<u>Mortgage Banker Examination Overview</u>

I. INTRODUCTION

The Texas Department of Savings and Mortgage Lending (SML) promotes compliance with the Mortgage Banker Registration and Residential Mortgage Loan Originator License Act, Real Estate Settlement Procedures Act (RESPA), Truth in lending Act (TILA), Equal Credit Opportunity Act (ECOA), 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 banker's compliance posture - compliance examinations, investigations and visitations. Compliance examinations are the primary means the SML uses to determine whether a banker and its Residential Mortgage Loan Originators (RMLOs) are meeting the responsibility of complying with the requirements and proscriptions of consumer protection laws and regulations. Investigations are conducted to follow up on particular consumer inquiries or complaints. Visitations are rare but conducted on occasion by the SML to review a banker'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 indentified 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 banker's compliance management system for implementing state and federal consumer protection statues and regulations.
- Initiate effective supervisory action when elements of a banker's compliance management system are deficient or when significant violations of law are found.

II. EXAMINATION APPROACH

The SML compliance examination scheduling 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 banker 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.

Determining Risk

Risk focusing involves a random selection of five loans per RMLO, if practical. If the size of the mortgage banker's operation makes this impractical, a minimum of fifty loans, to include at least one loan per RMLO, will be selected. Whenever possible, the selection should include one loan file in process and one denied loan per RMLO.

Evaluating the Compliance Management System

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

- Knowledge level and commitment of banker and personnel.

- Banker’s responsiveness to compliance deficiencies.
- Banker information systems and proper settings.
- Policies and procedures.
- Training program.

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

Unlicensed Activity

A reconciliation of SML office records for approved banker 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 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.

III. ROLE OF MORTGAGE BANKER EXAMINER

Mortgage banker examiners play a crucial role in the supervisory process. The compliance examination, along with follow-up supervisory attention to a banker’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 bankers improve their compliance posture and prevent future violations.

Primarily, examiners will conduct transaction testing through the sample of five loans per RMLO (if possible), evaluate the banker'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 banker’s designated representative(s) and with the RMLOs subject to examination.
- Assist the banker to help improve performance by providing sound recommendations for enhancing the company’s compliance management system.
- Share experiences and knowledge of successful compliance management systems.
- Provide guidance regarding the various consumer and fair lending laws and regulations.

IV. EXAMINATION MANAGEMENT

Mortgage banker examinations primarily involve four stages - pre-examination planning and analysis, on-site examination, reaching conclusions, and communicating findings to the banker via meetings and a report of examination.

Pre-examination Planning and Analysis

Pre-examination planning involves gathering information available in SML records and databases such as SEMARCA and the Nationwide Mortgage Licensing System & Registry (NMLS). (Note: SML will continue to use both SEMARCA and NMLS until full transition of all data to the NMLS system has been completed.) Prior notification of a pending examination begins with a telephone call or email to the mortgage banker's designated representative to determine an examination date that is acceptable to both parties. (See Exhibit 1 – Mortgage Banker Exam Schedule Worksheet.) The phone call is followed up with the Examination Notification cover letter from the Chief Examiner and an Initial Information Request (Exhibits 2 and 3), delivered via e-mail or fax to the banker's designated representative. SEMARCA and NMLS data that will be beneficial includes: list of offices, list of RMLO employees with current expiration dates, and annual 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 on discussion with the banker's representative(s) or individual RMLO(s) which reveal views about compliance, a lack of necessary procedures or controls, or the presence of violations.

On-site Examination

An initial meeting with the banker's designated representative should be scheduled as early as possible upon arriving on-site. The focus of the meeting should be to confirm the examiner's access to requested loan file records and to discuss any noteworthy items from the Initial Information Request. During the on-site phase of an examination, the examiner thoroughly reviews a banker's loan application log to make a determination of the loan cut, assesses the quality and viability of the compliance management system, and documents system weaknesses and violations of consumer protection laws and regulations. The compliance review includes, among other things, an evaluation of the effectiveness of training. During the examination, the examiner completes an Application Compliance Worksheet (Exhibit 4) for each of the loan files selected from the banker's loan application log. SML is currently in the process of implementing the use of ComplianceEase® software to assist in compliance reviews. Whenever possible, the Department will utilize this software to assist in the targeting of loan files to be examined.

SML will from time to time participate in multistate examinations in coordination with the Conference of State Bank Supervisors/American Association of Residential Mortgage Regulators ("CSBS/AARMR") Nationwide Cooperative Agreement for Mortgage Supervision. In that event, the SML examiner will coordinate all aspects of the examination with the assigned Examiner-In-Charge of the multistate examination.

Reaching Conclusions
At the conclusion of the on-site examination, an examiner:

- Defines and provides examples supporting violations and deficiencies.
- Summarizes all findings regarding the strengths and weaknesses of a banker's compliance, using the Mortgage Compliance Summary of Answers (Exhibit 5 – also referred to as "Banker Summary"), which is automatically generated upon completion of the Application Compliance Worksheet for each loan file.

Communicating Findings
Examiners must discuss findings and recommendations with the banker's designated representative(s) and if needed obtain a commitment for corrective action. These exit discussions will include delivery to the banker's representative(s) the summary pages for the Application Compliance Worksheet. The examiner will retain the original signed by the banker's representative acknowledging receipt. The examiner will also relay a preliminary compliance rating to the banker 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 banker's representative(s) regarding the examiner's findings and conclusions.
- Management response to findings with proposed corrective actions (if needed).

V. COMPLIANCE PROGRAM

A sound compliance program is essential to the efficient and successful operation of the mortgage banker enterprise. 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, and number of employed RMLOs, as well as the variety and types of products.

Policies and Procedures
Compliance policies and procedures generally should be described in a document, reviewed, and updated as the mortgage banker'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 banker's policies and procedures should provide citations of regulations and definitions, sample forms with instructions, banker policies, and, where appropriate, directions for routing, reviewing, retaining, and destroying transaction documents.

Monitoring

Monitoring is a proactive approach to identifying 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 banker's company should be factored into the intensity of reviews.