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# MORTGAGE COMPANY EXAMINATION OVERVIEW

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## INTRODUCTION

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The Texas Department of Savings and Mortgage Lending (SML) promotes compliance with the Residential Mortgage Loan Company and Residential Mortgage Loan Originator Licensing and Registration Act, the Real Estate Settlement Procedures Act (RESPA), the Truth in Lending Act (TILA), the Equal Credit Opportunity Act (ECOA), the Fair Credit Reporting Act (FACTA) and other State of Texas regulations through supervisory and outreach programs. The SML conducts three types of supervisory activities to review a mortgage company's and sponsored residential mortgage loan originators' (RMLO) compliance posture: compliance examinations, investigations, and visitations. Compliance examinations are the primary means the SML uses to determine whether a RMLO is meeting the responsibility of compliance with the requirements and guidelines of consumer protection laws and regulations. Investigations are conducted to follow up on particular consumer inquiries or complaints. Visitations, while rare, are conducted on occasion by SML to review a RMLO's progress on corrective actions in the interval between compliance examinations. Visitations are usually targeted events aimed at specific operational areas, or entire compliance management systems, previously identified as significantly deficient.

This document provides a general overview of the SML compliance examination. The purposes of compliance examinations are to:

- Review compliance with relevant laws and regulations.
- Assess the quality of the mortgage company's compliance management system for implementing state and federal consumer protection statutes and regulations.
- Initiate effective supervisory action when elements of a mortgage company's compliance management system are deficient or when significant violations of law are found.

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## EXAMINATION APPROACH

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The scheduling of SML compliance examinations is based on a risk-focused approach that incorporates items such as consumer complaints, inconsistent licensing information, inaccurate advertising or other sources, and the volume of production. Risk focusing involves using information gathered about the mortgage company and/or RMLO from these four primary criteria to direct SML examiner resources to those operational areas that present the greatest risk in compliance and to Texas consumers.

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## DETERMINING RISK

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Risk focusing involves a random selection of five loans per RMLO. Whenever possible, one of these files should be in process and one denied. Examiners will use their discretion to determine the need for expanding the scope of the review. For larger operations, where more than ten active RMLOs are licensed by the same mortgage company, a smaller statistical sample will be taken. When a smaller

sample is initiated, a minimum of fifty loans, or at least one file per RMLO, will be imposed.

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## EVALUATING THE COMPLIANCE MANAGEMENT SYSTEM

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The examiner considers the compliance risk profile for a mortgage company using various sources of information about its business lines, organizational structure, operations, and past supervisory performance. In addition, previous compliance examinations may have revealed either the complete absence of or significant deficiencies in the mortgage company's compliance management systems. Factors used in measuring adequacy include:

- Knowledge level and commitment of mortgage company and personnel.
- Mortgage company's responsiveness to compliance deficiencies.
- Mortgage company information systems and proper settings.
- Policies and procedures.
- Training program.

Based upon the results of this review, the examiner may conclude that weaknesses in the mortgage company's compliance management system may result in current or future noncompliance with consumer protection laws, regulations, or policy statements. The SML expects the mortgage company to have a viable system in place to manage its compliance risk, consistent with size and product mix.

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## UNLICENSED ACTIVITY

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A reconciliation of SML office records for approved mortgage company activities against field examination findings will sometimes reveal activity that is unlicensed. For example, a loan "processor", who is acting as a RMLO without having obtained a license, is conducting unauthorized unlicensed activity. Another common example is a RMLO who originated loan applications prior to his/her licensing date or during a period of time when the license was allowed to expire before renewal.

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## ROLE OF THE MORTGAGE COMPANY EXAMINER

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Mortgage company examiners play a crucial role in the supervisory process. The compliance examination, along with follow-up supervisory attention to a mortgage company's compliance program deficiencies and violations, helps to ensure that consumers obtain the benefits and protections afforded them under state and federal law. To this end, an examiner's efforts should help mortgage companies improve their compliance posture and prevent future violations.

Primarily, examiners will conduct transaction testing through the sample of five loans per RMLO, evaluate the mortgage company's compliance management system, and adjust the scope based on assessed risk areas.

As part of the examination process, examiners are expected to:

- Use a common-sense approach to examining and use sound judgment when making decisions.
- Maintain ongoing communication with the mortgage company's qualified individual (QI).
- Assist the mortgage company to help improve performance by providing sound recommendations for enhancing its compliance management system.
- Share experience and knowledge of successful compliance management systems.

