PwC Perspectives

CFPB's Integrated Mortgage Disclosures under RESPA/TILA – "Know Before You Owe"

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Implementing the simplified definition of an *"Application"*

Introduction

Welcome to the first edition of *PwC perspectives* on the Consumer Finance Protection Bureau's (CFPB) new "Know Before You Owe" Integrated Mortgage Disclosure rule, which will become effective for applications received on or after August 1, 2015 – which is not nearly as far away as it may seem. The goal of this series is to highlight key elements of the new rules, and to provide a perspective on potential operational and compliance impacts.

Background of "Know Before You Owe"

The new CFPB Integrated Mortgage Disclosure rule is part of the Dodd-Frank Wall Street Reform and Consumer Protection Act. It requires the CFPB to combine consumer disclosures under RESPA and TILA.[1] As a result the Good Faith Estimate (GFE) and initial Truth in Lending (TIL) disclosure will be replaced by a "Loan Estimate" and the HUD-1 and TIL closing disclosure will be replaced by a "Closing Disclosure."

Figure 1

The new forms themselves, however, are only one component of the changes brought forth in this new rule. The rulemaking stretches over approximately 1,900 pages and touches upon each area of the loan origination lifecycle, including the initial phase at time of *application*.

1 The Real Estate Settlement Procedures Act of 1974 (RESPA) (12 U.S.C. 2601 et seq.) (the Act) became effective on June 20, 1975. The Act requires lenders, mortgage brokers, or servicers of home loans to provide borrowers with pertinent and timely disclosures regarding the nature and costs of the real estate settlement process. The Act also prohibits specific practices, such as kickbacks, and places limitations upon the use of escrow accounts. The Department of Housing and Urban Development (HUD) originally promulgated Regulation X which implements RESPA. The Truth in Lending Act, known as Regulation Z, is issued by the Board of Governors of the Federal Reserve System. This regulation implements title XII, section 1204 of the Competitive Equality Banking Act of 1987. The regulation includes information-collection requirements promotes the informed use of consumer credit by requiring disclosures about its terms and cost. The regulation also gives consumers the right to cancel certain credit transactions that involve a lien on a consumer's principal dwelling, regulates certain credit card practices, and provides a means for fair and timely resolution of credit billing disputes.

Focus on the definition of "Application"

In this edition, we focus on the new definition of an "***application***," and its impact to the origination process, including interactions with applicants, borrowers, and business channels. Our aim is to help lenders and other participants in the origination process start to be able answer some or all of the following questions:

- ***How does the new definition impact the pre-qualification and pre-approval process?***
- ***What are the new considerations related to managing and verifying the mortgage broker's compliance?***
- ***How does the new definition relate to the definition of "application" under other regulatory requirements such as Reg B (ECOA) or Reg C (HMDA)?***
- ***What is the potential impact to the customer's experience?***

The new definition of an "Application"

Current rules require initial good faith estimates and truth in lending disclosures be issued to customers within three business days of receipt of a completed mortgage **application**. The new rules maintain the three business-day requirement.

Current rules provide that an "application" consists of the **six elements identified in the box to right, plus a seventh element: "any other information deemed necessary by the loan originator**." This seventh, catch-all requirement effectively allows each creditor to define what constitutes a completed application – and therefore to establish when the three-business-day requirement is triggered. Where this may be most impactful today is at the time of pre-qualification or pre-approval, where all six elements may be captured but the lender can still use a final requirement, such as an application fee, to trigger the RESPA/TILA disclosures. The definition of "application" under the new rule **eliminates the seventh "catch all" requirement**. As a result, the rule will standardize the RESPA/TILA definition of a mortgage application, providing consumers with a consistent bright line as to when the three-business-day timeline for the loan estimate disclosure begins.

Defining an application (current state)

- Consumer Name
- Income
- Social Security Number
- Property Address
- Estimated Value
- Loan Amount Requested
- ***Any other information deemed necessary by the loan originator lender***

Why is this critical? If a Loan Estimate is triggered before the borrower and lender fully understand the nature of the lending transaction, there will be an elevated risk of re-disclosures, which can negatively affect the customer experience and unnecessarily increase costs and processing time. Another consideration is if the loan estimate is issued prematurely, readjustments to the preliminary fees initially captured may exceed the thresholds allowed at time of the Closing Disclosure resulting in the lender absorbing those fees and negatively impacting the profit margin on the loan.

