EXECUTING EXCELLENCE

In today's highly scrutinized servicing sector, a robust quality control plan is essential—and expected.

By Michael Forester

Several years ago, no one was talking about servicing quality control. More recently, in the wake of "robo-signing" and the resultant servicer consent orders from regulators, servicing quality control has become a point of emphasis for the GSEs and private investors, and they've implemented new and enhanced requirements to underscore its importance.

With the spotlight on servicing quality, it is critical that servicers of every size maintain a strong quality control process. This process should involve the development of a solid quality control plan, sound execution of the plan, loss mitigation and foreclosure process reviews, and useful reporting with findings reviewed by senior management.

Compliance Requirements

Fannie Mae and Freddie Mac make it clear in their servicing guides that a servicing quality control process is compulsory. However, the guides provide little detail regarding specific requirements, such as the areas of servicing that should be covered, sample sizes, and reporting obligations.

On the other hand, the Federal Housing Administration (FHA) has detailed more specific servicing quality control requirements in its *FHA Title II Mortgagee Approval Handbook*. Chapter 7, Part C of the agency's handbook describes the areas to be reviewed, frequency, and sample size requirements. While some FHA requirements are not applicable to conventional loans, a look at these requirements can provide a starting point for any servicer's quality control program.

On April 13, 2011, federal regulators entered into consent orders with 14 of the largest mortgage servicers. Terms of the orders included requirements to:

- Improve communications with borrowers by providing them the name of the person at the servicer who is their primary point of contact.
- Ensure that foreclosures are not pursued once a mortgage has been approved for modification.
- Establish controls and oversight over the activities of third-party vendors that provide to the servicers various residential mortgage loan servicing, loss mitigation, or foreclosure-related support, including local counsel in foreclosure or bankruptcy proceedings.
- Provide remediation to borrowers who suffered financial injury as a result of wrongful foreclosures or other deficiencies identified in a review of the foreclosure process.
- Strengthen programs to ensure compliance with state and federal laws regarding servicing and foreclosures.

While the servicing consent orders are specific to 14 servicers, the requirements described in those orders have become informal servicing standards that regulators are looking to see in place for all servicers.

The Consumer Financial Protection Bureau (CFPB) has also focused on mortgage servicing. The *CFPB Supervision and Examination Manual* devotes 31 pages to mortgage servicing. The manual points out that mortgage servicers are subject to portions of the Real Estate Settlement Procedures Act (RESPA), Truth in Lending Act (TILA), Fair Debt Collection Practices Act (FDCPA), Fair Credit Reporting Act (FCRA), Gramm-Leach-Bliley Act (GLBA), and Equal Credit Opportunity Act (ECOA), among others.

The manual goes on to point out that "the examination process also will include assessing other risks to consumers that are not governed by specific statutory or regulatory provisions. These risks may include potentially unfair, deceptive, or abusive acts or practices (UDAAPs) with respect to servicers' interactions with consumers."

Building on the issues raised in regulators' consent orders, the CFPB in January 2013 issued its mortgage servicing rules, which become effective in January 2014. These rules include requirements covering:

- Periodic statements
- Interest rate adjustment notices
- Prompt payment crediting
- Force-placed insurance
- Error resolution
- Policies and procedures, specifically addressing timely and accurate information, proper loss mitigation, oversight of service providers, information transmissions during service transfers, the processing of information requests, and error notifications
- Early intervention for delinquent borrowers
- Continuity of contact
- Loss mitigation procedures

Devising a Robust QC Plan

Ensuring compliance with GSE, FHA, CFPB, and other investor and regulatory requirements necessitates a robust quality control program. The extent of these regulations and requirements, and the increased consequences of failing to meet the requirements, has elevated servicing quality control to a new level of importance.

The process starts with the development of a servicing quality control plan. The plan will document the scope, frequency, and sample size of the quality control reviews. The scope of the review should include, at a minimum:

- Default servicing, including loss mitigation efforts
- Foreclosure processing
- Boarding of new loans and servicing transfers
- Customer service
- Fees
- Escrow administration, including compliance with RESPA
- ARM adjustments
- Handling of prepayments and payoffs

The plan should detail what quality control procedures will be performed in each of the broad categories listed above. These procedures should include testing of all of the GSE, investor, and CFPB requirements that are applicable.

Quality control testing should generally be conducted monthly, although smaller servicers may consider quarterly reviews. FHA specifically requires monthly reviews of the servicing of delinquent loans.

Sample sizes are generally left to management's discretion, although again FHA is specific, requiring reviews of 10 percent of delinquent loans on a monthly basis and a review of at least 10 percent of all loans quarterly. FHA allows servicers with more than 3,500 loans to use statistical sampling.

FHA's sampling requirements are thought to represent the high end of a range of appropriate sample sizes that will depend on the level of controls already in place. If you review 10 percent of delinquent loans each month and the population of delinquent loans is static (i.e. chronic delinquent accounts), every delinquent loan will be reviewed in less than 12 months, which makes for a very large sample over the course of a year. Management should develop sample sizes that make sense for the size and risk of the particular servicing operation. Regardless of the sample sizes used, the rationale for determining the size should be documented in the plan.

Executing the Plan

Once a quality control plan has been developed, how is it implemented?

