull
Attorney

astull@clarkpartington.com
850-269-8858

Anastasia D. Stull is a financial services regulatory attorney at Clark Partington whose practice focuses on compliance, enforcement, and corporate matters, including cannabis legal consulting. Tasia is licensed in Florida and Washington, DC and previously held positions in private practice at BuckleySandler LLP, in-house at the Consumer Bankers Association and Merrill Lynch International Bank's in London, UK advising on complex banking and mortgage-related issues.

Tasia was honored to serve as the President and General Counsel of Women in Housing & Finance, Inc. and was on the board's executive committee for seven years. She's a FINRA Industry Arbitrator and a Certified Regulatory Compliance Professional (CRCP).

BUCKLEY SANDLER

Jonice Gray Tucker
Partner

jtucker@buckleysandler.com
202-349-8005

Jonice Gray Tucker represents clients in government investigations, enforcement actions, and examinations as well as in private civil litigation. Ms. Tucker also counsels clients on compliance with consumer protection laws and conducts internal investigations. She has been recognized in Chambers USA as a leading lawyer in the area of Financial Services Regulation: Banking (Enforcement & Investigations), where she has been described as "very well connected in the regulatory world", "very knowledgeable in the area," and a "go-to person for matters relating to the CFPB." Ms. Tucker also has been recognized by Best Lawyers in the areas of banking and finance law and has been named to the Super Lawyers list in the areas of banking, consumer law, and civil litigation defense. Ms. Tucker serves on the Board of Regents of the American College of Consumer Financial Services Lawyers and is the incoming Chair of the American Bar Association's Banking Law Committee.

If you are a mortgage compliance lawyer, this space is reserved for you.

From the Desk of the 'Om-Bobs-man'

"Om-Bobs-Man" is the nickname Bob Niemi earned while serving as the NMLS Ombudsman in 2014 and 2015. Bob is a former Ohio state regulator and now an expert consultant on NMLS and state regulatory matters. Bob can be reached at BNiemi@Bradley.com.

Growth in the Face of Loss

	12/31/17	12/31/18	
Licensed MLO's	158,199	165,240	+7,041
Licensed Companies	16,966	17,572	+606
Registered MLO's	9,491	9,196	(295)
Registered Comp	421,743	415,291	(6,452)

The NMLS Resource Center posted the Mortgage Industry Report for the fourth quarter of 2018. The report is published quarterly and compiles NMLS data on mortgage entities, 'branches' and mortgage loan originators who were state-licensed or registered. The report was anticipated to compare the reaction of lenders to the reduced paced of originations as a result of rising interest rates throughout the year.

State-licensed mortgage companies struggled during the second half of 2018 in response to four increases to target interest rates. The impact of rising rates and reduced consumer demand was reported by the MBA Vice President, Marina Walsh, in a March 26th posting, "Independent mortgage bankers continued to struggle in this very competitive mortgage market environment, with the average pre-tax net production income per loan reaching its lowest level since the inception of our report in 2008."

The press release also stated that both independent mortgage bankers and bank mortgage subsidiaries reported net losses for loans originated in the fourth quarter. Consolidation and cutbacks have been the headlines and even predicted in this column a year ago. So, it was expected.

During 2017, the number of state-licensed mortgage companies grew by 3.8% and the number of state-licensed MLOs increased by 8.9%. Perhaps first quarter 2019 data will show the impact of the constriction, since year end 2018 also showed increase over 2017.

The true impact may not be realized as MLO's would still be active on the last day even if not renewed, or mortgage companies have been hesitant to reduce payrolls during the holiday season.

The same was not true for banks and credit unions. Their impact was reductions of both staff and depository institutions. The overall impact across the mortgage industry was still a net gain of 589 MLOs after balancing the increase in state-licensed MLOs over decrease in the depository MLOs. While not a direct accounting, the expected retraction across the mortgage industry in response to reduced originations and compression of margins was not validated.

The Mortgage Call Report data did corroborate the downturn as mortgage originations by state-licensed companies decreased by 10.9 percent over the third quarter and by 16.5 percent over 2017. The reduction of consumer demand for refinancing followed with refinance volume down by over 40 percent in 2018. Originations for purchase mortgages only decreased by 3.0 percent but was the first decrease in six years. This information is generated from data as reported by state-licensed mortgage companies.