- Provide guidance regarding the various consumer and fair lending laws and regulations.

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## EXAMINATION MANAGEMENT

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Mortgage company examinations primarily involve four stages: pre-examination planning and analysis, on-site examination, reaching conclusions, and communicating findings to the mortgage company's QI via meetings and a report of examination.

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### PRE-EXAMINATION PLANNING AND ANALYSIS

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Pre-examination planning involves gathering information available in SML records and databases such as SEMARCA/NMLS and delivering prior notification to the mortgage company's QI of a pending examination. The prior notification begins with a telephone call to determine an examination date that is acceptable to both parties. The phone call is followed by the notification cover letter from the Chief Mortgage Examiner and "The Examination Process: What You Should Anticipate" document (Exhibit 1), delivered via e-mail or fax to the mortgage company's QI. Beneficial SEMARCA/NMLS data includes: a list of offices, a list of RMLOs with current license expiration dates, and call report data. Proper examination preparation and advanced planning maximizes the examiner's time and resources. The scope of an examination may be expanded based upon the RMLO's views about compliance, a lack of necessary procedures or controls, or the presence of violations.

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### ON-SITE EXAMINATION

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An initial meeting with the qualified individual of the mortgage company (QI) should be scheduled as quickly as possible upon arriving on-site. The focus of the meeting should be an interview for the examiner's completion of the Mortgage Company Questionnaire (Exhibit 5). The QI should provide a complete overview of the operation. During the on-site phase of an examination, the examiner thoroughly reviews a mortgage company's loan application log to make a determination of the loan cut; assesses the quality and viability of the compliance management system; and documents any system weaknesses and violations of consumer protection laws and regulations. The compliance review includes, among other things, an evaluation of the effectiveness of training.

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### REACHING CONCLUSIONS

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At the conclusion of the on-site examination, the examiner:

- Defines and provides examples supporting violations and deficiencies.
- Summarizes all findings regarding the strengths and weaknesses of a RMLO's compliance, using the summary page for the Application Compliance Worksheet (Exhibit 7).

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### COMMUNICATING FINDINGS

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Examiners must discuss findings and recommendations with the QI and, if needed, obtain a commitment for corrective action. These exit discussions will include a review of the completed Mortgage Company Questionnaire and summary pages of the Application Compliance Worksheet. The examiner will retain the originals signed by the QI, acknowledging receipt. The examiner will also relay a preliminary compliance rating prior to the end of the examination.

The results of the examination will also be communicated in a written format via the Report of Examination. The Report of Examination is a stand-alone document that details the following items:

- Scope of the examination.
- Compliance rating.
- Loan sample.
- Summary and detail of significant violations.
- Compliance program and management of the program.
- Discussion summary of the exit meeting with the QI regarding the examiner findings and conclusions.
- Management's response to findings with proposed corrective actions (if needed).

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## COMPLIANCE PROGRAM

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A sound compliance program is essential to the efficient and successful operation of the mortgage company operation. It is expected that no two compliance programs will be the same, and that the formality of a program will be dictated by a variety of considerations, including the volume of business, number of branches, number of licensed RMLOs, and the variety and types of products.

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## POLICIES AND PROCEDURES

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Compliance policies and procedures generally should be described in a document, to be reviewed and updated as the mortgage company's business and regulatory environment changes. Policies should be established to include goals, objectives, and appropriate procedures for meeting those goals and objectives. Generally, the degree of detail or specificity of procedures will vary in accordance with the complexity of the issues or transactions addressed. A mortgage company's policies and procedures should provide citations of regulations and definitions, sample forms with instructions, RMLO policies, and, where appropriate, directions for routing, reviewing, retaining, and destroying transaction documents.

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## MONITORING

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Monitoring is a proactive approach to identify procedural or training weaknesses in an effort to preclude regulatory violations. An effective monitoring system includes regularly scheduled reviews of:

- Disclosures and calculations for various product offerings.
- Document filing and retention procedures (especially in branch situations).
- Posted notices, marketing literature, and advertising (particularly if RMLOs advertise individually).

Monitoring also includes reviews at the transaction level during the normal, daily activities of employees in every operating unit. This might include, for example, verification of an annual percentage rate, or a second review of a loan application before the transaction is completed. Monitoring at this level helps establish management and staff accountability, and it identifies potential problems in a timely manner. The frequency and volume of employee turnover at a mortgage company should be factored into the intensity of reviews.