ROUNDTABLE

Hot Topics for Regulatory/ Compliance Pros

EDITOR'S NOTE—*This is the latest in a series dealing with the issues facing the real estate finance industry. Each issue we touch on a different topic, asking CMBA's experts for their thoughts on the issue at hand. In this issue of CMFN, we ask three legal/regulatory compliance experts for their take on the top issues of the day.* **Marty Allred***, is Vice President, Compliance with American Pacific Mortgage, and chairs the California MBA Mortgage Quality & Compliance Committee (MQAC);* **Monika L. McCarthy** *is Managing Director and General Counsel at CrossCheck Compliance, a nationwide consulting firm; and* **Michael Pfeifer** *is Managing Partner with Pfeifer & DeLaMora, LLP, and serves as the California MBA's General Counsel.*

The views and opinions expressed are solely those of the authors.

CALIFORNIA MBA: WHAT COMPLIANCE-RELATED CHALLENGES DO LENDERS FACE WHEN TRYING TO IMPLEMENT OR INTRODUCE AN "E"MORTGAGE?

Allred: A complete eMortgage will eventually become the norm because it's what our loan originators and consumers expect from us. We already see digital lending in non-mortgage products so the key is to parlay that into mortgages in a way that maintains security, integrity, consistency and compliance. Lenders have to navigate the eMortgage process in such a way that it meets all compliance requirements, creates operational efficiencies, and delivers a great consumer experience.

Some of the key compliance challenges relate to the variations in state law and investor requirements, privacy and security of the consumer's data and verification of the consumer's identification. Some states may not allow remote notarization, and some investors may require certain wet-signed documents, and such inconsistencies can lead to a hybrid-process or a variety of processes that impairs compliance and closing staff. And especially with all of the data breach concerns in the news, lenders must have robust cybersecurity controls to give consumers the confidence to do eMortgages with them.

The compliance and operational inconsistencies should inspire lenders to develop key relationships with their LOS and with closing vendors and settlement agents that are experienced with the digital mortgage process, and are good partners in the consumer experience as well. A good vendor will know the various state regulations and help the lender leverage their LOS and other tools to create a streamlined operational workflow. It's a good idea for compliance professionals to focus on being solution-

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oriented and flexible while the industry adapts to eMortgages, and they should consult the information from the CFPB's eClosing pilot from 2015, which contained valuable insight into the results of consumer and lender testing.

McCarthy: Today's consumer, especially millennials, utilize electronic media to conduct the business of their lives through email, text, twitter, Facebook, LinkedIn, Snapchat, and Vendmo, among others. It should not surprise us that consumers now expect their mortgage transactions to be facilitated electronically. Unfortunately, the fact remains that few transactions require as much documentation and dated signatures as a mortgage loan. Lenders have figured out that using a document vendor helps them comply with the document and disclosure requirements of the Electronic Signatures in Global and National Commerce Act (ESIGN), but the documents and disclosures themselves are only one of the many steps required to comply with ESIGN and the Uniform Electronic Transactions Act (UETA). Moreover, some state laws preempt or differ from ESIGN provisions. Our risk assessments and audits continue to find that lenders struggle with properly obtaining the requisite consents and their processes for revocation of consent, as well as communicating, recording and monitoring revocations, fail to meet regulatory standards.

Other challenges with eMortgages include the lack of federal standards validating e-notarizations and the need to evidence that the electronic record is an "original" to overcome recording, assignment and retention problems. For all of these reasons and the related inherent risks, some lenders hesitate to be the trailblazer utilizing the latest "e" technology. Despite the hesitation of some, the industry will continue to adapt new technology to enhance the consumer experience.

Pfeifer: While ESIGN (Electronic Signatures in Global and National Commerce Act), enacted in 2000, and UETA (Uniform Electronic Transactions Act), enacted in 1999, have laid the groundwork for e-mortgages by establishing a now familiar set of rules validating the use in commerce of electronic records and signatures, the "holy grail" of the all-digital "e-mortgage" has remained out of reach primarily because of legal and regulatory challenges in the loan closing process. There are three major compliance-related challenges: (1) electronic notarization of loan documents; (2) electronic recordation of the security instrument or mortgage; and (3) "e-vault"/bailee/ assignee issues involving warehouse lenders and the secondary market.

ELECTRONIC NOTARIZATION

ESIGN and UETA permit electronic notarization of records under which a notary may use an electronic signature and, instead of a stamp or seal, may include the information that would otherwise appear in the stamp or seal as part of the information included in the record. However, these laws do not

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change the requirement that the notary be physically present when the signature being notarized is made or adopted by the signer. Nor do they change other state requirements that apply to notaries, such as completion of a journal record for each notarial act. Efforts are underway at the state level to address these issues. To date, eleven states have programs governing so-called "eNotarization": AR, CO, IA, IN, MN, MO, NC, OR, PA, VA, WV. In seven additional states (CA, FL, MD, TX, UT, VT, WI.), notaries can be electronically enabled and are not required to register with the state.