License growth, perhaps spurred on by the completion of the Uniform State Test adoption, grew in 2018 as well. The 165,240 state-licensed MLOs held 594,041 licenses on the last day of year, or about 3.5 licenses per MLO. In 2017, that number was also just over three and a half licenses per MLO. Licenses grew, but not at a reduced pace.

Now that winter has passed, will the spring drop in interest rates deter or just defer the consolidation? MCM

The Mortgage Counselor

Mitchel H. Kider is the Chairman and Managing Partner of Weiner Brodsky Kider PC, a national law firm specializing in the representation of financial institutions, residential homebuilders, and real estate settlement service providers.

Seeing the CFPB Through New Eyes

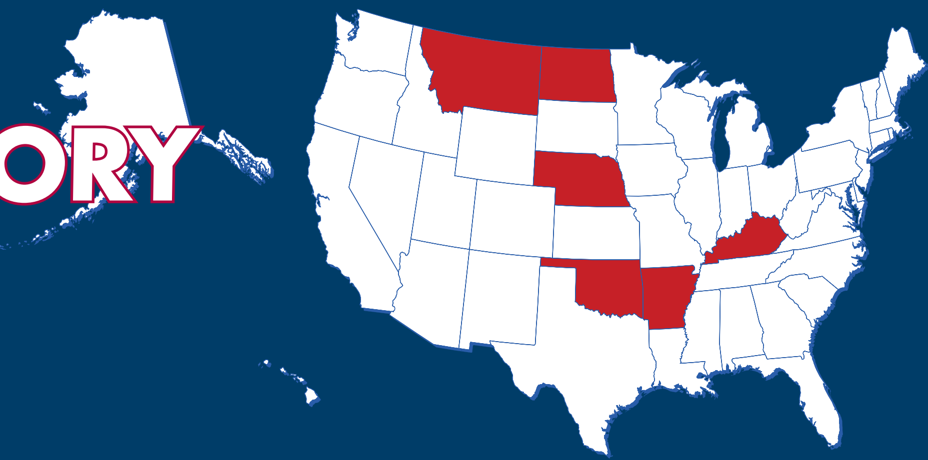
I have been thinking lately about perspective. If we could, as Proust suggested, see the universe through the eyes of another, or of one hundred others, what would we learn about the things we take for granted in our work and in our lives?

I had the privilege recently of teaching financial regulatory enforcement, and about the CFPB in particular, to classes of law students at two different universities. They are smart and accomplished, and many of them were still growing up when our industry went through the last financial crisis. What, I wondered, was their perspective on the debates concerning the Bureau's structure and its actions?

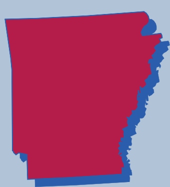
What I found was a group of thoughtful young people who are part of a generation that tends to view political issues superficially, almost tribally. To many of them, consumer protection regulation is "good" and therefore the CFPB must be right, and those who oppose it, wrong. When you educate them on the details, however, their response shifts. Learning the extent of the broad powers that are vested in a single director, and putting that together with what they have been learning in law school about our Constitution and the separation of powers that it enshrines, the students quickly see their assumptions complicated. Looking at the facts, rather than taking sides, they understand that not everything is properly viewed through a narrow political lens of liberal versus conservative.

Beyond teaching them about the CFPB and the challenges that it has posed for our industry, my goal was to teach these future attorneys that when they become lawyers, they will need to think first and foremost about the rule of law, and take politics out of the equation. These bright young students were able to take a step back from their initial, politically-driven response, and to fairly and productively grapple with policy challenges for which there are no easy answers. Reflecting on this experience, I believe that we all, in this industry and in our country, lawyers and non-lawyers alike, could think more about the structures and institutions that preserve our freedom, rather than about which political "tribes" support or oppose a given policy, and guard ourselves against the impulse to take sides. MCM

STATE REGULATORY ISSUES UPDATE

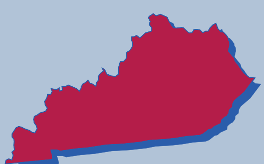


ARKANSAS



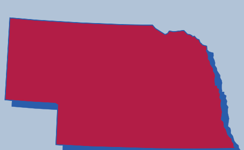
Fair Mortgage Lending Act – Arkansas has passed Senate Bill 188, the provisions of which become effective August 9, 2019 (SB 188).