Quality control is an audit function and should be performed by people independent of the servicing process. On the origination side of the business, most mortgage lenders have outsourced the quality control testing to third-party firms that specialize in performing quality control. A similar pattern is emerging with servicing quality control. While the use of a third-party firm may represent an additional expense, a third party brings independence and expertise while avoiding additional fixed costs that come with hiring internal staff to perform the function.

Engaging an outside firm to perform servicing quality control may make the quality control process easier, but it does not relieve the servicer of responsibility for quality control. All of the typical third-party vendor management policies and procedures related to the required due diligence and ongoing monitoring of outside service providers should be applied to the quality control provider as well. Inquire as to how customizable their process and reporting is and review sample reports.

If a third party is engaged, the servicer should review the vendor's work to ensure satisfactory execution of the quality control plan.

Keep in mind that quality control is no longer a "check the box" process—if it ever was—but carries significant responsibility for ensuring quality and compliance with an ever-changing and increasing level of requirements and regulations.

Loss Mit and Foreclosure Focus

Among the most significant changes in the CFPB regulations are requirements for loss mitigation and subsequent limitations on the foreclosure process. Servicers are required to follow specified loss mitigation procedures for a mortgage loan secured by a borrower's principal residence.

Servicers must establish or make good faith efforts to establish live contact with borrowers by the 36th day of delinquency and promptly inform such borrowers, where appropriate, that loss mitigation options may be available. In addition, a servicer must provide written notice with information about loss mitigation options by the 45th day of a borrower's delinquency.

Servicers are required to maintain reasonable policies and procedures with respect to providing delinquent borrowers with access to personnel who can assist them with loss mitigation options. The policies and procedures must be reasonably designed to ensure that a servicer assigns personnel to a delinquent borrower by the time the written notice required by the CFPB's early intervention rule is served on the 45th day of delinquency.

If a borrower submits an application for a loss mitigation option, the servicer is generally required to acknowledge the receipt of the application in writing within five days and inform the borrower whether the application is complete and, if not, what information is needed to complete it. The servicer must exercise reasonable diligence in obtaining documents and information to complete the application.

For a complete loss mitigation application received more than 37 days before a foreclosure sale, the servicer is required to evaluate the borrower, within 30 days, for all loss mitigation options the borrower may be eligible for in accordance with the investor's guidelines, including options that enable the borrower to retain the home (such as a loan modification) and non-retention options (such as a short sale).

In June 2011, the Office of the Comptroller of the Currency (OCC) issued bulletin 2011-29 that provided additional guidance regarding foreclosure management to the financial institutions the agency regulates. This bulletin was a result of the significant foreclosure processing and documentation issues that surfaced during the financial crisis and led to the servicing consent orders issued by both the OCC and the Federal Reserve.

In its bulletin, the OCC stated, "National banks should conduct a self-assessment of foreclosure management practices. Banks that identify weaknesses in their foreclosure processes through the self-assessment should take immediate corrective action. Banks should determine if the weaknesses resulted in any financial harm to borrowers and provide remediation where appropriate. Examiners will review the self-assessments, corrective actions, and any determinations of financial harm and related remediation in the next quarterly review or examination of the bank."

Because foreclosure has such a significant impact on the consumer, the CFPB is also focused on foreclosure.

Comprehensive foreclosure reviews should verify the loan was in default, that all disclosures and notices were made on a timely basis, and that the servicer had all required documents to foreclose. All fees charged should be reasonable and based on costs incurred.

Due to the critical nature of the foreclosure process, many servicers are treating foreclosure reviews as separate from the normal quality control process. While the reviews may be performed independent of other aspects of servicing quality control, it is recommended that a comprehensive quality control plan include foreclosure reviews.

Reporting Findings

The quality control plan should also describe how the results of the quality control process are reported. Quality control findings must be reported to executive management, and as frequently as possible. That does not mean that management needs details on every exception noted, however. Instead, a summary report that covers exception rates by category and shows the trend of exception rates over time is recommended.

Executive management needs to review these reports and understand remediation plans where exception rates indicate the need for process improvement. For this reason it is also important that servicing operations management receives and reviews the findings so that process improvements can be designed and implemented to address any shortcomings reported. Identifying systemic deficiencies in the process is a critical component to implementing the required corrective action. The deficiencies identified can be used to enhance training programs within the institution and ensure that all employees involved are informed and better prepared to perform their job responsibilities.

The importance of the quality control reports cannot be overemphasized. Take the time to design useful reports. Little is gained if in-depth quality control reviews are conducted, but the results cannot be understood and acted upon because the final reports are either too detailed or not comprehensive enough to tell the story.

The Bottom Line

The business of mortgage servicing is substantially about limiting risk and maintaining profitability. Regulators and investors have enhanced their scrutiny of the servicing quality control process. A mortgage servicing operation that initiates periodic monitoring through a formalized quality control program decreases its risk that violations and weaknesses will go undetected for long periods of time, potentially avoiding multiple regulatory violations and consumer harm. In addition, deficiencies identified in the quality control process can provide opportunities to reinforce procedures and enhance training for employees. Proactive actions will benefit the organization and demonstrate to regulatory agencies and investors that the appropriate procedures are in place to assist in establishing a sound servicing control environment.

Michael Forester is co-founder and managing director of CrossCheck Compliance, a regulatory compliance, audit, and loan review firm. He has more than 30 years' experience working in the mortgage and financial services industries. DS