

# The Whats, Hows and Whys of Automating Regulatory Compliance

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## Automated Compliance Systems – Questions to Address

- What are automated compliance systems?
- What kinds of things can they test for?
- How do they fit into lending workflow?
- What kinds of systems are out there today?
- How are companies using them today?
- What can you look for in an automated compliance system?

- **So What?**



## What are automated compliance systems?

They're technology-based systems that can:

- Receive information about a loan electronically
- Leverage licensing information to determine applicable limits
- Check the loan information against applicable compliance rules and regulations
- Test for regulatory requirements at Federal, State and Municipal levels
- Automatically calculate relevant terms, limits and thresholds
- Factor in institution-specific rules, policies and practices
- Provide pass/fail results, flags and information on how to cure
- List results in readable reports or feed data to other systems
- Typically have a rules engine at their core, for speed and ease of maintenance
- Feature rules that are maintained by legal staff, backed by leading law firms, and continually updated

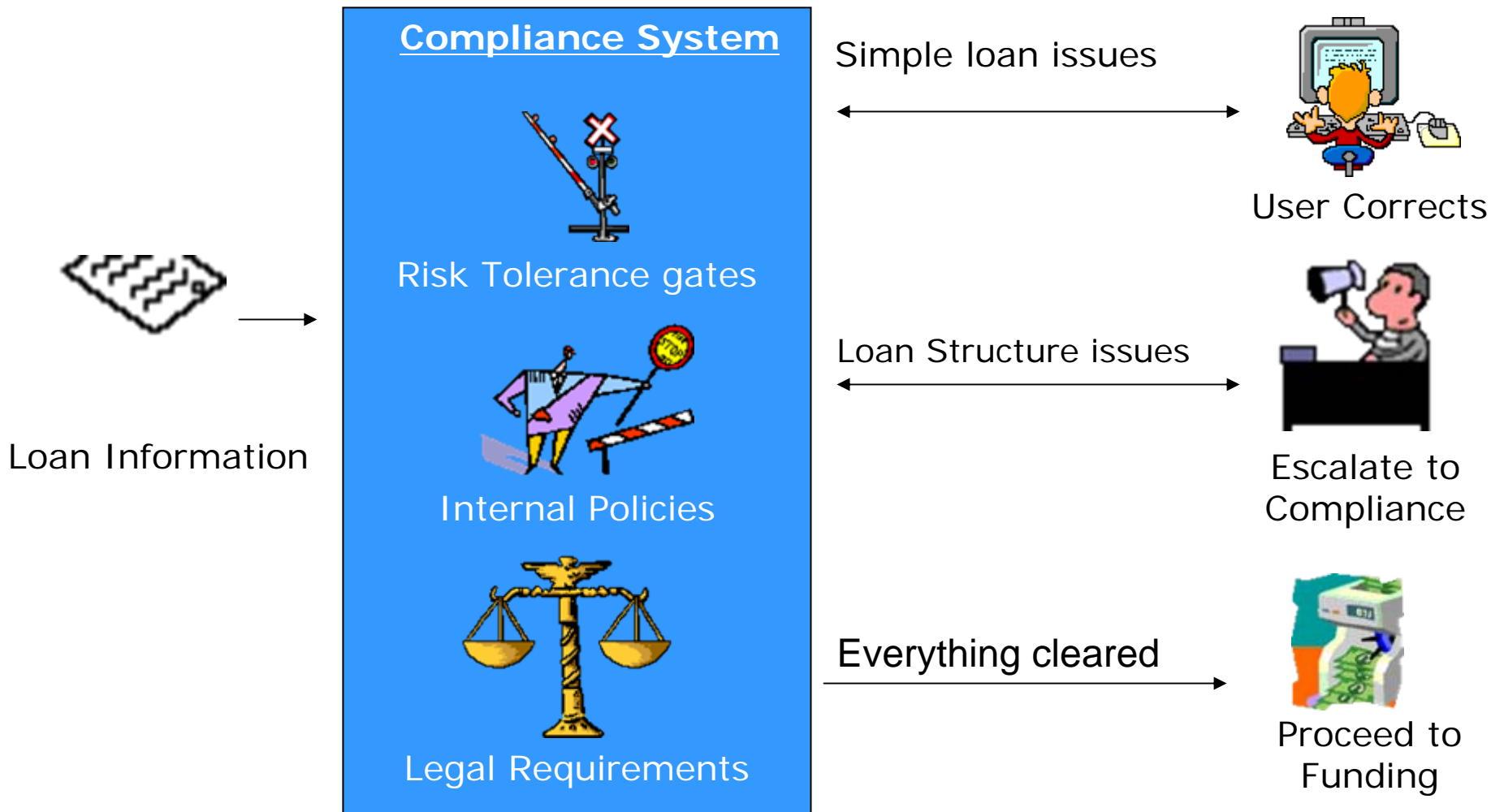
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Public service announcement: Spreadsheets are *not* automated compliance systems