KENTUCKY



Notary Provisions – Kentucky has enacted several provisions pertaining to notaries. Section 3 under the new provision provides a list of acts that may be performed by a notarial officer. These provisions are effective January 1, 2020 (SB 114).

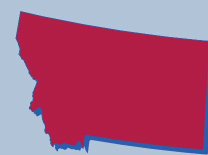
NEBRASKA



Uniform Power of Attorney Act – The State of Nebraska amended its provisions relating to its Uniform Power of Attorney Act under Legislative Bill 146 and Legislative Bill 145. These provisions are effective on September 6, 2019 or 3 months following adjournment of the current legislative session (LB 145 and LB 146).

Residential Mortgage Licensing Act – The State of Nebraska amended its provisions that include information relating to licensing requirements under its Residential Mortgage Licensing Act. Provisions in this bill range from effective on September 6, 2019, or, 3 months following adjournment of the current legislative session, to becoming operative on January 1, 2020 (LB 355).

MONTANA



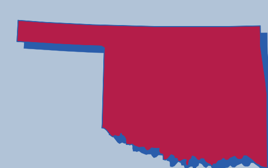
Notary Provisions – Effective October 1, 2019, the state of Montana amended provisions relating to its Revised Uniform Law on Notarial Acts that include electronic records, remote notarization and the use of electronic notarization systems and communicating technology (HB 370).

NORTH DAKOTA

Foreclosure Provisions – The State of North Dakota has enacted Senate Bill No. 2205, an act relating to abandoned property and foreclosure of real estate (SB 2205).

Notary Provisions – North Dakota has enacted House Bill No. 1110 relating to the adoption of the Revised Uniform Law on Notarial Acts. This section has been updated to include requirements concerning remote notarial acts utilizing communication technology (HB 1110).

OKLAHOMA



Fees – The Oklahoma Department of Consumer Credit has published its annual changes in dollar amounts for 2019. Generally, the revised dollar amounts are effective on July 1, 2019 (2019 Chart).

Congratulations, **Elliot Salzman**, on being selected *Mortgage Compliance Magazine*'s **Mortgage Compliance Professional of the Month – May 2019!**

As Chief Credit/Compliance Officer at LoanLogics, Elliot Salzman is responsible for enhancing and managing both the credit and compliance policy functions for LoanLogics LoanHD® platform to deliver a more comprehensive approach for ensuring loan quality. His duties also include oversight of the organization's Credit and Compliance Policies and Procedures. With his thought leadership and expertise of more than 26 years in the mortgage industry, Elliot has consistently increased the effectiveness of loan originations while mitigating risk and controlling costs through the development of a strong departmental structure, policy, and procedures. As a strong leader known for implementing and maintaining high standards, integrity, creative thinking skills, and strong work ethic, Elliot has developed and influenced multiple technology platforms within the Retail and Correspondent space. Way to go Elliot!


Elliot Salzman

MORTGAGE Compliance Magazine

THE MOST READ ARTICLE

APRIL 2019 ISSUE

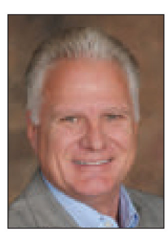
LOAN QUALITY IN THE ERA OF ULDD AND URLA

One of the more pressing initiatives over the past year relates to the updates to the Uniform Residential Loan Application (URLA) and the Uniform Loan Delivery Dataset (ULDD). For the first time in about 20 years, the URLA is getting a major overhaul and it isn't just cosmetic. The URLA has a whole new format, with new fields, data points, and requirements. With the initiatives going into effect in February 2020, it's high time that lenders take a look at how they will impact the industry's approach to loan quality going forward.

CONGRATULATIONS

Phil McCall

For writing the most read article in the April 2019 Issue of *Mortgage Compliance Magazine*.



Phil McCall is the President and Chief Operating Officer of ACES Risk Management Corp. (ARMCO).

