
MORTGAGE EXAMINATION OVERVIEW

INTRODUCTION

The Texas Department of Savings and Mortgage Lending (SML) promotes compliance with the Residential Mortgage Loan Company Licensing and Registration Act, Mortgage Banker Registration and Residential Mortgage Loan Originator License Act, Truth in Lending Act (TILA), Real Estate Settlement Procedures Act (RESPA), Equal Credit Opportunity Act (ECOA), Fair Credit Reporting Act (FCRA), Bank Secrecy Act (BSA), Gramm-Leach-Bliley Act (GLBA) and other State of Texas regulations through supervisory and outreach programs. SML conducts three types of supervisory activities: compliance examinations, investigations, and visitations. Compliance examinations are the primary means SML uses to determine whether a mortgage company or mortgage banker and its sponsored Residential Mortgage Loan Originators (RMLOs) are 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 company's and sponsored RMLOs' 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 compliance management system for implementing state and federal consumer protection statutes and regulations; and
- Initiate effective supervisory action when elements of the compliance management system are deficient or when significant violations of law are found.

EXAMINATION APPROACH

Determining Risk

The scheduling of SML compliance examinations is based on a risk-focused approach that incorporates factors such as prior examination rating, length of time since last examination, consumer complaints, inconsistent licensing information, inaccurate advertising, and Mortgage Call Report data. Risk focusing involves using information gathered about the company and/or RMLO from these primary areas to direct SML examiner resources to those operational areas that present the greatest risk in compliance and to Texas consumers. Examiners will use their discretion to determine the need for expanding the scope of the review.

Evaluating the Compliance Management System

The examiner considers the compliance risk profile using various sources of information including 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 compliance management systems. Factors used in measuring adequacy include:

- Knowledge level and commitment of the company and personnel
- Responsiveness to compliance deficiencies
- 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 compliance management system may result in current or future noncompliance with consumer protection laws, regulations, or policy statements. SML expects the company to have a viable system in place to manage its compliance risk, consistent with size and product mix.

Unlicensed Activity

A reconciliation of NMLS licensing records for approved activities against examination findings will sometimes reveal activity that is unlicensed. For example, an individual who originated loan applications prior to his/her license approval or with an expired license has conducted unlicensed activity. Another common example is a loan “processor” who processed loans as an independent contract loan processor without having obtained a license has conducted unlicensed activity.

ROLE OF THE MORTGAGE EXAMINER

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

Primarily, examiners will conduct transaction testing through the sample of five loan files per RMLO (when possible), evaluate the 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 sound judgment when making decisions.
- Maintain ongoing communication with the Qualified Individual (QI) or designated representative(s).

- Provide sound recommendations for improving performance and enhancing the compliance management system.
- Share experience and knowledge of successful compliance management systems.
- Provide guidance regarding the various consumer and fair lending laws and regulations.

EXAMINATION MANAGEMENT

Mortgage examinations primarily involve four stages: pre-examination planning and analysis, examination review, reaching conclusions, and communicating findings via meetings and a report of examination.

Pre-examination Planning and Analysis

Pre-examination planning involves gathering information available in SML records and the Nationwide Mortgage Licensing System & Registry (NMLS), and delivering prior notification to the mortgage company's QI or mortgage banker's designated representative of a pending examination. During pre-examination planning and analysis, the examiner determines if the examination will be conducted on-site or off-site. A number of factors should be considered when making this determination including: whether or not the primary office or branch location is in Texas, whether or not the QI or designated representatives will be present at the Texas location, the number of sponsored RMLOs, transaction volume based on Mortgage Call Reports, and prior examination findings or other supervisory concerns.

Prior notification begins with a telephone call or e-mail to determine an examination date that is acceptable to both parties. The initial communication is followed up with the Examination Notification Letter and an Initial Information Request, delivered via e-mail. The e-mail includes the deadline for delivery of the transaction log and the initial information request items, and instructions on how to access the Department's Citrix ShareFile portal to upload the requested information and loan files.

Once the transaction log is received, the examiner conducts a thorough review to determine the loan sample. Beneficial data includes: a list of sponsored RMLOs with current license status dates, a list of offices, quarterly mortgage call report data, and prior examination information including the report of examination. NMLS licensing records are reviewed for each individual listed as loan originator on the transaction log to verify proper licensure. Thorough examination preparation and advanced planning maximizes the examiner's time and resources. The scope of an examination may be expanded based upon the presence of violations, a lack of necessary procedures or controls, red flags or inconsistencies identified during the examination, or the company's overall views about compliance.

On-Site Examination

An initial meeting with the qualified individual (QI) or designated representative(s) should be completed as quickly as possible upon arriving on-site. The focus of the meeting is to confirm the information gathered from NMLS and the Initial Information Request, and for the representatives to provide an overview of the operation. During the on-site phase of an examination, the examiner thoroughly reviews the selected loan files; 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.

During the examination, the examiner completes an Application Compliance Worksheet for each of the loan files selected from the transaction log. In addition, examiners use ComplianceEase software, on a limited scale, as a tool in the file review.

Off-Site Examination

As noted above, pre-examination planning and analysis will in some cases result in the determination that an examination will be conducted off-site. In an off-site examination, the initial meeting with the QI or banker's designated representative(s) is conducted by telephone or video conference, and should be scheduled as early as possible following formal notification of the pending examination. All other aspects of the examination mirror an on-site examination, except that examiner inquiries, requests for supplemental documentation, and the exit meeting are handled by telephone, e-mail and/or video conference in place of in-person meetings.

Compliance Management Program

A sound compliance program is essential for the efficient and successful operation of a company. 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.

Policies and Procedures

Compliance policies and procedures generally should be described in a document, to be reviewed and updated as the 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. 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.

Monitoring

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
- 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 should be factored into the intensity of reviews.

Reaching Conclusions

At the conclusion of the examination, the examiner:

- Summarizes all findings using the Findings Summary and Mortgage Compliance Summary of Answers, which is automatically generated upon completion of the Application Compliance Worksheet for each loan file.
- Defines and provides examples supporting violations and deficiencies.

Communicating Findings

Examiners must discuss findings and recommendations with the QI or banker's representative(s) and, if needed, obtain a commitment for corrective action. These exit discussions will include a review of the completed Findings Summary, Mortgage Compliance Summary of Answers, and any supporting documentation. Copies of the meeting materials are provided to the QI or banker's representative(s) prior to the meeting for their review and records. The Findings Summary is signed by both the examiner and QI or banker's representative, acknowledging receipt. The examiner will relay a preliminary compliance rating during the meeting.

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 regarding the examiner findings and conclusions
- Management's response to findings with proposed corrective actions (if needed)

MULTISTATE EXAMINATIONS

SML may 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. SML will accept the joint Report of Examination (ROE) and will not issue a separate ROE.