



BANKING, INSURANCE, AND CAPITAL MARKETS

# EFFECTIVELY MANAGING “KNOW BEFORE YOU OWE” TILA-RESPA DISCLOSURES

## KEY OPPORTUNITIES AND LEADING STRATEGIES FOR LOAN ORIGINATORS AND SERVICERS

On November 20, 2013, the Consumer Financial Protection Bureau (“CFPB”) issued the Final Rule on the Integrated Mortgage Disclosures (the “Rule”) under both the Real Estate Settlement Procedures Act (“RESPA”) and the Truth-in-Lending Act (“TILA”). As part of a Dodd-Frank Act mandate, the Rule aims to combine two sets of forms that customers receive under both RESPA and TILA between the time of the initial borrower loan application and the closing/origination of a mortgage. The result is the integration of the Good Faith Estimate (“GFE”) and the initial Truth-in-Lending (“TIL”) disclosures into the new Loan Estimate form and the HUD-1 and Final TIL disclosures into the new Closing Disclosure. These new disclosures, also referred as the ‘Know Before You Owe’ disclosures, aim to reduce the overlapping of information received by customers, as well as to simplify the overall origination process. Most of the information in the current forms will be retained in the new forms. However, these new forms will be subject to new delivery timeframes, new specific information to be disclosed, and other regulatory requirements embedded in the Rule.

The essential TILA-RESPA changes and implications are straightforward, but there are a number of complex nuances which, for most institutions, will require a very significant implementation process. Mortgage entities will need to identify their loan populations, business processes, and staff affected by the Rule in order to develop appropriate policies, procedures, and employee training. Procedures and controls will need to be reviewed and updated. Some processes will need to be developed from both an operational and technological/systems standpoint. Borrower information and loan data will need to be re-mapped to produce the new disclosure forms. Systems will need to be updated to comply with new content requirements such as a new estimate of the total principal paid off in five years and the total interest paid (“TIP”) over the term of the loan as a percentage of the loan amount. Servicers and originators (as well as their third-party service vendors) must be compliant with all the Rule changes in order to originate any new mortgage loan applications received after August 1, 2015.

In this paper, we provide a high-level overview of impact of the TILA-RESPA changes in four key process areas within loan originations. We also outline potential challenges to implementation that lenders should consider.

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### About Navigant

Navigant Consulting, Inc. (NYSE: NCI) is a specialized, global professional services firm that helps clients take control of their future. Navigant’s professionals apply deep industry knowledge, substantive technical expertise, and an enterprising approach to help clients build, manage and/or protect their business interests. With a focus on markets and clients facing transformational change and significant regulatory or legal pressures, the Firm primarily serves clients in the healthcare, energy and financial services industries. Across a range of advisory, consulting, outsourcing, and technology/analytics services, Navigant’s practitioners bring sharp insight that pinpoints opportunities and delivers powerful results. More information about Navigant can be found at [navigant.com](http://navigant.com).

## KEY CHANGES

The key changes for TILA-RESPA Rules are listed below.

NEW GUIDANCE	PREVIOUS GUIDANCE	KEY CHANGES
Definition of Borrower Application	Included “any information deemed necessary by the loan originator” in definition of application.	A new definition of application (which triggers an obligation to provide a loan estimate) includes the following six components: borrower’s name, income, social security number, the property address, a property valuation or estimate, and the loan amount pursued.
Loan Estimate (Form H-24)	GFE and Initial TIL	The new loan estimate combines a number of fields from the GFE and the Initial TIL. New disclosure elements require lenders to communicate to borrowers: <ul style="list-style-type: none"> <li>• Total interest paid as the total payment amount over five years.</li> <li>• TIP as the total interest percentage over the life of the loan.</li> </ul> Updated guidance on origination charges at different tolerance levels: <ul style="list-style-type: none"> <li>• Charges subject to zero percentage tolerance;</li> <li>• Charges subject to ten percentage tolerance; and,</li> <li>• Charges subject to no tolerance.</li> </ul>
Closing Disclosure (Form H-25)	HUD-1 and Final TIL	New timing requirement to provide Closing Disclosure within three business days prior to consummation.  The disclosure now provides a detailed side by side comparison between the Loan Estimate and the Closing Disclosure.  Form H-25 discloses new information including the lender’s partial payment policy.
Other Requirements Beyond Loan Closing:  Escrow Closing Notice (Form H-29)  Disclosure of Partial Payment Policy  Record Retention	New	New Escrow Closing Notice must be provided no later than three business days prior to closing an escrow account and no later than 30 business days if cancelled for any other reason. The notices include items such as the date of the escrow account cancellation, the reason behind the cancellation, and the detailed costs to the borrower.  Partial payment acceptance and if borrower payments that are less than the periodic payment amount will be accepted.  New record retention guidelines of five years for closing disclosure and applicable documentation, two years for Escrow Cancellation notices, and three years for all other evidence of compliance under the TILA-RESPA Integrated Disclosure provisions.

