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Act Now Before It's Too Late ...



By Vincent Spoto

Guidelines and standards developed by the Consumer Financial Protection Bureau (CFPB), specifically those contained in Section 1024.38 of the Real Estate Settlement Procedures Act (Regulation X), require mortgage servicers to have policies and procedures reasonably designed to achieve the objective of facilitating periodic reviews of third-party vendors, the purpose of which is to evaluate and monitor overall performance effectiveness and compliance. CFPB guidelines further indicate that vendors utilized must have

the requisite financial strength, organizational capacity and policies and procedures in place to maintain full compliance with applicable laws and regulations, including (but not limited to) those developed by the CFPB, Federal Housing Finance Agency (FHFA) and Office of the Comptroller of the Currency (OCC).

Given the surge in defaults that have occurred within the past decade, the roles servicers play in the loss mitigation and foreclosure process has significantly increased. As such, servicers have placed greater reliance on the use of outside vendors to handle the resulting large workload and volume increases. Accordingly, the use of third-party legal

service providers has dramatically increased across the industry.

Quite often, servicers will engage outside vendors to perform a myriad of activities including appraisals, property valuations, property inspections, skip tracing, property management, collection calling and a host of legal services including foreclosure processing, loss administration and default management actions, title administration, bankruptcy processing and real estate-owned (REO) management. The recent introduction of strict standards and compliance guidelines established by the CFPB over foreclosure and other legal protocols make it imperative for servicers to ensure that any such legal

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functions outsourced to vendors are performed in accordance with applicable guidelines and standards. As these services directly impact and touch consumers, it is critical that third-party legal service providers:

- (i) Appropriately comply with all legal, CFPB and other regulatory guidelines;
- (ii) Act in accordance with the underlying contractual guidelines and specific directives given by the mortgage loan servicer, and
- (iii) Be both financially and operationally sound.

Specific areas to be reviewed when performing assessments of third-party legal service providers may include a variety of items, including but not limited to:

- Core competencies and services performed;
- State presence and state-specific industry references;
- Adequate and relevant litigation experience within the state (including prior and current litigations);
- Prior volume experience;
- Attorney licensing, staff experience and oversight;
- File oversight and file maintenance standards;
- Ethics and professional standards;
- Timelines, information privacy and capacity;
- Technology infrastructure, staffing and reporting capabilities;
- Insurance coverage, financial strength and business continuity;
- Quality control processes and employee training;
- Conflicts of interest, disclosures and diversity data;

- Current and prior audit/regulatory issues noted, fines or penalties that may have been assessed and the current status of corrective actions taken; and
- Other general matters of compliance and quality control.

Loan servicers frequently utilize the services of external consulting and advisory firms to perform or to augment the surveillance of selected vendors. To the extent external consulting and advisory firms are considered, servicers should base their selection on firms that utilize a comprehensive set of standard tools when conducting surveillance routines. While approaches will vary depending upon the size and sophistication of the surveillance firm selected, experience shows that the most optimum results are achieved by surveillance firms that generally deploy the following tools:

- On-boarding checklists to be completed by the vendors in advance of an on-site field audit;
- Annual/semi-annual surveys to be completed by the vendors, with information provided subsequently validated;
- Detailed audit programs for use in conducting field audits; and
- Other CFPB and government-sponsored enterprise (GSE) default administration guidelines (as applicable).

Critical in the selection process used by servicers should be the identification of an independent advisory and consulting firm that offers a full range of surveillance activities covering all outside vendors, including those services offered by third-party legal service providers. A review should be performed to ensure that the selected surveillance provider does not have any economic or business affiliations with any of the vendors used by servicer.