If you would like to read the full article, CLICK HERE

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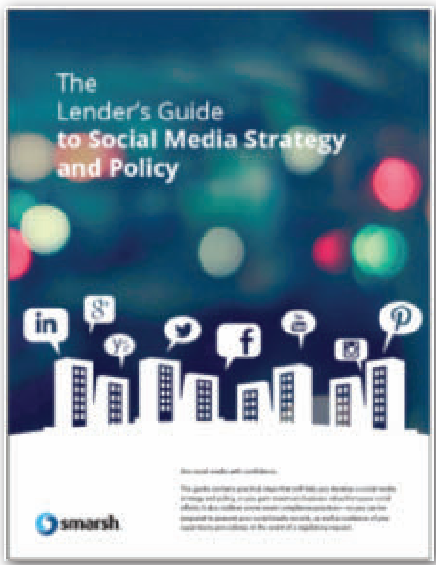

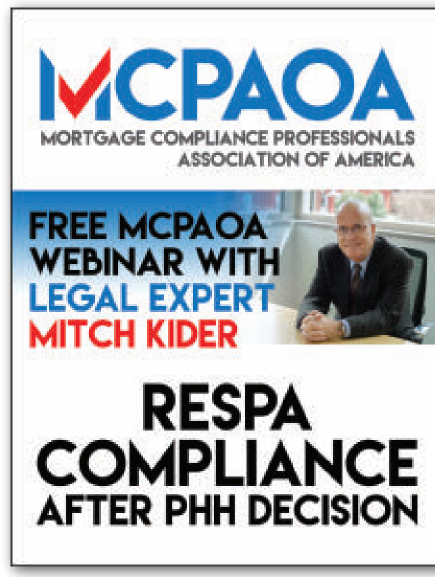

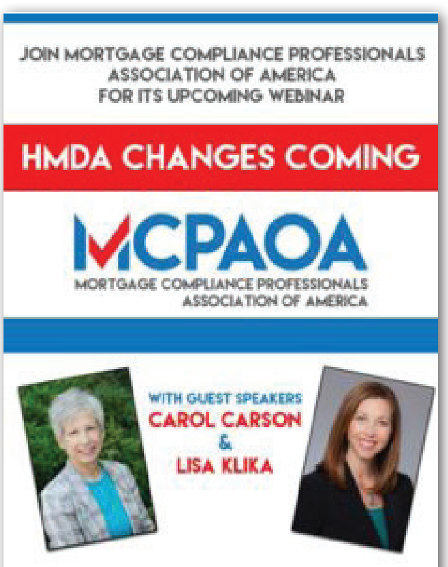

YOUR WHITE PAPER HERE

POLICE BLOTTER

THE MORTGAGE COMPLIANCE DRAGNET

Ladies and gentlemen, the story that you are about to read is true. The names of the perpetrators are the names of real people that used to be in our industry. Let's all take notice and learn from their high disregard of the law and the respect of our industry. When you see something, Say something. Report it to the FBI - Phone: 1-800-CALLFBI (225-5324)

IF YOU COMMIT THE CRIME, BE PREPARED TO DO THE TIME!

Lynn CPA Pleads Guilty to Mortgage and Tax Charges

BOSTON – A Lynn accountant pleaded guilty today in federal court in Boston to assisting a multi-year mortgage fraud scheme by creating fraudulent tax returns and submitting fraudulent letters to lenders.

David Plunkett, 53, of Lynn, pleaded guilty to one count of bank fraud and one count of aiding in the submission of false tax returns. U.S. District Court Judge Richard G. Stearns scheduled sentencing for June 25, 2019.

George Kritopoulos, 46, of Salem, one of the alleged leaders of the mortgage fraud scheme, was indicted in September 2018, and has pleaded not guilty. Co-conspirator, Joseph Bates III, 38, of Lynnfield, pleaded guilty in October 2018 to one count of conspiracy, three counts of wire fraud affecting a financial institution, and two counts of bank fraud.

According to the charging documents, from 2006 through 2015, Bates and others engaged in a scheme to defraud banks and other financial institutions by causing false information to be submitted to those institutions on behalf of borrowers – people recruited to purchase properties – located primarily in Salem. The properties were usually multi-family buildings with two-to-four units, which the co-conspirators then converted into condominiums. The co-conspirators recruited other borrowers to purchase the individual condominium units, which were also financed by fraudulent mortgage loans.

