Objects on the horizon are closer than they appear

In August of 2015, three documents at the very core of the mortgage process are being supplanted by two completely new documents. Mandated by Dodd-Frank and designed by the Consumer Finance Protection Bureau (CFPB), these two seemingly innocuous disclosures bring monumental changes to every corner of the mortgage process as well as every participant.

Think August 1, 2015 is far in the future? Think again. To be fully prepared for Know Before You Owe, the time to start is now.

Lessons Learned

The mortgage industry is no stranger to compliance-driven changes to lending processes. The Qualified Mortgage / Ability to Repay (QM/ATR) Rules are now five months old. While tangentially related to Know Before You Owe (KBYO) through Dodd-Frank, the lessons the industry learned in implementing QM/ATR are instructive.

First, we found out that time was not on our side. QM/ATR changed the way lenders approach lending from the perspective of borrower eligibility as well as investor acceptability. Resolving this alone took months of individual policy debate.

Another equally important lesson was the challenge of implementing the tests necessary to determine classification and eligibility. A third lesson was the need for staff training and borrower education. And, fourth, the implementation of QM/ATR underscored the need for technology to unify compliance initiatives. There is simply too much at stake, given the complexity of the Rules and Know Before You Owe, to rely on subjective, manual processes.

Lenders who were prepared for the Qualified Mortgage / Ability to Repay Rules were those that addressed all four areas of concern long before January 10, 2014. Those that prepare for KBYO — starting now — have the best chance of being ready for it.

Technology, the Unifying Factor

Lenders cannot afford to assume their current mortgage lending technologies will automatically meet KBYO demands. What looks like a simple change -- substituting two disclosures for three -- is actually far from easy. The problem is not the documents themselves but what they represent. New calculations combined with completely new presentations present major technical challenges. Many systems were designed around the HUD-1, which is replaced under the regulation by the Closing Disclosure.

This is no simple replacement, however. HUD line numbers, relied on by virtually all systems and lenders, are replaced throughout by new numbers and new terms. Retiring the HUD-1, therefore, presents time consuming, expensive, and for some, impossible technical challenges.

What’s a lender to do? Being ready on August 1, 2015 is not good enough for many reasons. The first step is to gain commitment now from mortgage technology providers for early delivery. Understand their detailed Know Before You Owe plans as well as their timelines for deployment. Lending teams must understand the plans of their technology providers since reliance on them is essential to their own plans. Making sure KBYO capabilities are in place several months before the effective date is essential to a successful, fully compliant roll-out.

A second step is investigating new systems. Enhanced ease of compliance is a strong incentive for lenders that have been contemplating technology upgrades to take action. The disparate, quasi-integrated system model long employed by mortgage lenders presents data integrity challenges, especially where disclosures and documents are concerned. Know Before You Owe leaves no margin for error. Lenders may have been complacent about managing multiple data sets for the same loan, but comprehensive systems that begin with the point of sale and end with closing documents deal with this problem once and for all.

People: Education is Essential

Change is hard. Wholesale changes that tamper with the very traditions upon which mortgage lending was founded are even harder. Know Before You Owe combines the initial Truth-in-Lending (TIL) and Good Faith Estimate (GFE) disclosures into the Loan Estimate document. The Closing Disclosure replaces the final TIL and the HUD-1.

The TIL, GFE and HUD-1 have been in continuous use for more than 30 years. Known to everyone in the industry — lenders, borrowers, and investors — they are relied upon as they represent the very essence of the loan itself. With a quick glance at these three documents every lender in every lending discipline can quickly decipher a mortgage.

Lending teams must be ready to do the same using the Loan Estimate and the Closing Disclosure before August 1, 2015. Developing training plans now that teach loan originators, processors, underwriters, closers and funders how to read these documents as quickly and as easily as they read the legacy packages is essential to maintaining an efficient, borrower friendly process. As with the other initiatives, now is the time to start developing these plans.

Maintaining a borrower-friendly process is essential. The purchase market is heating up now in various geographies and is expected to be in full swing for the 2015 season. Purchase loans cannot wait. Borrowers will not understand, nor tolerate, closing delays.

Know Before You Owe affects borrowers, too. First-time buyers will be relatively easy to educate since they are less likely to have expectations about the process or the forms they will encounter. Repeat borrowers, however, will expect the GFE, TIL and HUD-1. They, too, must be educated about the new forms and the changes in process they represent.

Maintaining an acceptable borrower experience is the paramount reason for educating lending teams now. There is another important reason to do so: under the regulations, lenders have an affirmative obligation to educate consumers. During examinations examining teams will likely want to review training materials and sales
scripts, if your organization uses them. In the end, though, the best test of this obligation will be borrower satisfaction. After all, there’s no truer test of understanding than being able to teach and train another. A well-educated borrower is a happy borrower.

Process: Driven by Regulation, Enabled through Technology

Today’s lenders face a two-pronged process redesign conundrum. What may prove to have been the longest refinance cycle in the history of mortgage lending has come to a close. Refinance lending as a percentage of the overall market continues to decline, a trend that is expected to continue for some years to come.

Meanwhile purchase money lending, a more complex, time-consuming and expensive form of lending, takes the place of refinance lending. Purchase money lending requires different processes that effectively bring the real estate and the mortgage transaction to closure at precisely the same time. Redesigned processes that take these factors into account while maximizing efficiency are priorities for every lender; borrowers demand efficiency, and profitability requires it.

Know Before You Owe requires process changes as well, starting with pre-qualification/pre-approval and continuing all the way through closing. As discussed earlier, the Loan Estimate replaces the initial TIL and the GFE in the initial disclosure package. Like the initial TIL and the GFE, it must be provided within three days of application. The Closing Disclosure, which replaces the HUD-1 and the final TIL, presents a new wrinkle. It must be provided to the borrower three business days prior to closing. This is a significant change since most HUD-1’s today are drawn just prior to closing; borrowers see them for the first time at the closing table. Under KBYO, all lending processes will have to be redesigned and backed up at least three days to meet the Closing Disclosure timing requirement.

Closing disclosure timing is one variable driving process change. Preparation of the disclosure itself is another. HUD-1’s are typically completed by the settlement agent. Closing disclosures can also be completed by the agent; however, they become the lender’s sole responsibility. While delegation of the duty is permissible under the regulation, careful thought must be given to the prudence of doing so. The sweeping process changes necessary as a result of Know Before You Owe and the purchase market switch emphasize the importance of technology. Mortgage lending has never been as complex or expensive as it is today, or as it will become leading up to August 1, 2015. Comprehensive, inclusive lending technologies are essential to needed process efficiency.

Time is of the Essence

The phrase ‘Time is of the Essence’ is found in every real estate contract. The meaning is obvious: closing the contemplated transaction as soon as possible is in all parties’ best interests. Its very appearance is a reminder of the duty to act swiftly. The phrase is also applicable to the effort of being ready when Know Before You Owe takes effect on August 1, 2015. Technology upgrades, people education – for both mortgage personnel and consumers --- and process modifications are the key items for every lender’s KBYO action plan. Those who realize that time is of the essence – and take action now – will be best prepared on August 1, 2015.
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