Specifically, servicers should seek firms that utilize the following approach in conducting surveillance reviews of external vendors and third-party legal service providers:

- **Preparation:** Prior to arriving on-site, vendors and third-party legal service providers should be supplied with the full scope of document information requests to be utilized when conducting any subsequent on-site audit review. Specific items provided may include:
 - (i) An on-boarding checklist;
 - (ii) An informational survey or questionnaire to be completed in-advance by the vendor to facilitate the subsequent on-site field audit review;
 - (iii) A formal and comprehensive set of audit programs for use in conducting on-site surveillance reviews, and
 - (iv) Other CFPB, FHFA, OCC and GSA default administration guidelines, as applicable.
- **Site visit:** An on-site audit visit of the vendor or third-party legal service provider should be performed within approximately two to three weeks of receiving the requested information. On-site audit visits will generally range between three and five business days; however, timing may vary depending upon the size and processing volumes of the vendor or third-party legal service provider.
- **Staffing size:** On-site audit visits would generally be staffed with anywhere from two to five professionals (again, actual staff resources engaged would depend upon the size, complexity and processing volumes of the vendor or third-party legal service provider);

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● **Staffing competency:** Seasoned mortgage professionals should be allocated to perform on-site audit visits. Specifically, staffing selections should consist of:

- (i) Trained financial accounting and servicing operations professionals capable of reviewing, analyzing and opining on the financial viability and processing capacity of each vendor or third-party legal service provider;
- (ii) Experienced legal experts familiar with specific state and local default administration guidelines (i.e. those relating to foreclosures, bankruptcies, asset maintenance and administration, etc.);
- (iii) Seasoned servicing professionals intimately familiar with the various facets of default management services;
- (iv) Experienced compliance professionals familiar with federal, state and local guidelines who are fully capable of assessing the completeness and adequacy of written policies and procedures; and
- (v) experienced technology professionals intimately familiar with technical infrastructures relating to default management practices, workflow protocols and continuity of business planning.

Servicers should be careful not to select a surveillance firm that utilizes a “one-size-fits all/cookie-cutter” approach. Instead, consideration should be given to the size of the vendor or third-party legal service provider in relation to their geographic location, years of experience and

the volume of transactions being processed. A flexible review approach should be taken by the surveillance provider (for example, the small four-person vendor in a remote geographic location having a proven history of strong performance should likely be assessed differently than a larger, more complex vendor/third-party legal service provider having a broader footprint across a more diverse constituency or geography).

Upon completion of the on-site field audit, a sit-down closing meeting should be held with senior management of the vendor or the third-party legal service provider to discuss the results of the review performed, specific findings noted and any preliminary performance grading assessment that may be provided. Generally, within 30 calendar days of the completion any on-site field-audit, a written report should be prepared that supports the evaluation performed. Specific findings and issues should be presented, applicable recommendations for corrective actions discussed, associated implementation target dates identified and timeframes for performance of a follow-up review agreed to.

Generally, servicers should select surveillance firms that formally rate vendor performance (i.e. those that are fully acceptable, those that are acceptable with some concerns noted, or those that are not acceptable). In assigning such ratings, any subjectivity would be eliminated or minimized to the greatest extent possible. As such, servicers may consider using surveillance firms having a formal scoring model that utilizes individual numerical grading assignments opposite a compre-

hensive set of questions/processing routines within a series of weighted performance attributes and categories.

Any supporting written reports that are prepared by the surveillance provider should be treated in a highly confidential manner and should only be shared with the servicer and the vendor/third-party legal service provider upon receipt of specific and mutual approvals/consent agreements.

Surveillance firms should collaborate closely with each mortgage servicer and the respective third-party legal service providers, and should modify their review approach as necessary.

By following the suggested protocols discussed, servicers can more comfortably ensure that surveillance providers selected have the essential tools and approaches in place to evaluate and monitor overall performance effectiveness and compliance of vendors and third-party service providers. Servicers will also be secure in knowing that selected vendors and third-party legal service providers are performing optimally and in a fully compliant fashion. In doing so, servicers will also be well positioned to undergo any regulatory scrutiny requiring them to have policies and procedures reasonably designed to achieve the objective of facilitating periodic reviews of vendors and third-party legal service providers.

Vincent Spoto is partner and managing director of New York, N.Y.-based RRMS Advisors LLC. He has more than 25 years experience in the financial services sector. He may be reached by phone at (212) 843-9159 or e-mail vspoto@rrmsco.com.

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