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INDUSTRY INSIGHT / CRAIG NAZZARO

RAISING A RED FLAG

Private-label servicing's growing popularity and the influx of nonbank servicers spurs a host of regulatory concerns and calls for increased guidance and oversight.

As compliance costs continue to rise for mortgage servicing, so does the popularity of private-label servicing. As a product, private-label servicing is not complicated. A subservicer will service an institution's portfolio while retaining the bank's branding throughout the entire loan life cycle, leaving the borrower unaware of the identity of the subservicer.

This approach ideally affords the originating lender the benefit of customer retention through consistent brand recognition, while simultaneously providing the institution a lowered cost of compliance, since the act of servicing—and therefore the compliance costs associated with said servicing—is shifted to the private-label servicer.

Private-label arrangements range from the simple cobranding of billing statements that include the institution's name and logo all the way through private borrower-facing loan-level websites, Automated Clearing House drafts, credit reporting, and collection activity—all done in the originating institution's name by the subservicer. With the most comprehensive offerings of private-label servicing, the borrower would never know the subservicer existed. The wide spectrum of how this product may be offered begs for regulatory guidance.

SEEKING THE CFPB'S GUIDANCE

Earlier this year, the U.S. Government Accountability Office (GAO) issued a report to congressional requesters Sen. Elizabeth

Warren (D-Massachusetts) and Rep. Elijah E. Cummings (D-Maryland) entitled "Nonbank Mortgage Servicers: Existing Regulatory Oversight Could Be Strengthened."

The GAO emphasized the fact that the share of mortgages serviced by nonbanks increased from 6.8 percent in 2012 to 24.2 percent in 2015. The GAO found that it is important for the Consumer Financial Protection Bureau (CFPB) to take steps to identify nonbank entities and collect more comprehensive data to further ensure that all nonbank servicers comply with federal laws governing mortgage lending and consumer protection.

The increasing popularity of private-label servicing mixed with the rise of market share held by nonbank servicers leads me to believe that the practice is ripe for review by the CFPB under its risk-based approach to supervision and enforcement. In anticipation of this, the CFPB should issue guidance on the practice. Ideally, it would formally approve the practice and provide a set of best practices to follow when performing private-label servicing.

SERVICE PROVIDER VS. SUBSERVICER

Nowhere in any official CFPB guidance or regulation does the bureau bless the practice of private-label servicing. The practice relies on the argument that a subservicer providing private-label servicing is acting as a service provider or vendor of the servicer that retains the mortgage servicing rights (MSRs). As a service provider or vendor, it is not acting as a traditional subservicer.

The argument, while formally untested, is a valid one. There are service providers that perform activities for servicers every day and do the work in the names of servicers. However, the reverse argument is also valid: Outsourcing the entire servicing business to a service provider escalates it to a subservicer.

Reg X Section 1024.31 defines "master servicer" as "the owner of the right to perform servicing. A master servicer may perform the servicing itself or do so through a subservicer." The regulation goes on to define "subservicer" as "a servicer that does not own the right to perform servicing but that performs servicing on behalf of the master servicer." And "servicer provider" is generally defined in section 1002(26) of the Dodd-Frank Act as "any person that provides a material service to a covered person in connection with the offering or provision by such covered person of a consumer financial product or service."

REGULATORY QUESTIONS ABOUND

With such uncertainty surrounding the actual roles of each participant, there comes a plethora of regulatory questions:

Are institutions required to issue a notice of transfer of servicing rights when the loan boards with a private-label servicer?

Can the private-label servicer furnish credit reporting in the name of the holder of the MSRs without violating the Fair Credit Reporting Act?

Whose name will appear on debt validation notices or mini Miranda warnings when acting as a collector on defaulted loans? Will this give rise to a claim under the Fair Debt Collections and Practices Act?

If a borrower enters a branch or calls an institution directly for support with loss mitigation or to make a payment, what will the employee tell the borrower about his or her mortgage? Will the institution's systems of record even identify the person as a mortgage customer? If not and the borrower is told he or she is not a customer, does this give rise to unfair, deceptive, or abusive acts or practices—commonly referred to as UDAAP—violation?

Who issues a privacy notice under the Gramm-Leach-Bliley Act, and what name is the notice placed in?

As the market share of nonbank servicers continues to grow along with the popularity of private-label servicing, so will the CFPB supervision and enforcement focus on these issues as well. As an industry, we should demand more guidance before we wind up in another situation similar to RESPA Section 8 compliance, where good actors in the space believe they are conducting business in compliance with all regulations only to find out through enforcement actions that the CFPB does not agree.

It's particularly a concern in this situation because the CFPB would not have to redefine its view of any existing regulation, as no current federal regulation or regulator has directly addressed the activities of private-label servicers.

WHERE THE RISK LIES

It's also important to note that the CFPB is very clear about vendor liability and has issued guidance on the topic in CFPB Bulletin 2012-03: If an institution is currently utilizing a subservicer for private-label servicing, this does not absolve the institution of the compliance and/or regulatory risk.

Prior to engagement, an institution should have a complete audit of policies, procedures, and controls the private-label servicer has in place, including loan boarding, payment application, servicing transfer, loss mitigation, escrow analysis, complaint handling and escalation procedures, LPI processes, collection, and so on. These full-360 reviews should also be completed and updated on a regular and ongoing basis.

These oversight procedures and controls will limit regulatory exposure but not eradicate it. Subservicers offering private-label servicing should be assessing if they have sufficient controls in place to best guard against any regulatory inquiries. They should also take the time to re-review the regulatory risks associated with the details of their private-label offerings.

Eventually, the mortgage industry will see guidance and regulations that address the issues raised in private-label servicing at the state level and/or the federal level. Until then, the industry should become more attentive to the risks associated with the practice.