Two New Jersey Men Arraigned In Reverse Mortgage Scheme

TRENTON, N.J. – A Passaic County, New Jersey man and a Bergen County, New Jersey man have been arraigned for their respective roles in a reverse mortgage scheme that took advantage of several elderly homeowners, U.S. Attorney Craig Carpenito announced today.

Rafael Peralta, 46, of Clifton, New Jersey and Philip Puccio Jr., 40, of Mahwah, New Jersey were indicted Feb. 8, 2019, by a federal grand jury on one count of conspiracy to commit bank fraud and six counts of bank fraud. They were arraigned March 15, 2019, before U.S. District Judge Anne E. Thompson in Trenton federal court.

According to documents filed in this case and statements made in court:

From November 2007 through December 2010, Peralta and Puccio, home repair contractors, allegedly conspired to fraudulently obtain Home Equity Conversion Mortgage (HECM) – also known as reverse mortgage – proceeds by submitting inflated and fraudulent documentation to various victim banks to influence their decision to approve and fund HECMs. Peralta and Puccio recruited a conspirator to prepare inflated real estate appraisals that falsely increased the value of the properties securing the HECMs, thereby influencing each lender's decision to provide loans in amounts greater than what would otherwise be available.

Peralta and Puccio also caused the submission of false and fraudulent loan documents that actively concealed the disbursement of loan proceeds to Peralta, Puccio, and entities they owned and controlled. The diverted loan proceeds were deposited into bank accounts controlled by Peralta and Puccio and used for their personal benefit and to further the conspiracy.

The conspiracy to commit bank fraud and bank fraud charges carry a maximum potential penalty of 30 years in prison, a fine of $1 million, or twice the gross pecuniary gain by the defendants or twice the gross pecuniary loss to others, whichever is greater. MCM

MBA
MORTGAGE BANKERS ASSOCIATION

Education & Training Calendar

May 2019

Date	Course Name	Dates	Link
May 1	**CFPB Exams, and Trends in State Examinations**	May 1	https://www.mba.org/store/events/webinar/ce-cfpb-exams-and-trends-in-state-examinations
May 2	**Key Considerations of RMBS Programs**	May 2	https://www.mba.org/store/events/webinar/key-considerations-of-rmbs-programs
	Remote Online Notarization-Understanding Technical Standards	May 2	https://www.mba.org/store/events/webinar/remote-online-notarization-understanding-technical-standards
May 7	**Introduction To Mortgage Banking**	May 7 - 21	https://www.mba.org/store/events/instructor-guided-online-course/introduction-to-mortgage-banking-may-2019
	Steps Warehouse Lenders Must Take in Today's Market	May 7	https://www.mba.org/store/events/webinar/steps-warehouse-lenders-must-take-in-todays-market
May 8	**Payoff Statement Requirements for Mortgage Servicers**	May 8	https://www.mba.org/store/events/webinar/ce-payoff-statement-requirements-for-mortgage-servicers
May 14	**School of Mortgage Banking I**	May 14 - 17	https://www.mba.org/store/events/school-of-mortgage-banking-i/school-of-mortgage-banking-i-may-2019-chicago-il
	School of Mortgage Banking II	May 14 - 17	https://www.mba.org/store/events/somb2/school-of-mortgage-banking-ii-may-2019-chicago-il
May 15	**ECOA Case Law: Past, Present, & Future**	May 15	https://www.mba.org/store/events/webinar/ce-ecoa-case-law-past-present-and-future
May 22	**Regulatory Considerations for HELOCs**	May 22	https://www.mba.org/store/events/webinar/ce-regulatory-considerations-for-helocs
	Cyber Liability Insurance for the Mortgage Finance Industry	May 22	https://www.mba.org/store/events/webinar/cyber-liability-insurance-for-the-mortgage-finance-industry
May 23	**The Latest in Vendor Management Regulations**	May 23	https://www.mba.org/store/events/webinar/ce-the-latest-in-vendor-management-regulations
May 28	**False Claims Act Update**	May 28	https://www.mba.org/store/events/webinar/ce-false-claims-act-update
May 29	**Update on Recent Activity & Managing Consumer Complaints**	May 29	https://www.mba.org/store/events/webinar/ceupdate-on-recent-activity-and-managing-consumer-complaints

