RESIDENTIAL

Are You Integrating TRID Into Your QC Process?

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The Dodd-Frank Act directed the Consumer Financial Protection Bureau (CFPB) to combine TILA and RESPA requirements into an integrated set of disclosures. The new disclosure requirements, referred to as "Know Before You Owe" by the CFPB but better known in the mortgage industry as TRID, took effect October 3, 2015.

TRID's roots can be traced to the CFPB and Dodd-Frank, which were in turn brought about in reaction to the "Great Recession." Another reaction to the recession issues in the mortgage industry is expanded quality control (QC) requirements promulgated by the GSEs. These increased requirements include pre-funding quality assurance and robust guidelines for establishing quality standards and a QC process. For the most part, mortgage lenders have successfully implemented a structure for identifying deficiencies and implementing plans to quickly remediate underlying issues and deficiencies. The Fannie Mae Seller Servicer Guide *(Part D, Ensuring Quality Control (QC) Part 1, Lender QC Process, Chapter 1 Lender Quality Control Process)* states that the QC plan must also guard against "fraud, negligence, errors, and omissions by officers, employees, contractors (whether or not involved in the origination of the mortgage loans), brokers, borrowers, marketing partners, and others involved in the mortgage process."

Despite an increased emphasis on quality control post-recession, the GSEs do not require compliance findings, including TRID errors, to be included in the gross or net defect rates identified in their QC process. The GSEs have also stated they will not perform TRID reviews in their quality assurance process; however, they are reserving the right to do so in future audits. So, should lenders ignore compliance issues during the quality phases of the origination cycle? We would answer that question with a resounding "no." While GSEs do not require TRID reviews, both GSEs and other investors refuse to purchase—or force lenders to repurchase—loans based on real or perceived TRID violations. More importantly, there are serious penalties for TRID noncompliance, making it critical that lenders use the QC process to identify and remediate any compliance issues.

Assuming the risk of unsalable loans and regulatory penalties are good reason to include compliance in general and TRID in particular in the QC process, to what extent should the QC process review be modified? There are many factors to be considered by a lender when determining the compliance scope for pre-funding and post-closing reviews. These factors can include past performance on compliance issues, risk weighting of specific compliance regulations, and the extent of existing compliance monitoring. If previous reviews (either performed internally or by a regulator) have indicated a pattern of compliance errors, you may want to include those types

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mean a retrofit will not be required by LA's ordinance. If an asset is on the City of LA's list of impacted buildings and has a passing Probable Maximum Loss (PML) rating, an engineering design study will verify if and what kind of retrofit is needed to ensure compliance. The lender has 5 fundamental options if they choose to move ahead with the issuance of the loan:

1. **Ignore.** Lenders may absorb the risk and move ahead with the issuance of the loan without adjusting their due diligence or risk management practices. This is not recommended.
2. **Demand retrofit.** The loan can be funded with the stipulation that the borrower perform the retrofit within the specified time, with funds for the retrofit held back and paid out through construction.
3. **Treat as an immediate repair or reserve item.** The cost of required retrofits may be calculated into the loan as any other capital expense would be. Lenders may also require earthquake insurance.
4. **Create an exception to the carve-out.** If the borrower doesn't comply, lenders may isolate the cost of retrofits from carve-out conditions.
5. **Agency supplemental loans.** Lenders may allow borrower to access additional funds through agency supplemental loans as discussed above.

GETTING AHEAD OF REGULATIONS

LA's seismic ordinance is a challenge for lenders, but it's also a challenge for engineering firms because there are more projects than there are engineers. Affected building owners are advised to engage an engineer early on to provide a scope and approximate cost of the works required. The high demand for engineering services means that those are not proactive may have far fewer choices 12 months from the deadline.

Ultimately, managing the impacts of LA's seismic ordinance will require lenders to take on a proactive approach and an experienced due diligence team. When utilizing holdbacks for at-risk properties an accurate estimate of required works must be obtained, and as the volume of requests grows a backlog may cause delays, potentially pushing back deals and adding costs to the due diligence process. Therefore, it is important to work with an engineering due diligence provider that has the resources to handle large volumes, and has a thorough understanding of transactional seismic risk management and the retrofit design aspects of the ordinance. Getting the right help will be key for lenders to understand which loans may add undue seismic risk to their portfolio, and to allow them to efficiently close loans they choose to pursue. Ultimately, where there is a need for financing someone will step in to fill the demand—it will be interesting to see how the lending community's response continues to unfold over coming months.

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of compliance regulations in your prefunding review process until you determine the error rate is under control. The newness of TRID may also cause your organization to view it as inherently higher risk and include a greater percentage of loans for TRID reviews for the first six or 12 months. If your company is conducting substantial compliance audits during or as part of the prefunding review stage, you may determine that a reduction in the number of regulatory compliance reviews in the post-closing QC review phase is warranted.

Another factor to consider when determining the level and stage of compliance audits may be dependent on the requirements of your non-GSE investors. Are they requiring your QC review process to include compliance reviews? Are any of these non-GSE investors performing their own compliance reviews of your files? If so, are they finding errors in their reviews of your loans? Are these errors considered material findings? Does your organization have concerns about your non-GSE investor refusing to purchase a loan or delaying funding as a result of their TRID or regulatory compliance findings? A number of lenders have chosen to review all loans prior to funding for TRID compliance. These lenders are seeking a higher confidence level that both their systems and their staff are preparing correct disclosures and that any errors are being resolved and reducing risk prior to closing.

While TRID error rates have improved as more lenders gain experience, there are so many regulatory provisions related to TRID

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that it will likely take an extended period before lenders feel confident their process substantially meets regulatory requirements. TRID findings relating to inaccurate calculations need to be examined for root causes. For example, the Total of Payments may be in error. The reason could be the loan origination system did not identify the mortgage insurance premiums or pre-paid interest and so they were not included in the calculations. Perhaps the mapping was not coded correctly at the time of loan origination. You would want to determine if this is a systemic issue so that changes could be quickly implemented for all new loans.

If you elect to include a TRID review in your QC process, you will also need to determine the thoroughness of the review. There are easily over 140 TRID disclosure provisions. Will you be auditing each provision? Or, will you decide to include only the provisions deemed to be considered "material"? Even if you choose only the "material" provisions, the process will be time consuming. Another question is whether your calculations will be performed manually? Who will be performing the TRID audit? Will these individuals have specific expertise in TRID and regulatory compliance? Or, will you train your QC underwriters to perform the TRID reviews?

Alternatively, if you are utilizing a third party to perform your QC reviews and you expect them to include a TRID review, have you identified the disclosure provisions that you expect them to review? Do you have a handle on the time it will take include the TRID disclosure provisions in the QC review? Perhaps you will decide to include TRID in the QC review, but limit the review to only a handful of the disclosure provisions. All of these factors need to be addressed with your third party vendor. The additional costs associated with the TRID review need to be discussed. It is not uncommon for thorough TRID reviews to range from 1 ½ to 3 hours per file. Remember, this time is in addition to the time required to review other aspects of the QC review related to underwriting and appraisal review. While this can be expensive, the cost of not having any type of TRID review may be far greater over the long term.