ELECTRONIC RECORDATION

According to Fannie Mae," eRecording" (electronic recordation of mortgage instruments) is permitted in approximately 1,488 counties covering about 2/3 of the U.S. population, as the largest, most widely populated counties allow eRecording. Coverage has steadily increased year over year and continues to do so.

E-VAULT/BAILEE/ASSIGNMENT ISSUES

The final obstacle is establishment of a uniform system of preserving and tracking electronic mortgage documentation and assignments in such a way that warehouse lenders and secondary market investors feel that the documentation of their investments is safe, accurate, and fraud-free, and that assignments are properly recorded, indexed, and tracked. MERS made some significant inroads into this problem, but was tied up in litigation for years while courts sorted out what custodial and assignment practices are and are not acceptable. Fannie Mae has addressed this issue by utilizing a tri-party funding agreement which acts as a master "Bailee Agreement" for eNotes delivered to Fannie Mae by a warehouse lender on behalf of a Fannie Mae lender. The agreement locks down the wiring instructions, should Fannie Mae purchase the loans, and allows Fannie Mae to control the eNote as designated custodian for the warehouse bank as a secured party and designee for the lender until purchased.

CALIFORNIA MBA: HOW ARE LENDERS UTILIZING NEW TECHNOLOGIES TO IMPROVE COMPLIANCE EFFORTS?

McCarthy: There are an ever-increasing number of new technologies available to lenders to help them reduce compliance risk and increase the efficiency of their loan origination and servicing business. Assessing compliance in general is more effective and perhaps more efficient with use of "big data". The caveat; however, is whether the data is monitored for both data integrity and compliance with the myriad of applicable federal and state laws. Automation has also proven to be a significant benefit in expediting the regulatory examination process. "Robotic process automation" is the latest technology to bring efficiency to compliance monitoring and testing.

We now see lenders focused on the integrity of their Home Mortgage Disclosure Act (HMDA) data as they prepare to comply with the amendments effective January 2018. While there are a host of software vendors that provide good reporting solutions, the reality is that a lender must have controls in place to ensure the integrity of the data and understand what their data reveals. A report generated by a software application is only valuable if the data being analyzed is accurate and the person reading the report understands what it says. Regulators expect the board of directors, chief compliance officer and senior management to explain the data, including results of analysis, anomalies and how they were addressed, as well as to provide documentation of any required corrective actions taken. To fully grasp the fair lending implications of a lender's data, technology skills are essential in addition to fair lending expertise. Many lenders use consultants to provide this expertise and may do so under the attorney-client privilege of their trusted outside counsel. Thus, the technology is only one step in the process to improve compliance in the face of today's regulatory risks.

Pfeifer: Technology solutions for electronic recordation and so called "e-vaults" are relatively straightforward and rely, at least in part, on optical character recognition technology that has been around for some time. From a technology standpoint, the real challenge has been to develop an "e-notarization" solution to the problem of verifying the identity and e-signature of the borrower

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remotely. In January, 2017, the National Notary Association published a 134 page document entitled "The Model Electronic Notarization Act of 2017" ("MENA"). According to the "Forward" of the model act, MENA is a "comprehensive standard and guide for public officials who are establishing rules to govern the notarization of electronic records…[It] expands and updates the electronic provisions of the 2010 Model Notary Act, reflecting the evolving developments and demands of technology, business and government. The primary intended purpose of the MENA is to set forth a progressive model for state and territorial officials to weave electronic notarization provisions into an existing paper-based regime in order to form an integrated, single system for both electronic and non-electronic notarial acts. It is designed to be implemented either as a "plug-in" update or complete replacement for Article III of the Model Notary Act of 2010." (A copy is available at www.nationalnotary.org.)

Initially, according to the National Notary Association, all rules for electronic notarization required face-to-face, physical appearance between the electronic signer and the notary public. The reason was primarily to provide reliable verification of identity, including fingerprints. In 2012, however, Virginia became the first state to authorize remote electronic notarizations based on video and audio conference technology. In 2015, Montana became the second state to enact legislation allowing remote electronic notarizations without physical appearance by the signer before the notary. Since even the National Notary Association acknowledges that "remote electronic notarization carries a high potential for fraudulent exploitation and legal challenges," the Association "posits" that "remote electronic notarization executed via 'audio-video communication' only is advisable and in the public interest when governed by rigorous rules to ensure trustworthy notarizations."

Consistent with the standards set forth in MENA, some technology companies, such as "Quicken" and "Notarize," are building e-notarization platforms designed to satisfy newly enacted state law requirements. Notarize claims even to "have the support" of Fannie Mae and Freddie Mac. Whether these solutions will stand the test of time, however, remains to be seen because they have not yet been tested in the courts.

