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Looking at liability from the lender's perspective

Lender liability has been a hot topic in the title insurance and settlement services industries for more than two years now, since the Consumer Financial Protection Bureau (CFPB) came out with a bulletin reminding lenders of their liability for the actions of their third-party providers. The Office of the Comptroller of the Currency shortly thereafter issued a bulletin to expand on the obligations it felt lenders had for third parties, which was originally issued in 2001.

Since that time, the title and settlement services industries have begun to figure out ways to ensure the lenders they work with that they are in compliance with necessary laws and regulations and protect consumers. Best practices have been outlined and industry members are putting together policies and procedures to outline their adherence to these requirements.

During the American Escrow Association's (AEA) 2014 Conference, lenders shared with attendees their perspective on the liability that has been placed on them and how this will impact the way the new mortgage disclosure requirements are implemented.

Arthur Davis, AEA general counsel, noted that settlement providers are in a unique position.

"You are neither an employee nor independent contractor with a lender, you are a title agent or closing agent," he said. "The basic construction of what you do is … based on what you agree to do and the working relationship that is established. You are a special purpose/limited purpose agent as defined by the totality of the working relationship, including customs and practices as well as instructions."

He said that while the relationship will be the same, it will need to adapt to adjust to new requirements, such as the new combined mortgage disclosure requirements that bring new lender liability.

Lots of changes

When tackling these issues, it's important to understand where the other parties are coming from. The new mortgage disclosure, which goes into effect Aug. 1, 2015, comes on the heels of some other significant changes for the lending community.

"We are just completing… the implementation of several major rules and rule changes, including the ability to repay or qualified mortgage rule," said **Ken Markison**, vice president, regulatory counsel, Mortgage Bankers Association. "We've also seen major changes to rules governing servicers, loan officer compensation, appraisals and the list goes on. So what we are doing now in addressing the new disclosures comes while we are still digesting all of that."

While the mortgage industry will be prepared for these changes, at this stage,they are putting their arms around the issues and addressing how their businesses should comply with the rule, Markison said.

Lenders are thinking about what business process and system changes, computer systems and other operations, have to change," he said. "They are looking fresh at policies and procedures to see where they will have to change by virtue o f this."

For example, in order to aid consumer shopping, the bureau scaled back the number of items of information a consumer is required to provide a lender before getting a loan estimate.

"That sounds like a small change, but having said that, how we train our employees, our originators and our wholesale channel around this issue becomes a major training and business process concern," he said.

Provider lists and tolerances

Markison also noted that the new loan estimate comes with liability and new, tightened tolerances.

"For example, the charges of any provider who the lender selects, such as an appraiser, now come with a zero tolerance, meaning they cannot vary from estimate to closing. For example, if the charge for an appraiser is quoted to the borrower in the estimate at $300, then unless there are circumstances justifying a change, and the circumstances are limited, that $300 is all the consumer may be charged," he said. This change requires new processes to avoid undue liability and costs.

Richard Horn, partner at Dentons US LLP, who led the mortgage disclosure rule while at the CFPB, reiterated this fact.

"The rule expands the zero percent tolerance category to include charges that are paid to affiliates of the creditor or mortgage broker, as well as charges paid to service providers the consumer cannot shop for ," he said. "What that does is put more liability on the lender for the accuracy of those estimates. That is definitely a concern in the industry."

In addition to new zero tolerances, there are additional rules surrounding the settlement service provider list creditors are required to provide to consumers. All of these new tolerance rules means the information on third-party pricing that is provided to consumers will become much more important to the lender to know.

Three-day rule

Lenders also want to address the three-day rule and what it will mean for their business practices. Under this rule, the closing disclosure must be delivered to the consumer three business days before consummation of the transaction. If a significant change occurs, the disclosure must be redisclosed and the three day waiting period will start again.

Markison noted that this will likely require an enormous movement of information to the lender, prior to three days before closing. He also said lenders have not yet figured out exactly how these disclosures are going to be provided to consumers.

Regardless of who provides the disclosure, the lender is on the hook for making sure that it was provided on time and is accurate.

"Significant errors will lead to massive ramifications for the lender," Davis said. "With liability being all on the lender, you may be a neutral third party, but you can't be independent of that.

