



MORTGAGE QUALITY
Management & Research

Rolling Sevens

The Top 14 Provisions Every Lender Should Examine When Reviewing Vendor Contracts



INTRODUCTION

With great power comes great liability. Bank and non-bank mortgage lenders deal with consumers' most valuable information and possessions – sensitive personal data, asset account details and homes – items with which they can ill afford to gamble.

Mortgage lending is also an extraordinarily complex machine and requires lenders to engage in intimate relationships with vendors to keep operations running smoothly and optimally. As such, the contract review component of vendor management is critical to any lending operation's comprehensive risk mitigation strategy – the contract dictates the beginning, middle and end of the relationship.

Given the critical and comprehensive nature of these documents, vendor contract review can feel like a bit of a crap shoot because it can be difficult to account for all the variables that make for a successful vendor relationship. If one or two crucial components are overlooked, lenders could be rolling snake eyes instead of sevens in regards to their vendor relationships.

Thus, lenders should hold scheduled reviews of vendor agreements to ensure that they have not placed their bets on a losing hand. Here are the 14 most critical vendor contract provisions that every lender should examine when reviewing vendor agreements.

1 **Ensure you have a fully executed copy of all vendor contracts**

Step one of the contract review process is to ensure that all vendor contracts are on file. While this may seem obvious, when pressed, many lenders find they cannot immediately produce a copy of their fully executed, countersigned vendor contracts.

Lenders should also check that each contract has not expired and has been fully executed – meaning the contract has been dated, signed and countersigned. It is all too common for lenders to sign a contract, submit it to a vendor for countersigning and never receive a final copy of the fully executed contract. Any missing records of fully executed contracts must be retrieved from your vendors.

2 **Check for clearly defined vendor services and deliverables**

Contracts that clearly define vendor responsibilities restrict lender liability, strengthen contract enforceability and give lenders greater leverage in addressing service violations and performance related disputes. In service-level vendor agreements, the following items should be clearly set forth:

- The nature of services provided
- The standards of service performance
- The frequency with which services will be performed
- The effective date and length of service duration

Defining service boundaries in the vendor agreement is equally important. Protections may not cover vendors that are performing services outside of the scope of the agreement.

3 **Validate confidentiality provisions**

Ultimately, the lenders are responsible for the fate of any information they transmit to a vendor. Reputational risks and noncompliance penalties make it imperative that lenders review vendor service agreements for confidentiality provisions. There are two types of confidentiality that should be present in lender agreements: confidentiality of privacy and confidentiality of trade secrets.

Contracts should specify a vendor's duty to not disclose any lender information unless it is required to perform contractual services or comply with regulations. When a vendor has access to consumer nonpublic personal information (NPPI), provisions must be in place that ensures consumer information is carefully safeguarded.

Additionally, contracts should be checked for provisions that shield the confidentiality of trade secrets. This type of provision protects vendors from using and sharing the trade secrets of lenders and vice versa.

4 Confirm the vendor's security breach protocol

Lenders should check that vendors are obligated to immediately notify lenders of any security breach, especially if any borrower NPPI is compromised. Ideally, these notifications will specify how vendors will communicate security breaches to lenders, the types of information that has been compromised and how the breach will likely affect the lender.

5 Review contract termination provisions

Lenders should look for termination provisions and verify whether they may terminate vendor agreements without cause, within a reasonable period of time (within 60 days) or in the event of a material or security breach.

Other aspects of contract termination provisions that should be identified are automatic termination or renewal dates. Will the contract remain in place until terminated by one of the parties? Are there pre-defined effective and termination dates? Will the contract automatically renew absent any action within a specified window of time? Without awareness of termination provisions, lenders may find themselves locked into paying another year of service for an automatically renewed contract or suddenly without a provider once a service period has ended.

6 Verify adequate insurance coverage

Insurance is an essential aspect of even the most bare-bones risk management strategy. However, it is perhaps the most overlooked component of vendor contract analysis. Without adequate insurance, lenders could find themselves on the hook for harm caused by vendors lacking the financial wherewithal to cover their damages. Because insurance comes in many flavors, lenders should stipulate the types of insurance and coverage amounts that vendors must maintain in addition to notifying the lender of any changes in insurance coverage.

As part of responsible vendor management, lenders should not just check that vendor contracts contain insurance provisions, but also go one step further and verify that vendors have current and adequate coverage by obtaining a copy of the vendor's certificate of insurance. Lenders should never do business with an uninsured or underinsured vendor.

7 Guarantee that you have the right to audit or monitor the vendor

Saying it is one thing; doing it is another. The right for lenders to audit or monitor the performance of their vendors should be written into service contracts so that lenders can verify that vendors are upholding their end of the agreement. Depending on the vendor contract, it may be stipulated that audits shall be conducted by an independent party, the lender or the vendor's internal staff. Vendor auditing may not be relevant to some types of low-risk vendor relationships and services, but for critical vendors, service contracts should stipulate a right to audit or monitor.