Allred: As a lender, we are always on the hunt for technology solutions that strengthen our compliance management system, and increase speed and efficiency in our monitoring efforts. We also aim to provide high tech experiences for our consumers and the element of human touch that our originators desire, so we have to view compliance and technology from various lenses. Our compliance department works closely with our LOS and QC vendors to turn manual processes into systematic controls which helps mitigate errors and increase speed and efficiency of loan-level compliance monitoring. Lenders need smart technology that efficiently performs transaction (loan-level) testing during the loan process and post-close to identify areas that need improvement. This allows lenders to do self-testing, implement corrective action, and ultimately can reduce examination findings.

Online advertising, website and social media compliance is an area where technology is critical because information can constantly change. Lenders must find the right vendors and/or internal resources to review, monitor and archive their online presence and activity. State and federal examiners have 24/7 access to review a lender's online presence, making it imperative that a lender has the ideal controls and monitoring in place to ensure 24/7 online compliance. It can be a challenge to find a single vendor that meets all compliance needs, so lenders may need multiple vendors or resources for a successful online compliance strategy.

Finally, other technology solutions that are gaining in necessity are ones that improve data integrity through real-time exception reporting; improve compliance eLearning through alternative methods and gamification; and assist consumers with limited English proficiency ("LEP") through the loan process. These are certainly some of the current compliance-tech areas that we are focused on as a lender.

CALIFORNIA MBA: WHAT ARE THE BIGGEST STATE COMPLIANCE/ REGULATORY CHALLENGES LENDERS/SERVICERS WILL FACE IN 2018?

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Pfeifer: I believe the biggest challenges will be in persuading states to enact MENA, or something similar to it; in implementing the requirements of what is actually enacted, and in integrating electronic notarization protocols into the loan closing process. Secondarily, unless most states follow MENA fairly exactly when adopting it, there may be challenges by other states, or by borrowers' attorneys, to the enforceability of the underlying mortgage documents. Beyond that, I believe that there are many issues yet to be worked out with respect to so-called "e-vaults" and satisfying individual state law requirements regarding custody and ownership of "e-mortgages" and recordation of assignments. These problems have been around for years, where only paper loan documents have existed. Adding "e-mortgages" to the mix significantly complicates the situation. And, while Fannie Mae and Freddie Mac may continue to develop contractual solutions for their customers and their warehouse lenders, complying with those contracts in fact may present a constellation of technology issues in and of itself.

Allred: Lenders will be working with the new HMDA requirements in 2018 and actively monitoring the expanded data collection to ensure accurate reporting. Additionally, more changes to KBYO are expected and desired, especially if the changes have a positive result around the "black hole" scenarios. There is also an uptick in discussion and activity around solutions for LEP consumers. The desire from the CFPB for lenders to better serve these consumers can often conflict with state regulation around contract law and even fair lending and UDAAP rules. But we expect to find solutions that can comply with the spirit of both federal and state regulations.

At the state examination level, compliance professionals should be aware of hot topics from their state's examination and enforcement departments, e.g. California's per diem interest rules. Many of the states have newsletters and/or webinars that cover hot topics and updates for lenders and servicers. Be proactive and do a level of due diligence on your processes to measure compliance. It's a good idea to develop a comprehensive exam prep project for each state that you're licensed in, and inspect what you expect. Compliance teams should also consult with their IT/IS teams on cybersecurity since there is an increasing trend in states requesting a cybersecurity survey along with their exam questionnaires, which may eventually turn into more regulation similar to New York.

Servicers will stay busy in 2018 with the ongoing implementation of the 2016 Mortgage Servicing Rule and subsequent updates. Servicers should increase their quality assurance efforts internally, or with their vendors, to self-audit their activity against the new rules. The CFPB's Supervisory Highlights are also a good resource to review for common examination findings that servicers can learn from.

McCarthy: The biggest reputational challenge is to avoid cybersecurity failures and the hacking of consumer data. Lenders should expect state regulators to be keenly aware of security issues in 2018 as they continue to be front-page news. The challenge for lenders and servicers alike is the consumer demand for electronic communication and how to keep all communications compliant with privacy and security requirements. The answer for many has been to put better controls in place to stop the transmission of non-public consumer data and increase the ease of use of encryption. Automating technology controls as much as possible with old fashioned awareness training of current protocols is the path to reducing that risk.

We are also seeing state regulators step up their supervisory and enforcement activities. Specifically, states are starting to include the Know Before You Owe rule (or TRID) in their examination scope of originators and tougher examinations of servicers will include how their vendors perform their functions. Servicers will no doubt continue to be put to the test on how well they comply with the new servicing rules and may face penalties if they don't. Knowing these risks loom large in 2018, we recommend our clients take precautionary measures such as targeted audits or risk assessments to identify their weaknesses and fix them before their state or prudential regulator finds them during an examination.