# What are automated compliance systems?

The view from 30,000 feet



## What kinds of things can they test for?

**They can, generally speaking, test against most quantifiable laws/regulations, including:**

- Federal Truth-in-lending requirements
  - » What should the payment schedule really look like (rate adjustments, MI, Neg-Am, etc.)
  - » Are Truth-in-Lending (TIL) disclosures accurate within applicable tolerances
  - » Right-of-rescission, timing of disclosures
- Federal (HOEPA), state and municipal “high-cost” lending laws
  - » Which laws actually apply to the loan?
  - » What is the jurisdiction-specific APR and “points and fees”?
  - » Most importantly – Is the loan “high-cost”?
  - » If needed, run tests that only apply to “high-cost” loans (needed disclosures, income requirements, etc.)
- State consumer credit and other regulations
  - » Verify licenses, factor in how a lender is licensed and which exemptions/preemptions apply
  - » Does the loan violate usury limits, late fee caps, prepayment penalty limits, etc.
  - » Does the loan exceed other fee limit requirements that may apply?
  - » Other “fun” fee limits (Go ahead and charge a fee at origination...just don’t call it an “origination fee”)

## What kinds of things can they test for?

Test coverage can also simultaneously go beyond the actual law to include:

- Secondary market criteria
  - » GSE limits
  - » Rating agency commentary
  - » Investor-specific policies
- Custom internal policies
  - » Best-practices (e.g. “global” caps on total fees)
  - » Limits imposed on certain channels (e.g. criteria applied to correspondent loans)
  - » Safety cushions (lower thresholds by 0.01%, pad total fees, etc.)

## How do they fit into lending workflow?

### At multiple points in the lending process, as loan terms are finalized:

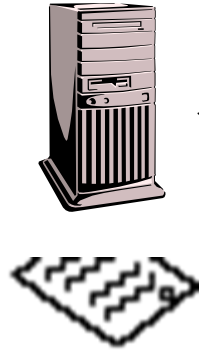
- In general, as soon as you could create a Good-Faith-Estimate/TIL you can run compliance (loan-level data sets are very similar)
- If compliance system is “service-based” it can be plugged into existing systems
  - » Works like a “traffic light” to control lending operations
  - » Loan information goes in (electronically) and results come back in seconds
  - » Biggest benefit when integrated as automated check in Loan Origination or other internal workflow systems
- Audits can be manual or semi-automated, requiring only a web browser
  - » Best left to lower-volume channels
  - » Makes a certain amount of sense for QC
  - » Useful in instances where you don’t have systems to integrate with
- For bulk portfolio audits most systems also feature ability to run batches outside of the origination workflow
- Running automated compliance as part of drawing docs makes good sense, if possible (last-minute fees and charges can make all of the difference)

# How do they fit into lending workflow?

The integrated approach at a glance

## Starts with:

Loan Data from LOS, workflow system, documents...



## Compliance System



Pulls in licensing information



Runs Applicable Rules & Regulations



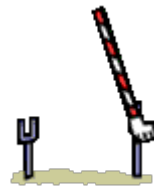
Re-Calculates, TIL, APR, loan amounts, etc.