Conferences/Conventions
Instructor Guided Online Course (IGOL)
MBA Research Events
Other
Classroom Course
Webinar
MISMO Events

Compliance Alphabet Soups

Each month we will serve up cans of Alphabet Soup applicable to the mortgage industry. Each flavor of Alphabet Soup will include the soup's acronym and its actual name, and a hyperlink to the regulation, law, or rule from the agency that administers it. It's all right here; relax and enjoy reading your favorite bowl of Mortgage Compliance Alphabet Soup.

FLOOD INSURANCE RULES

Flood compliance has been challenging historically, and it has become more complex with implementation of a new flood check form, flood changes included in the CFPB's mortgage servicing rules, and the promulgation of the Biggert-Waters Flood Insurance Reform Act of 2012 (Biggert-Waters).

The National Flood Insurance Program (NFIP) is administered primarily under two statutes: the National Flood Insurance Act of 1968 (1968 Act) and the Flood Disaster Protection Act of 1973 (FDPA). The FDPA requires federal financial regulatory agencies to adopt regulations prohibiting their regulated lending institutions from making, increasing, extending, or renewing a loan secured by improved real estate or a mobile home located or to be located in a standard flood hazard area (SFHA) in a community participating in the NFIP unless the property securing the loan is covered by flood insurance.

Flood Law Reforms

The Biggert-Waters Flood Insurance Reform Act of 2012 is a law passed by Congress and signed by the President in 2012 that extends the National Flood Insurance Program (NFIP) for five years, while requiring significant program reform.

In early 2014, the Homeowner Flood Insurance Affordability Act of 2013 was signed into law. The law delays some sections of the Biggert-Waters Flood Insurance Reform Act of 2012 (Biggert-Waters) to prohibit the Federal Emergency Management Agency (FEMA) Administrator from providing flood insurance to a prospective insured at rates less than those estimated for any property purchased after the expiration of a designated six-month period (currently, any property purchased after July 6, 2012). The law includes the following:

- Reinstates lower flood insurance premium rates for grandfathered properties repealed by Biggert-Waters;
- Extends the effective date for new escrow rules under Biggert-Waters from July 6, 2014, to January 1, 2016;
- Sets the effective date for the escrow requirements to loans closed on or after January 1, 2016; and
- Makes flood insurance premium escrows optional for:
  - Junior liens (when the proper coverage is maintained with the first lien);
  - Condo and co-op loans (when the Residential Condominium Building Association Policy (RCBAP) is covered by flood insurance);
  - Home Equity Lines of Credit (HELOC);
  - Commercial purpose loans secured by a residence;
  - Nonperforming loans; and,
  - Loans with a term less than 12 months (typically construction or temporary financing).

Certain aspects of the law became effective January 1, 2016:

- Escrow required as of January 1, 2016 – Under HFIAA, regulated institutions will be required to escrow flood insurance premiums and fees secured by residential improved real estate or mobile homes that are made, increased, renewed or extended on or after January 1, 2016, unless the loan qualifies for a statutory exemption or the institution itself is exempt because it has total assets of less than $1 billion and meets certain other criteria.
- Options for borrowers as of January 1, 2016 – HFIAA requires non-exempt institutions to provide borrowers of residential loans already on the books as of January 1, 2016, the option to escrow flood insurance premiums and fees.

Effective July 1, 2019, financial institutions are required to accept policies that meet the statutory definition of private flood insurance in the Biggert-Waters Act. Financial institutions will also be allowed to accept flood insurance provided by private insurers that does not meet the statutory definition of private flood insurance, subject to certain conditions. In addition, financial institutions are permitted to accept certain flood coverage issued by mutual aid societies.