Managing the impacts of the new definition

Under the new rules, lenders are not forbidden from requesting additional information as part of the application process. In fact, the CFPB does not believe the new rule will necessarily result in major changes as to when lenders provide disclosures in connection with an application, even for lenders that currently rely on the catch-all element.[2] Rather, the CFPB acknowledges that the rule permits a lender to **sequence the application process**[3] to gather additional items of information, including the loan product type the borrower seeks, before triggering a requirement to issue a Loan Estimate (the Loan Estimate must include a description of the loan product type).[4] On the other hand, lenders must be mindful that they are prohibited from holding up on providing a Loan Estimate because a borrower has not provided the additional requested information.

Two strategic approaches may be followed in how information is gathered from the applicant as part of this sequencing – "reactive" or "proactive."

> Under a ***reactive approach***, the lender may modify the sales approach to include a sequence of data requests that is designed to reduce the risk that the lender will receive all six elements of an application before the proposed lending transaction has sufficiently solidified. Lenders who adopt this approach must be very careful to avoid effectively holding back on sending a Loan Estimate because they have not received certain information that goes beyond the six elements of an "application."
>
> Under a ***proactive approach***, the lender requests all six elements of an application up front as well as requests the other key elements that would normally be identified with further discussion with the applicant, such as loan program. Although the other elements can no longer be required in defining an "application," the lender can encourage the applicant to provide these additional elements to assist in expediting the loan process. Again, lenders must be very careful to avoid effectively holding back on sending a Loan Estimate because they have not received certain information that goes beyond the six elements of an "application."

In either case, communication with the applicant will be critical in explaining expectations and the origination process.

Online applications. Lenders with an on-line application platform can update the application workflow to request data sequentially consistent with either of the two approaches above. The design of the sequencing of the application process can be built into the workflow through controls and dialog boxes but will typically require development of business requirements and technical specifications, system changes and UAT, supported by FAQs and technical training guides. For platforms that include live chat or telephone support, it also will be critical to complement the online application process with appropriate training for customer service representatives as well.

In-person applications. The success of the implementation of an in-person application process to mitigate the impacts of the new definition of "application" will depend on the **strength of the supporting procedures and oversight and the effectiveness of the training administered to the personnel who take applications**. While the principles are the same for the in-person process as they are for the online application process, an in-person application process is inherently more subject to variation in execution. Lenders should consider clearly documenting procedures for their salesforce, including how to address the scenario where the information necessary to complete an application is received before intended. All new procedures should incorporate compliance monitoring and testing as well as controls that clearly identify the point at which the Loan Estimate is triggered.

Mortgage brokers. The new rule requires that either the broker or the lender provide the customer with a Loan Estimate within three business days and that the lender shall ensure that disclosures provided by a mortgage broker are provided in accordance with all requirements of the rule. This is not necessarily different than today's requirements.

However, due to the change in the definition of an "application," **the lender should consider the various risks that may be encountered, including accepting a Loan Estimate that may**:

…have not met the time requirements of 3-days by the broker.

…result in the need of an immediate re-disclosure.

…have an adverse impact on the profit margin due to the disclosure of insufficient fees or closing costs that ultimately exceed the thresholds at time of the Closing Disclosure.

1 http://files.consumerfinance.gov/f/201311_cfpb_final-rule-preamble_integrated-mortgage-disclosures.pdf, page 1297

2 http://files.consumerfinance.gov/f/201311_cfpb_final-rule_integrated-mortgage-disclosures.pdf [1026.19(e)(2)(iii)]

3 See discussion at 78 Fed. Reg. 79730, 79764-67 (Dec. 31, 2013) ("The Bureau does not believe the deletion of the catch-all item will cause creditors to issue a large number of revised Loan Estimates that would create consumer confusion and information overload. The final rule permits creditors to sequence the application process to gather additional items of information, including the potential loan product a consumer is considering, which some creditors assert are needed to provide reliable estimates. This reduces the risk of re-disclosures.").

As a result, it will be critical for lenders and mortgage brokers to communicate and coordinate how information is collected and who does what when an "application" becomes complete. Again, sequencing of information gathering can reduce the risk of avoidable re-disclosures but, for lenders relying on mortgage brokers, that information gathering process will not necessarily be under the direct control of the lender. Reliance on a thorough due diligence of the broker's application procedures will be key. Lenders that use a wholesale channel should consider the impact of the new definition of "application" through a combination of coordination with mortgage brokers and the lender's third-party risk management oversight processes.

