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US Mortgage Lenders Face Difficulties Complying with New Rules, a Credit Negative for RMBS

From Credit Outlook

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Several third-party review (TPR) firms have revealed to us that more than 90% of the first pipeline of residential mortgage loans subject to the US Consumer Financial Protection Bureau's (CFPB) recently enacted TILA-RESPA Integrated Disclosure Rules (TRID) that they reviewed had TRID compliance violations, although many of them were only "technical" in nature. These results suggest that some lenders are having difficulty complying with the rules, a credit negative because it increases the likelihood that loans with compliance violations will be included in future residential mortgage-backed securities (RMBS) pools.

The extent to which such violations would increase losses for RMBS is still unclear without further interpretation by the courts or the CFBP. Furthermore, difficulty complying with TRID may result in delayed issuance of new securitizations owing to issuer concerns about including loans with compliance violations.

TRID, which went into effect for loans whose borrowers completed applications after 2 October 2015, requires mortgage lenders to provide new and expanded loan estimates and closing disclosures to consumers within specific time frames. Its purpose is to ensure that consumers clearly understand the cost and risk of the proposed mortgage loan and have a chance to shop for a more suitable product. TRID arguably expands the amount of erroneous information for which a secondary market purchaser, including an RMBS trust, is liable.

The TPR firms' informal feedback to us was based on reviews of around 300 loans from more than a dozen lenders, whose identities the TPR firms did not reveal to us. Additionally, since the TPR firms performed these reviews for transactions not connected with a securitization, we did not see the actual diligence results. Nevertheless, the fact that all the TPR firms told us that such a large portion of the loans had notable violations is significant.

Many of the violations were reportedly technical in nature, such as the need to use the same spelling convention for counterparties or the absence of a required hyphen. However, the TPR firms still believed the violations were material because the extent to which a secondary market purchaser, such as an RMBS trust, would bear damages or costs from delayed foreclosures is still unclear without further court or CFPB interpretation.[1] The number of technical violations should decline over the next several months as lenders adjust their loan origination systems to comply with the rule's nuances.

THIS REPORT WAS REPUBLISHED ON 10 DECEMBER 2015 TO CORRECT AN EDITING ERROR.

What is Moody's Credit Outlook?

Published every Monday and Thursday morning, Moody's Credit Outlook informs our research clients of the credit implications of current events.

[1] Similarly, under our rating methodology, a TPR firm should grade a compliance violation as a "C" if the violation could adversely affect the loan or its holders. In contrast, a "B" grade violation does not and will not have any adverse effect on the loan or its holders.

Some of these technical violations are likely to be low risk. Even if TRID confers assignee liability for technical violations, such as those listed above, the risk of significant damage from them is low. We believe it is unlikely that courts will hold up a foreclosure or award damages for these kinds of violations. Furthermore, a transaction would be protected from this risk if features such as representations and warranties or indemnification required a creditworthy entity to reimburse the RMBS trust for any losses resulting from violations of the rule. On the other hand, we believe that violations related to incorrect settlement fees, which previously did not carry assignee liability under the Real Estate Settlement Procedures Act, now carry higher risk under TRID.

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