http://www.fema.gov/national-flood-insurance-program

The Compliance GAMES

Find these words that Compliance Professionals use on a daily basis. Who says compliance can't be fun?

```
L W A D A T A N A O Q F F L O K V F G F Y E A I F
X B B Q U I A U F R B Y N B M N L P U P Q Z G E D
J X K K H A V V H I N I P W W F A A T W W F S R U
L E N D I N G B M S Z B S R L M A Y Q P T J S V Q
Q N W L K C U W D E H Q K S S S T P S L D U Q F B
H K Z O R H X B J G F A N N I E M A E D P C X R T
H N I O L R T T U O Q E A L Z N S P R O G R A M S
G X D M P Z M H Y M F L R L K H K H B N X S O X W
F N W I Q D O T R F O Y Z E R B D E V N C V R D C
J A X N L U Y Y U E H A W Z R G D S U C E W Y C O
C E I G Q U M V P H A I S I D D X D B R K R D U N
U X U R K I O D P W L T K O V F T P I T J E V X T
Q X K T K V J O I N S D E M C H O J I L Z U U K R
M I T G U B A L A L T E R N A T I V E R X P Z N O
J D U C S E R V I C I N G Q T A X P X V G D H V L
G Y N I V P Z Y Z K M K S J L X R I D E P S O I A
J M O O X A W V Z K Q D I Z V R L H Y V E S M Q O
Q X O E I C Y O Q R W Z E A N K Z U R I S K E D Q
L I F E X E Y Q I S Y P H L D O P X I N K M E R Z
V J R I L L Q O C S W R E G U L A T O R Y C U E R
C M A N U F A C T U R E D J F I L L J Q D G N A U
B D D V K X P C F V J N J F R A M E W O R K S M J
Q Q O R C M I Z B S R Y S L O A N G W I R C M E Z
W B Z I J A S E H F U D Z C E G V C Q V T A X R N
Z F B P K O T H I N K K S Y V R A O Y Z F I B S D
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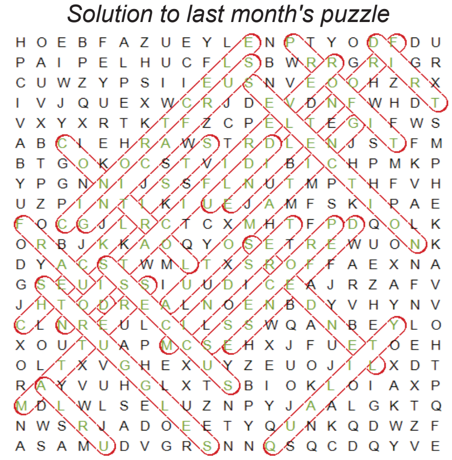
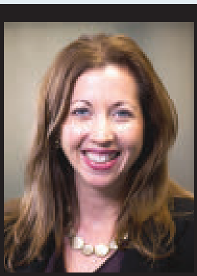
AI	LOAN
ALTERNATIVE	LOOMING
CONTROL	MANUFACTURED
DATA	PACE
DREAMERS	PROGRAMS
FAIR	REGULATORY
FANNIEMAE	RISE
FRAMEWORK	RISK
HOME	SERVICING
JOIN	THINK
LENDING	THREAT
LIFE	

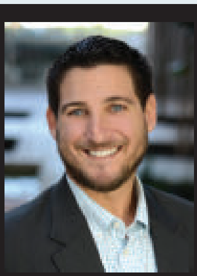
Solution to last month's puzzle



ASK THE COMPLIANCE EXPERTS


Burton Embry


Lisa Klika


Josh Weinberg


Felecia Bowers

I was hoping to get your opinion on this scenario. A loan is denied, and an adverse action notice is generated, can we re-activated the same loan number under a new loan program?

In a circumstance where a credit decision has been made and an adverse action communicated to the borrower, that file has reached a final disposition and should remain a denied loan. Reinstating a previously denied loan causes concern and issues with ECOA and especially HMDA. You may only have one disposition per loan file, so you cannot report both a denial and an approval on the same loan transaction. That being said, to promote Fair Lending, support the purpose behind the ECOA, and to provide every borrower an opportunity to qualify, it is highly encouraged to include a second review process for all loans recommended for denial, prior to an adverse action being sent to the consumer. Your scenario seems like the ideal candidate for an Underwriter to provide a counter-offer. If the borrower accepts the terms of the counter-offer, the loan may proceed under the new terms, however if the borrower rejects the counter-offer, then you should deny the loan on the original terms requested but be sure to document that a counter-offer was presented.

Got Questions? We Got Answers!

Send your compliance questions to questions@mortgagecompliancemagazine.com

The Compliance Experts are not lawyers and the answers which are given are not to be taken, construed or interpreted as legal advice. You should consult with your attorney for your legal advice. The answers the Compliance Experts provide are based upon their own professional experience, knowledge, and expertise, which they have acquired while working as leaders in the mortgage compliance field for many years. All answers herein are the answers of the collective group of experts and not just one individual expert answering each question.

Compliance WHIZ

WHAT DID YOU LEARN ABOUT REGULATORY COMPLIANCE?