"TILA injects a private cause of action against the lender, bringing statutory damages and attorney's fees," he continued. "When a mistake, for example, is made, we can expect that there will be an effort to bring suit and we wish to avoid that possibility with the changes that are coming. There is a lot of new information on the disclosure and a lot of detail on the forms. That is a huge liability for lenders because if there is one error under one subsection of the rule, that is a risk to the lender, so the lender is going to be concerned about that."

Penny Reed, vice president, strategic consultant, Wells Fargo Bank, added that changes in the numbers provided on the disclosures could change whether the loan is a qualified mortgage (QM) or not.

"Even though there is flexibility under RESPA/TILA, there is not flexibility necessarily in QM," she said. "Lenders are probably going to default to the most restrictive way of doing it. If you think about the process, where we envision it gravitating to is, if you think of everything you are doing right at the last minute today, you are going to do those same things, just probably the week before."

As attendees continued asking questions about the ramifications of the three-day rule, **Leslie Wyatt**, director of industry relations at Softpro, tried to put everything in perspective, noting that because the CFPB requires the assumption of it taking three days for a consumer to receive the disclosure in the mail, the longest amount of time between issuing the disclosure and being able to close is six days.

"The reality of all of the timing issues is all that matters is when the consumer gives you confirmation of receipt," she said. "It trumps any waiting period time frame. So if I do for some reason put it in the mail, and on day four [the consumer] sends me an email saying, 'I got the closing disclosure' or sends me a copy of whatever I asked to get signed as confirmation, from that day forward I have a three-day waiting period."

How this may look

In explaining how some aspects of the lender/title agent relationship may look in the future, Reed went back to the CFPB bulletin.

"Under this guidance, if you are a service provider to a covered person… then these rules apply to you," Reed said. "And this is … why lenders are probably going to want to know more about you than they ever wanted to before and ever asked before. It's not necessarily that you are no longer an independent third party to the transaction. We now have to prove that you are a neutral third party."

Reed said she envisions a future state where large lenders are going to have tiers of service providers. Those providers under contract already require due diligence to include drilling down to the level of code reviews and site visits and making sure the provider has adequate security.

Other providers who the lender does significant but less business with, where consumer data and funds are exchanged frequently, will require less due diligence.

"We don't necessarily need to do a full on-site visit, but we are going to want to know 'Do you adhere to best practices? What does your state require?'" Reed said. "We need to have a baseline. We may ask you, 'Do you get audited? Can we have a copy of your most recent audit?'"

In a third tier, the provider may only do one transaction with the lender every 60 days. In that situation, the lender may want some sort of self certification from the settlement provider, explaining that the agent's license is in good standing and the company has the proper insurances in order to demonstrate to the regulators that the lender is doing sufficient due diligence.

"I know it's a different combination to what we have today because you stand out there as that neutral third party," Reed said. "We are just going to have to be able to demonstrate to our regulators that you in face have processes in place to ensure that you are that neutral third party."

Reed noted that how far down the transaction chain lenders are required to conduct due diligence is still unclear, but that the CFPB has said that the due diligence should be reasonable.

"You have to stop someplace, and for us, it's essentially going to be who touches our consumer, who touches our money or who touches our systems directly and when we have someone under contract, we literally do go in and do a code review of their technology to make sure there is not a vulnerability there that somebody can enter their software and they can infect us."

Reed noted that one group of service providers lenders are looking at is mobile signing agents. She said that because these service providers range from stand-alone signing agents to members of larger companies, the approach is going to be different. She said a number of lenders and trade associations are working together to see if they can come up with a baseline of best practices for notaries.

In addition, because of the need for increased communication, in the future it is likely that settlement software and loan origination software will have to be able to move information back and forth seamlessly. Horn mentioned the potential of the Uniform Closing Dataset recently issued by Fannie Mae and Freddie Mac, which maps the Closing Disclosure to the Mortgage Industry Standards Maintenance Organization (MISMO) standard, as a uniform data standard that can facilitate this transfer of information.

"Some software may be ready by Aug. 1 and have a vessel to transfer data back and forth between the lender's LOS and title software. Some will not," Wyatt said. "That is not a requirement of the rule so it's not that they are not doing what they are supposed to do, it's just that they may not be ready for that yet. I know some will and its part of the conversation you should be having with your vendor."