### 1. Borrower Application

As a result of the new Rule, a customer application (that triggers an obligation to provide a loan estimate) is now defined by the receipt of six components of borrower information provided for the purpose of obtaining a mortgage loan. This information consists of the borrower’s name, income, social security number, the property address, a property valuation or estimate, and the loan amount pursued. In addition, the update now removes the current definition that considers a borrower’s application as “any other information deemed necessary by the loan originator.” Moreover, a loan originator or mortgage broker must provide the borrower with the new Loan Estimate form no later than three business days after these six pieces of information are received from the borrower.

## 2. Loan Estimate

The new Loan Estimate disclosure (Form H-24) incorporates fields mostly from the existing GFE and the initial TIL disclosure and contains three pages of information. The first page includes the general loan terms with the new prepayment penalty disclosure requirement, the new projected payments' breakdown, and the estimated costs at closing. With this new form, lenders are now required to disclose the maximum prepayment penalty amount, as well as a monthly breakdown of maximum and minimum periodic payment amounts. On the second page, the form details all closing costs, including a detailed cost analysis of the amount needed to be paid by the borrower at consummation or 'Cash to Close.' The last page includes additional information on the loan, including five-year projections of the total amount to be paid, and the TIP.

Beyond the information contained in the Loan Estimate, the Rule establishes further requirements on the terms necessary to provide revisions (changes to the amounts initially disclosed), as well as guidance on the associated percentage tolerance categories to the charges imposed to borrowers. The main challenge with this requirement will be for lenders to update their current processes and systems to integrate all borrower charges data, and address the new zero percentage tolerance, 10 percentage tolerance, and no tolerance requirements. Navigant believes that one of the most significant challenges arising from the new Rule will be the requirement to coordinate the receipt of fee information from vendors so that lenders are receiving more real time information (earlier in the underwriting process) to ensure that fees stay within the tolerance amounts to the maximum extent possible.

## 3. Closing Disclosure

In general, the new five-page Closing Disclosure (Form H-25) combines the current information on the HUD-1 and the final TIL disclosure, which must be provided to the borrower at least three business days prior to consummation. The first page includes similar information corresponding to the Loan Estimate: the terms of the loan, the estimated borrower payments, and the general closing costs. The second page provides a detailed breakdown of the closing costs paid by the borrower, lender, and other applicable sources before and during the actual closing. The third page calculates the cash required to close and a general summary of all closing transactions between the borrower and seller. More importantly, it highlights any differences between this form and the prior amounts provided to the borrower on the Loan Estimate. The fourth page imparts the borrower with additional new information, including the lender's partial payment policy, and required information regarding the borrower's escrow account and payments. The last page of the disclosure outlines the general loan calculations totals,

other disclosures applicable, as well as contact information (for applicable lender, broker, and/or settlement agents) and must be signed by the borrower(s).

Similar to the Loan Estimate disclosure, the CFPB has also provided further requirements for lenders on revisions of the form, associated closing cost tolerances, and new record retention requirements.

