

The "State" of Expert Systems Hotchkiss, Lynette

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Over the past few years, the benefit of **automating regulatory compliance** in mortgage lending has been oft discussed. Conferences have featured panels and trade journals have carried articles pointing out how technology can ease the regulatory compliance burden. Generally, these discussions focus on the ways in which technology can help with federal regulations such as the **Truth in Lending Act** (TILA) and the **Home Ownership Equity Protection Act** (HOEPA) or with state and local high-cost laws.

One area that has been overlooked is the way in which **automated compliance systems**-often called "**expert systems**" -can be a lifesaver when it comes to compliance with state consumer credit laws.

If you lend in more than one state, things become very complicated very quickly. The more states covered by your lending programs, the more complex your life becomes. Every state has its own take on what is permitted for loans made to the consumers within its borders, covering, among other things, late charge and grace period restrictions, prepayment penalty permissibility, interest limitations and calculations, and fees that are permitted or prohibited.

The range of permitted practices varies not only from state to state, but from one loan type to the next within a single state. For example, in **New Jersey**, certain broker fees are permitted in a first lien loan made by a licensed lender, but charging a borrower for any broker fees in a subordinate lien loan made by a licensed lender is strictly forbidden. In **Kansas**, for certain first lien loans made under the **Kansas Usury Law**, prepayment penalties are permitted for a limited period of time, while prepayment penalties are prohibited in loans made under the **Kansas Uniform Consumer Credit Code**.

An expert system that includes a state consumer credit compliance option will have all of this information built in and will stop you from making a loan if a prohibited fee is included in the loan, or if an otherwise permitted fee is prohibited because it is paid to the lender or the broker rather than to a third party provider. Further, these expert systems will stop you if the loan contains a prohibited prepayment penalty or if the late charge is too high or the grace period too short.

These systems also can ensure that the fees charged by the lender or the broker don't exceed any dollar or percentage limitation imposed by state law-such as a 1 percent loan origination fee or a 2 percent broker fee limitation. Expert systems can review the loan to make sure the state interest rate ceilings are not breached, that interest does not begin to accrue before permitted by state law, and that a 360-day year isn't used to calculate interest when the law mandates a 365-day year. Expert systems also can apply a state specific mortgage insurance drop-off requirement that is more conservative than federal law. And the list goes on. These few examples give you just a sample of the breadth of compliance coverage possible with these systems.

Licensing is another area in which an expert system can provide great assistance. Systems that contain a license review option permit you to ensure that the broker in a wholesale loan is not only licensed and in good standing but also holds the correct license type for the loan being made. Such a license review, when also applied to the lending branch, can alert you to any licensing problems your branches may be experiencing.

A good expert system has the ability to **tailor its loan reviews** to mirror your specific lending model. If you are a national bank or federal savings bank, the system will recognize your ability to export interest from your home state or a host state and will apply the correct rules to fit that profile. If you are a licensed lender, the system will determine what license you are using and will apply the correct rules for that license type.

Like an elephant, an expert system never forgets. This means that the results of your reviews are **uniform and consistent** time after time. These systems are built using the knowledge provided by many of the best legal minds in mortgage compliance today; it's like taking all of these great legal minds and downloading them into a computer, developing a great "super legal brain". And while an individual attorney might forget that the Indiana **UCCC** late charge is currently \$16.50, or that **Tennessee** limits broker fees to 2 percent, or that **New York** has a state specific mortgage insurance drop-off requirement, the "super brain" of these systems won't forget what it knows.

Expert systems provide many benefits that will help you save time and money. The process of dotting all the "i's" and crossing all the "t's" can be performed much more quickly. There are a number of different delivery mechanisms possible for using one of these systems. To access the loan data for review, an expert system can:

- 1) **Integrate directly** into your loan origination system or other system of record,
- 2) **Provide loan reviews** based on loan data provided on a data tape or flat file and reviewed on a "batch" basis, or
- 3) **Review loan data** that a user has input through screens directly into the system.

Lenders can use an expert system as part of their origination process, reviewing 100 percent of the loan files during the normal origination flow. Servicers and secondary market purchasers can use these systems to review loans they plan to purchase or service to make sure those loans pass muster before being accepted.

Using an expert system permits you to focus less on the tedious chore of maintaining and updating spreadsheets and databases of state law issues and constantly training new people to use them. This leaves time for your people to focus on the other issues that are not as easy to automate.

An expert system can make your life easier through the magic of technology.

*(The views expressed in **Tech Forum** do not necessarily reflect the views or policies of the **Mortgage Bankers Association**. **MBA Tech NewsLink** welcomes your contributions. Articles and inquiries should be submitted to **Mike Sorohan**, editor, at msorohan@mortgagebankers.org.)*