## Results in:

Decision to Fund or Purchase

**Pass**, **Fail** and/or recommendations



## What kinds of systems are out there today?

The spectrum varies widely; but some general examples of systems include:

- High-cost auditing systems
  - » Limit coverage to “high-cost” laws
  - » Integration possibilities are less flexible
  - » Some come bundled with doc-prep services
  - » Some loan origination systems come with the ability to configure these types of tests yourself
- High-cost with some Truth-in-Lending support
  - » Add some limited APR recalculation and disclosure checking
  - » May feature file-by-file upload capability from LOS or standard file formats
  - » Might not support all loan types (no HELOC or “Exotic” mortgage support)
  - » Vendor-hosted ASP service (accessed via web browser)
- High-cost, full Truth-in-Lending, State consumer credit regs, Investor policies
  - » Built on scalable rules engine to offer ability to add custom rules
  - » Feature service-oriented architecture to integrate with other systems
  - » Take into account licensing, exemptions and preemptions
  - » May be ASP (hosted by the vendor) or installed in-house
- Some lenders do build and maintain their own systems in-house

## How are companies using them today?

Here's what we're seeing (Disclaimer - not a scientific survey, by any means):

- What are the most common types of systems from which audits are being run?
  - » From LOS with complete integration (most common)
  - » Web browser-based compliance audit via file upload from LOS
  - » At doc draw via integration with third-party doc prep provider
  - » Via direct integration with other types of underwriting, workflow, QC systems (least common)
- How many times are audits being run on each loan?
  - » On average, 2-3 distinct places in their process where compliance audits are run
  - » Statistically this varies widely among different types of lenders
  - » Some have upwards of 15 places in their process where compliance audits are run

## **What can you look for in a third-party automated compliance system? Examine your institution's needs and evaluate vendors vs. internal solutions:**

- Features of the system
  - » What's the coverage of the system?
  - » Do you need a "high-cost" calculator, or more than that?
  - » What kind of reporting capabilities are there?
- Quality of the system's regulatory tests
  - » Who maintains the rules in the system?
  - » Is research provided by experts in the field?
  - » How much customization of tests will you require?
- Integration possibilities
  - » What are your integration needs?
  - » Can you leverage integrations that the vendor has pre-built with other systems
  - » Will you need multiple access points to audits (web browser, LOS, Doc Prep system)

# So What?

Here's the compliance story we hear from companies most often



Legal hunts down relevant regs

Pass to IT for implementation



IT backlog pushes burden back



Compliance chases down Depts & Divisions for compliance



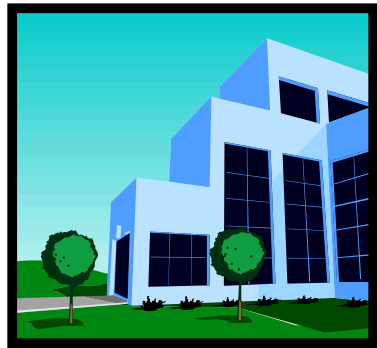
Without proper controls, somewhere a compliance slip-up occurs



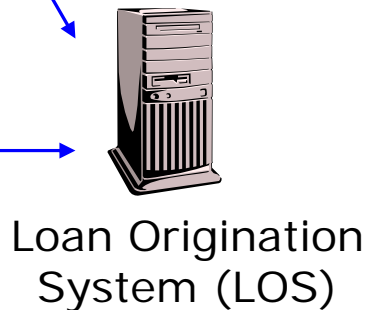
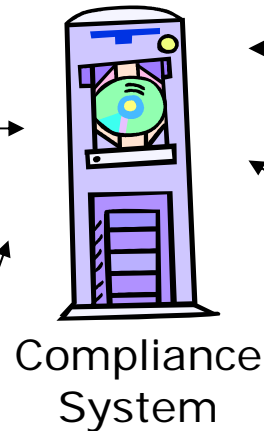
Regulations are a moving target

# So What?

A centralized third-party compliance system addresses those challenges



Depts & Divisions have direct access to controls



Document System



Rules & Regulations centrally maintained



Legal can work directly w/ vendor on custom rules



Vendor continually updates Rules & Regs in system



## So What?

**There are some clear benefits to a third-party automated compliance system:**

- Risk mitigation
  - » Centralized system allows for better institution-wide controls
  - » Compliance coverage can be increased to as much as 100%
  - » Seamless integration with internal systems can eliminate slippage
- Cost savings / efficiency
  - » Reduced legal costs and less of a burden placed on internal IT
  - » Better use of resources (maintain existing team while increasing coverage)
  - » With a system maintained by a third-party, total cost of ownership goes down
- Competitive advantages
  - » Roll out new products faster
  - » Streamline acquisition and funding processes to create value for brokers/correspondents
  - » Adapt to “exotic” loan programs before your competition
  - » Lower your cost of doing business, creating more competitive pricing

**Thanks very much!**