Caution: All regulatory definitions of "application" are not alike

When determining how to respond to the new definition of an "application," it is important to bear in mind that other regulatory requirements use different definitions of an "application." Reg Z and RESPA govern when and how to give applicants information about a loan. Reg B (Equal Credit Opportunity Act) is concerned with the treatment of applicants and borrowers and whether they are given equal information. Reg C (Home Mortgage Disclosure Act or HMDA) focuses on where and to whom the lender is willing to make loans. And finally the Fair Credit Reporting Act protects when and how information about consumers is used and shared. Because of the different goals for each of these regulations, each one contains its own unique definition of an "application" and required reporting.

The challenge is that lenders that use the seventh "catch-all" in defining an "application" today frequently treat the definition for RESPA/TILA purposes as effectively the same as the definitions under Regulation B or Regulation C, thereby triggering obligations under RESPA/TILA concurrently with obligations under either Reg B, Reg C. However, with the new rule, a RESPA/TILA "application" is more clearly defined and distinctive from the definitions under these other regulations, and must be treated as such to accurately comply with all regulatory timing requirements.

The standard Uniform Residential Loan Application (URLA) or a similar type application form, when completed in its entirety, will typically satisfy all the regulations noted above (including HMDA, which generally requires creditors to report, among other things, the sex and race of an applicant when received from certain business channels). However, it is important to note even pre-approvals and pre-qualifications may trigger an "application." This is the case most recently with HMDA as of December 2011.[5] Further, initial dialog with the borrower may also trigger an "application" under Reg B or HMDA depending on what has been communicated or committed to the applicant by the lender. Each of these initial activities should be reviewed in distinguishing what constitutes an "application" under each regulation and, consequently, what are the proceeding disclosures and timelines required for compliance.

With the new rule, a RESPA/TILA "application" is more clearly defined and distinctive from the definitions under these other regulations, and must be treated as such to accurately comply with all regulatory timing requirements.

5 203.2(b)(2) A request for preapproval for a home purchase loan is an application under paragraph (b)(1) of this section if the request is reviewed under a program in which the financial institution, after a comprehensive analysis of the creditworthiness of the applicant, issues a written commitment to the applicant valid for a designated period of time to extend a home purchase loan up to a specified amount. The written commitment may not be subject to conditions other than: (i) Conditions that require the identification of a suitable property; (ii) Conditions that require that no material change has occurred in the applicant's financial condition or creditworthiness prior to closing; and (iii) Limited conditions that are not related to the financial condition or creditworthiness of the applicant that the lender ordinarily attaches to a traditional home mortgage application (such as certification of a clear termite inspection).

The customer experience

Although we speak throughout this Volume I about potential challenges in the interaction with the applicant or borrower and the importance of setting expectations early on, there can potentially be a great deal gained from turning the transition to the new rules into an enhanced customer experience. Now that the industry has transitioned into a purchase originations cycle, we typically find the real estate agent will have one of the first interactions with the customer either prior to the introduction to the lender or concurrently. **Pro-actively reaching out to your realtor market, offering education and training on the new rules and timelines, may be a successful way to 1) create a relationship and rapport with new offices and agents and, 2) allow expectations to be set early on for all the various players tied to the sales transaction, including your customer**. The more that is known upfront, including potential escrow time delays, etc. the less frustration will potentially be experienced.

Even beyond the purchase transaction, lenders should ensure the front-line staff from sales to processing for each type of loan transaction can speak with confidence to the new disclosures and timelines. This, coupled with understanding when an "application" has been triggered, will be critical in successfully maneuvering your customer through the initial stages of the origination process. The positive customer experience is typically tied to access of ready information; including having their questions answered on aspects of the disclosure forms they receive to avoid confusion and frustration. **The more your front-line staff and resources are effectively educated on the new rules and provide transparency with the process the greater the likelihood of a positive customer experience**.

Conclusion

As mortgage lenders prepare for the August 1, 2015, it is critical to focus early on the potential impact of the new definition of an "application."

This will be particularly important for lenders and mortgage brokers that currently rely on the catch-all seventh element of an "application." However, it may also be useful for lenders and brokers that currently use only the six core elements of an "application" to analyze their application processes and consider the extent to which their current processes expose them to undue risk of having to make avoidable re-disclosures – particularly in light of the potentially higher cost of each disclosure under the new rules.

Interestingly, unlike the new Loan Estimate and Closing Disclosure, which cannot be used to replace current disclosures ahead of the August 1, 2015 effective date of the new rule, there is no regulatory impediment to implementing revisions to lenders' and brokers' applications processes now. **Early implementation, ahead of the regulatory deadline, may help to mitigate the impacts of the new definition of an "application" well ahead of the rule's effective date**. This might be something to consider as a way to check one off the list towards August 1, 2015 compliance.

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