Win the New Google Home! *There will be a drawing every three months. Each month every person who scores 100% gets their name placed into the drum for the drawing. This means that it's possible for one of our readers to have their name placed into the drum three (3) times for each quarterly drawing. A reader who scores 100% on each Quiz during the quarter could have an advantage over others by having their name placed into the drum 3 times. The winner will be featured with their photo and bio published in Mortgage Compliance Magazine along with a photo of the prize. Send a copy of this page along with your answers to Whiz@MortgageComplianceMagazine.Com.*

Circle the best answer to each question based on the articles in this month's *Mortgage Compliance Magazine:*

1. This operational discipline must be established first in order to build a culture of quality. (Pages 10-11)

A. Reporting
B. Validating application data
C. Ensuring CEO accountability
D. None of the above

2. DACA is VISA status that was offered to children who were brought to the U.S. illegally by their parents and have now been here in the U.S. ____________________. (Pages 20-22)

A. For the majority of their lives
B. For at least 10 years
C. For six months
D. None of the above

3. HUD and the FHA have provided definitive guidance that they are backing DACA mortgages. (Pages 20-22)

A. True
B. False

4. A loan program's structure is important to categorize because, in doing so, a lender is able to identify applicable laws and regulatory requirements to consider. (Pages 24-30)

A. True
B. False

5. ______________ is a program that allows a consumer to supplement the purchase price of a home or access their home equity through an investor investing in the consumer's home. (Pages 24-30)

A. Lease-to-own financing
B. Option to purchase
C. Sales-leaseback program
D. A co-investor contract

6. Which of the follow issues must be considered when exploring ways to augment company revenue and/or to enhance mortgage loan offerings? (Pages 24-30)

A. Legal
B. Lease
C. Securities and tax
D. Regulatory
E. All of the above

7. Which of the following is considered a best practice regarding the use of alternative data? (Pages 32-35)

A. Develop clear policies, procedures, and training
B. Involve marketing in the development and use of new data sets and models
C. Ensure the data has a clear nexus with an applicant's demographics
D. Perform initial validation of models using alternative data

8. According to this article, investors, including GSEs, are moving loan reviews and due diligence closer to the point of sale. (Page 36-40)

A. True
B. False

9. ________________ and ________________ are significant AI capabilities that provide better decision support in credit risk management and profitability forecasting in mortgage lending. (Page 42-45)

A. QC reviews; predictive modeling
B. Scenario analysis; QC reviews
C. Predictive modeling; Scenario analysis
D. None of the above

10. According to the article, the FHA process along with Fannie Mae's competition leads to the manufacturing of risk loans. (Page 46-48)

A. True
B. False

Send Answers to: Whiz@MortgageComplianceMagazine.Com

Name: ______________________________ Title: ______________________________

Company: ______________________________ State: ____________

Phone: ______________________________ Mobile: ______________________________

Email: ______________________________

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COMPLIANCETECH ALL LENDERS ARE NOT ALIKE	Mike Taliefero *Practice Leader* *info@compliancetech.com* *202.832.3800*	ComplianceTech delivers superior tools and insights to manage fair lending compliance and maximize the penetration of untapped markets through industry intelligence. Lenders and federal agencies use our cloud-based software products, LendingPatterns™ and Fair Lending Magic™ , to identify, monitor, and mitigate fair lending compliance risk. LendingPatterns™ easily provides fair lending performance of a single lender against its peers. Fair Lending Magic™ combines HMDA with LOS "Plus" data to generate descriptive statistics, regression and matched pair reports.
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