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# Washington Amends Consumer Loan Act Regulations: What Mortgage Servicers and Passive Investors Need to Know

On September 1, 2018, Washington will join the growing number of states that are requiring passive owners of mortgage servicing rights (MSRs), regardless of whether they acquire standalone MSRs or whole residential loans, servicing-released, to obtain a license under the Consumer Loan Act (RCW Chapter 31.04) even though such entities will not perform any direct servicing or consumer-facing activities. Through the amendment of the rules implementing the Act, the Washington Department of Financial Institutions (DFI) has also created first-of-their-kind requirements for the maintenance of a compliance management system that adheres to federal standards, maintenance of recorded telephone calls, and restrictions on certain servicing activities from being conducted offshore.

## License Requirements for MSR Holders

The Act requires a licensee to service or modify the terms or conditions of residential mortgage loans, but the definition of the term "service or servicing a mortgage loan" under the Act or the rules has not been interpreted to include mere passive holding of MSRs without performing any servicing functions and does not trigger licensing under the consumer loan company license. The rules promulgated by the DFI alter this interpretation.

In its rulemaking documentation, the DFI specifically stated that the rules, which implement the licensing requirement, "must be amended to clarify the roles of parties investing in, owning, and servicing residential mortgage loans." The DFI accomplished this by amending WAC 208-620-011's definition of "service" or "servicing a loan" to include a list of entities that are "regulated persons" under the Act. Specifically, a "master servicer," defined to mean a person "responsible for ongoing servicing administration either by directly servicing *or through servicing agreements with licensed or exempt subservicers*" (emphasis added), will be a regulated entity. As a result, on and after September 1, 2018, an entity that purchases closed mortgage loans with the servicing rights is considered to be a master servicer under the rules, and a license is required to engage in such activities.

Significantly, however, the rules exclude investors and note buyers from the definition of "regulated persons" under the Act and, therefore, they are not required to be licensed in order to engage in business. "Investor" is defined to mean a person "holding securities or other types of instruments backed by pools of residential mortgage loans," but "servicers, master servicers, or subservicers" are specifically excluded from the definition. "Note buyer" is defined to mean "persons who purchase mortgage loans without servicing rights and who are not servicers, master servicers, or subservicers."

Additionally, the rules provide that an entity that currently holds a consumer loan company license will not be required to obtain a separate license in order to service Washington MSRs.

*A&B Observations*: The DFI will consider an entity that passively invests in Washington MSRs on the secondary market to be servicing Washington residential mortgage loans. This means that passive investors in standalone Washington MSRs and Washington residential mortgage loans on a servicing-released basis on the secondary market are required to obtain a consumer loan company license to engage in such activities on and after September 1, 2018. However, entities that engage in securitization transactions that include Washington MSRs or those entities that purchase Washington residential mortgage loans on a servicing-retained basis will not be subject to licensing.

## Record Retention, Including Telephone Calls

The DFI clarified requirements for the retention of loan-servicing records, which will have to include servicing agreements, notes from government-sponsored entities (GSEs), if applicable, and recorded telephone calls with consumers. While the general record-retention period is generally the longer of three years after making the final entry or the period of time required by federal law, for telephone calls, the rules indicate that the timeline is "three years after the date of the call or longer if required by another law."

Additionally, while the rules permit electronic retention of records, subject to certain conditions, the DFI has made clear that a licensee may only use a cloud service for records maintenance if the underlying servers are located in the U.S. or U.S. territories.

*A&B Observation*: The requirement to maintain records of telephone calls should not come as a surprise. Despite the lack of express requirement under WAC 208-620-520 previously, in its winter 2018 newsletter, the DFI informally asserted that within the meaning of WAC 208-620-520(1), electronic records include "electronically recorded telephone calls with borrowers," which "must be retained for at least three years after the last entry on the loan." The requirement to retain recorded telephone conversations differs from prior guidance of the DFI in that calls need to be retained for three years from the date of the call (or longer if required by another law) and is also beyond the scope of requirements in most other jurisdictions. Consumer loan company licensees should review their record-retention policies to determine if adjustment is required to satisfy the rules' requirements for loan-servicing files.