## 4. Other Requirements Beyond Loan Closing

The Rule also includes a few requirements applicable after the mortgage loan has been originated. In particular, the Escrow Closing Notice (Form H-29) applies to closed-end consumer credit transactions secured by real property and it is subject to new specific timing and information requirements. For example, the new notice must be provided no later than three business days prior to closing the borrower's escrow account (when consumer requests a cancellation) and no later than 30 business days if cancelled for any other reason. This post-consummation notice shall inform the borrower of the date of the escrow account cancellation, the reason behind the cancellation, and the detailed costs to the borrower, which includes cancellation fees, the required format, and other miscellaneous information.

Similarly, a few nuances beyond loan origination are noted in the Rule. For example, the CFPB also has required that servicers disclose their partial payment policy. This includes whether borrower payments that are less than the periodic payment amount will be accepted or not. Also, addressed is whether the acceptance of these payments will not be applied to the borrower's account until the consumer pays the remainder of the amount due. Another requisite facet includes informing the borrower that if the loan is sold the new "lender" may have a different policy. Specifically in the case of loan information and record retention, the Rule specifies that the servicer keep all closing disclosure and applicable documentation for five years, Escrow Cancellation notices and transfer of servicers for two years, and all other evidence of compliance under the TILA-RESPA Integrated Disclosure provisions for three years.

## IMPLICATIONS AND CHALLENGES TO IMPLEMENTATION

Planning ahead and understanding the different implementation challenges under this Rule update could prove to be a high priority very soon, especially for loan originators. While most of the internal changes will depend on each lender's business model, compliance with the Rule must also be worked out with impacted service vendors and business partners. Based on the key changes mentioned above, the list below delineates briefly the potential implications necessary for lenders to be compliant with the new TILA-RESPA Rule:

- Each lender will need to identify key process updates and educate/train staff to ensure compliance of their policies and procedures.
- New processes and operational controls may need to be developed to help ensure the Rule is followed timely and accurately especially once borrower information is received triggering the delivery of a Loan Estimate.
- Updates to preventative and detective controls to ensure the business has the right safeguards in place to meet the requirements.
- Beyond the mapping of loan data to the new disclosure formats, technology changes will be necessary to integrate and reproduce new information required in the disclosures, such as accurate closing costs, five-year estimates of total amounts paid, and the TIP among others.

## CONCLUSION

Some lenders may experience difficulty implementing these updates on time, especially with other changing compliance requirements and regulatory audits. An important piece of the implementation of this Rule will be for lenders to conduct an initial assessment of the system upgrades and options available to satisfy the new requirements. It is critical that the initial assessment identifies managers and resources that can mold implementation efforts to the CFPB's expectations, and can develop effective training references and awareness of the new procedural changes. Similar to the CFPB origination and servicing requirements that became effective in January 2014, an important implication of this Rule will include updates to the policies, processes, procedures, and controls, in addition to the required system updates. While August 2015 may seem distant, we believe it is imperative that lenders and servicers plan ahead to anticipate any compliance risks or loan origination challenges.

## HOW NAVIGANT CAN HELP

Navigant has assisted a wide range of institutions with implementing mortgage solutions related to compliance and regulatory requirements such as the TILA-RESPA Integrated Disclosure Rule. A selection of the service offerings we have performed is below, but each engagement is approached with a customized execution strategy built around your company's needs and budget. Our broad expertise and extensive experience gives us powerful insights into all aspects of assessment, design, implementation, execution and ongoing monitoring involving large regulatory changes, including knowledge of what regulators are most concerned with in a dynamic regulatory environment.

- Compliance reviews
- Compliance program, policies and procedure development
- Risk analysis and assessments
- CFPB Exam preparation
- Loan file lookback testing
- Business process re-engineering
- Process mapping
- QC reviews
- Strategy reviews
- Servicing operations reviews
- Securitization structuring and accounting
- Mortgage loan accounting
- Controls deficiency remediation
- System selection
- Targeted operating model development
- Risk and capital modeling
- Process and workflow automation
- Compliance training program development
- Periodic monitoring