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Entering the Era of Consumer Protection

Managing risk in all elements of loan production is vital to compliance

As more regulations and policies come forth from the Consumer Financial Protection Bureau (CFPB), it is apparent that real change has come to the mortgage industry. The CFPB's demands on lenders for transparency and accountability are flowing downward to third-party providers and every step of the loan-production process. As lenders demand more responsibility and accountability from their providers, the resultant changes likely will alter business models.

No one, not even the CFPB, knows exactly where or when these changes will end. For now, however, mortgage originators are one of the parties in the spotlight. The policies, practices, procedures and employees of all loan originators will be under constant scrutiny because the era of consumer protection likely has arrived. Although conversations in the past several years have been centered on lenders being responsible for the activities of their providers, there has been a great deal of dialog about vendor vetting and how much vetting is necessary to prevent irresponsible lending.

Prevention

Let's first acknowledge that there were problems in the financial industry in general and the mortgage industry in particular. These problems adversely affected every person and company in the mortgage business, and the economy as a whole. These were problems so severe that every effort now is being made to prevent any resemblance of a reoccurrence. The government's solution to these problems, as the industry is well aware, is regulations. And a lot of them.

Given that broad landscape, mortgage professionals shouldn't forget that the efforts of the CFPB are consumer centric. But how will all of these corrective measures affect the player at the heart of the mortgage process, the mortgage loan originator (MLO)?

Although there are now fewer lenders — and those lenders have stricter requirements for borrowers — the fundamental loan calculus for loan originators has not changed: The MLO needs a high closing ratio. Mortgage originators must be cautious because what has changed is the duty of care imposed on the MLO and the heightened scrutiny of personal behavior. Every effort originators put forth in the future must be strategic, not just in the time invested with the loan applicant and the loan, but strategic as to the other parties with whom originators once casually referred business back and forth.

Objective analysis

Most will agree that self-regulation, self-evaluation and other forms of evaluation that allow for the inclusion of subjective factors and biased data have proven repeatedly that they do not produce a good long-term result. As mortgage brokers, bankers and originators work to analyze not only the loans they originate but also the parties with whom they work, it's important to examine critically the very tools of that analysis.

For example, let's look briefly at the dreaded credit report and the FICO scoring process. Both remain a mystery to many, but the business community relies on one or both scores for determining everything from extending credit to qualifying for a job. The scores have proven to be a reliable predictor in risk-management analysis. These scores identify who the person was, is and is likely to be as a borrower or an employee. Of course, to the individuals themselves, these scores are inaccurate because they are based on only part of a person's history. They are static and deny the individual the opportunity to explain the circumstances that caused the negative report or problem.

Just as mortgage originators look at credit scores to determine if a borrower is a good risk for a loan, many employers also look at credit scores and other factors as part of their hiring decisions. These items create an objective overview of a prospective employee, but hiring often remains a highly subjective process. For example, let's take a subjective look at a highly skilled and productive potential MLO. The prospective employer has an immediate need for a high-revenue generating MLO. The prospective employer first sees the prospect's income-generating potential and now is willing to overlook the judgments against the prospective employee — the late pays on the current credit report and the poor attendance record that caused the termination from the previous employer. The circumstances causing these issues were explained away easily by the prospective employee; a job offer was extended and accepted.

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An objective view of the same potential employee may not have resulted in a job offer, however. Of course, there are those situations where incidents can be explained away, but this prospect likely would have been poorly rated. In this scenario, the prospective employer satisfied its immediate need for a productive MLO but willingly overlooked the predictable risks associated with the employee. Worse, the employer placed the new MLO in a position to influence consumers, possibly steer business and commit other acts creating potential conflicts of interest and self-dealing opportunities. In other words, the employer ignored objective risk-management tools.

In today's regulatory environment, mortgage brokers and bankers cannot afford to make the same errors because the consequences could be grave.

Increased responsibility

Mortgage brokers and bankers have a duty of care and now must consider risk management when selecting partners or referring business to another party. Why? Because if there is an issue with a loan in the future, it may not be just a loan that did not close. With the new rules, mortgage originators may be liable for the actions of everyone they used to facilitate the loan, as well as the performance of referral parties, like home inspectors, notaries, real estate agents, title-and-settlement agents, and attorneys. Originators and their companies could be exposed to civil liability for the actions of any party used in the process, and fines or penalties from regulatory authorities.

Although some claim this sweeping exercise of authority and promise of enhanced enforcement by the CFPB is just the initial step to purify the pool of providers in the financial-services industry, mortgage professionals must recognize the realities of immediate compliance. The vetting process, regardless of the methodology used, is not necessarily negative for the industry — unless you are the bad actors the regulations are designed to weed out.

Risk management

It is presumed that mortgage originators work hard and do so for the reward of being compensated for their performance. If or when there are issues with a loan, most or all of these efforts would have been in vain. All the unpaid time spent on corrective measures could have been spent on another loan that would produce additional compensation. It used to be that inefficiency at any point in the process simply would cost time, but with all of the new regulations, inefficiency could cost jobs, and subject originators and their companies to fines and other penalties.

Mortgage professionals should consider these suggestions as they review procedures and processes to ensure that they are compliant and have reduced risk.

1. **Review personal processes and practices** to ensure they are in accord with your company's compliance training and procedures, and the ongoing information coming from the regulatory authorities.
2. **Discuss any discrepancies** you may discover in the procedures with your supervisor or the company's compliance officer, and document your discussion.
3. **Be aware of fines and penalties** imposed by regulators. Familiarize yourself with the facts to ensure your practices and procedures are fully compliant, and not placing you in jeopardy of being subject to similar fines and penalties.
4. **Select third-party providers that are financially solid,** as well as qualified and capable of doing the task assigned to them. When asked, they should be able to demonstrate easily their financial stability with bona-fide financial statements, not just letters of recommendation.
5. **Report suspicious conduct and questionable practices** to the appropriate authorities. It is the responsibility of everyone in the mortgage industry to remove the bad actors from the business.

Mortgage professionals must do everything possible to ensure that their loans — and their third-party vendors — meet the standards of today's regulatory environment. ●