8 Make sure third-party contracting provisions are clearly stipulated
Contracts should be examined for assignment provisions – clauses that specify if vendors are restricted from subcontracting services and whether contract assignment requires lender consent. This type of provision prevents vendors from assigning contracts to third-party subcontractors that have not been vetted by the lender. It is a best practice to ensure that assigning a contract to a third party is prohibited without lender consent. If your contract allows for vendor assignment of services, carefully spell out stipulations regarding vendor liability for a subcontractor’s actions and vendor responsibility to monitor third-party provider performance.

9 Evaluate the vendor’s indemnification provisions
Indemnification clauses strengthen a lender’s ability to collect on damages caused by vendor wrongdoing. These types of provisions set forth whether lenders are required to indemnify the vendor and under what circumstances. Additionally, contracts should be examined for the presence of no harm provisions that shield vendors from any liability.

10 Examine the vendor’s dispute resolution procedures
Lenders should look for governing law provisions and whether their agreement specifies which state’s laws will be used to interpret the contract in the event of a dispute. Beyond identifying the legal jurisdiction of an agreement, lenders should examine vendor contracts for dispute resolution provisions. Common dispute resolution procedures include undergoing mediation before heading to court, entering into binding arbitration in lieu of courtroom proceedings and requiring arbitration before proceeding to court. It is important to identify both the jurisdictional law and the escalating procedures governing dispute resolution.

11 Look for non-compete and non-solicitation provisions
Vendor contracts should be examined for non-compete or non-solicitation provisions, which specify whether one or both parties are prohibited from selling similar products or services. These clauses may further contain a license agreement delineating that lenders or vendors cannot reverse engineer, copy, or manipulate a material product or service in order to produce a competing product. Additionally, agreements should be checked for whether parties are restricted from soliciting the other’s employees and contractors.

12 Make certain that offshore services will not be used

In the face of rising costs, many companies in the mortgage industry are offshoring services to cheaper labor markets. From a lender's standpoint, this is risky because it is extremely difficult to perform proper due diligence on an offshore services provider. In addition, the privacy rules in other countries do not always mirror those in the United States, which only increases the risk level, especially if the offshore vendor is dealing with NPPI. What's more, regulators are not keen on this practice either. Therefore, it is best to avoid this at all costs.

13 Authenticate the vendor's record retention policy

Lenders are subject to a range of record retention requirements, depending on the state, and vendors should be adhering to these same regulations as well to ensure their lender clients remain in compliance. Therefore, if it is not already included, it is wise to have your vendor's record retention policy spelled out in the contract. This includes any information contained within the vendor's systems of record.

14 Certify your access to information upon termination

While no one enters into a relationship expecting it to end, there are times when an agreement with a vendor runs its course. When this happens, lenders need to know the procedure for accessing any information the vendor may have retained, and if this provision is not present in the existing contract, it certainly needs to be added to ensure the lender has access to the information it has paid the vendor to collect over the course of the relationship.

As these 14 points illustrate, betting the house without conducting a proper assessment of your vendor contracts is a risk that may not pay off in the long run. If you are ready to put the odds in your favor, bring HQ Vendor Management (HQVM) to the table. A dba of mortgage risk management and compliance services provider MQMR, HQVM is the leading provider of vendor management services focused specifically for the mortgage industry. As part of its comprehensive vendor management program, HQVM's team of vendor management professionals will conduct a thorough review of all your vendor contracts to ensure the deck is not stacked against you.

To learn more about HQVM's services, visit hqvendormanagement.com, mqmresearch.com or contact info@mqmresearch.com.



About Mortgage Quality Management and Research, LLC

MQMR bridges the gap between risk and compliance through its suite of risk-related services. Since its inception, MQMR has launched multiple products and services to assist lenders in navigating regulatory requirements, including providing mortgage compliance consulting throughout the origination process, conducting internal audit risk assessments and ongoing internal audit support, servicing QC and subservicing oversight to master servicers, and filling the void of meeting vendor management oversight requirements. With 2,000+ operational reviews of mortgage companies, subservicers, document custodians, and vendors annually, MQMR prides itself on being an industry leader in counterparty risk and compliance.

To learn more, visit mqmresearch.com, subsequentqc.com, and hqvendormanagement.com.

About HQ Vendor Management

MQMR founded dba HQ Vendor Management (HQVM) in 2014 to deliver a holistic, cost-effective and customizable vendor management solution to meet third party oversight requirements. HQVM's mission is to strategically manage vendors to maximize an organization's investment in outsourcing. Leveraging software automation to streamline workflow management and serve as a centralized repository, HQVM works with each lender to create a customizable solution that aligns with the lender's current business model and risk appetite. HQVM's experienced team includes credit analysts, financial analysts, attorneys and auditors whose collective skills and expertise establish a unique platform to audit vendors and assess risk.

To learn more, visit hqvendormanagement.com