## Compliance Management System

Since 2012, the federal Consumer Financial Protection Bureau (CFPB) has included in its Supervision and Examination Manual guidance on the operation of an effective compliance management system (CMS). With the adoption of the rules, Washington becomes one of the first states to mandate adoption of a CMS that meets the CFPB's standards. Specifically, a licensee must maintain as part of its books and records a CMS that contains, at a minimum: (1) board and management oversight; and (2) a compliance program, including policies and procedures, training, monitoring and/or audit, and consumer complaint response functions.

*A&B Observation*: The DFI, in making Washington the first state to mandate a CMS for licensees, ups the ante for servicers and emphasizes how important a CMS is for servicer operations.

Additionally, the CMS requirement expands the scope of records a licensee must maintain. WAC 208-620-520 requires a licensee to maintain "general records," including "books, accounts, records, papers, documents, files, and other information relevant to making loans or servicing residential mortgage loans"; there is no express requirement relating to policies, procedures, and other compliance materials except for those relating to third-party service providers (in WAC 208-620-900). The adoption of WAC 208-620-585 makes clear that a licensee must maintain policies and procedures (among other materials) in the regular course of business. Accordingly, licensees should ensure that their recordkeeping policies reflect the new scope of Washington requirements and that policies and procedures include a review and revision history to memorialize changes in versions.

## Prohibited Conduct (Including Conducting Activities Outside the U.S.)

The rules add to the list of conduct in which a residential mortgage loan servicer may not engage: (1) "knowingly or recklessly improperly onboarding a residential mortgage loan" into its loan servicing system; and (2) conducting any of certain enumerated activities from a location outside the U.S. or U.S. territories. Activities that may not be offshored are receiving payments and maintaining payment records, collection activities, any communications with consumers, and the receipt of data from or disbursement of data to consumers. The rules also clarify that a licensee may offshore data entry, document review, recommendations for action, records searches, credit dispute analysis, and escrow analysis functions. These restrictions are in addition to complying with all applicable laws because the rules have been amended to provide that a violation of any applicable state or federal law, regulation, or program is a violation of the Act.

*A&B Observation*: With the rules clarifying that the DFI can impose penalties for a violation of federal or Washington law, consumer loan company licensees should identify and correct any potential deficiencies in their onboarding systems to avoid liability for "reckless" improper onboarding. Additionally, any licensee that offshores any loan-servicing functions (directly or through its service providers) should review the scope of offshored activities to ensure that it complies with the DFI's limits on offshoring.

## Other Rule Provisions of Note

The amended rules include several other provisions that will impact the business practices of consumer loan company licensees as of September 1, 2018, including:

- **Revised Reporting Requirements** (WAC 208-620-490). On and after September 1, 2018, any licensee that will be updating the location of its books and records must provide notice *at least 10 days before* the change occurs by processing an amendment to its company NMLS record. Additionally, any licensee whose capital fell below the required GSE minimum capital requirements, if applicable, must report such an event to the DFI within 10 days of the event.
- Moreover, any licensee that receives notification from a GSE of termination or of a breach of contract, waiver, or nonperformance must amend its company NMLS record after receiving such notification if the reason for the notification remains unresolved for more than 90 days. The rules appear to obligate such a licensee to amend its company NMLS record *within 20 days after* the expiration of this 90-day period.

- **Surrendering a License** (WAC 208-620-499(4)). On and after September 1, 2018, an entity licensed to engage in business as a residential mortgage loan servicer that would like to surrender its license must provide the DFI with a description of the disposition of its servicing volume, including the name of the purchaser and the specific notice to consumers about the sale of their servicing in order for the DFI to allow the licensee to surrender its consumer loan license.
- **Reconveyance Requirements** (WAC 208-620-550(13)). The rules increase the deadline for a licensee's reconveyance of title to collateral after payment of a loan in full from 30 to 60 business days.
- **Recodification of Certain Servicing Requirements** (WAC 208-620-905, 208-620-920, 208-620-930, and 208-620-935). The DFI has removed requirements specifically relating to the maintenance of escrow accounts, borrower requests for information, loss mitigation, and foreclosure and moved them to dedicated rules on those topics. The recodification does not include any substantive changes to the existing requirements.

## Conclusion

Both MSR holders and consumer loan company licensees should take care to review the requirements of the rules to ensure that they are in compliance—whether by obtaining a license or by aligning their recordkeeping and other practices with the new requirements. The DFI's creation of broad enforcement powers under the rules—permitting discipline under the Act for a violation of any applicable state or federal law, regulation, or program—should make compliance with the rules a matter of relative urgency for entities doing business in Washington State.

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