

## **MORTGAGE EXAMINATION OVERVIEW**

### **INTRODUCTION**

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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, Wrap Mortgage Loan Financing, Texas Constitution, 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 two types of supervisory activities: compliance examinations and investigations. Compliance examinations are the primary means SML uses to determine whether a mortgage company, mortgage banker, wrap lender, and their sponsored Residential Mortgage Loan Originators (RMLOs) comply with the requirements and guidelines of state and federal consumer protection laws and regulations. Investigations are conducted to follow up on particular consumer inquiries or complaints.

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**

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#### **Determining Risk**

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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.

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## Evaluating the Compliance Management System

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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

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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.

## ROLE OF THE EXAMINER

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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 under state and federal law. To this end, an examiner's efforts should help companies improve their compliance posture and prevent future violations.

Examiners will conduct transaction testing, 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 and sound judgment when making decisions.
- Maintain ongoing communication with the Qualifying Individual (QI) or designated representative(s).

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- 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

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

#### Pre-examination Planning and Analysis

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Pre-examination planning involves gathering information available in SML records and the Nationwide Multistate Licensing System & Registry (NMLS). SML gives advance notice of each examination, except in cases where giving advance notice would impair the examination, to the primary contact person of the mortgage banker or mortgage company listed in NMLS or to a person designated by the primary contact person. Prior notification begins with a telephone call or e-mail. The initial communication is followed up with the Examination Notification Letter delivered via e-mail. The e-mail includes the deadline for delivery of the mortgage transaction log and instructions on how to access the State Examination System (SES). The examination will be conducted through the State Examination System (SES).

Once the mortgage 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, mortgage call report data, and prior examination information, including the report of examination. NMLS licensing records are reviewed for individual loan originators 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. After reviewing the mortgage transaction log, the examiner will send the loan file requests through SES so that the company can prepare and upload electronic copies of the requested files to SES.

#### Record Review

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During the record review 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 examiner may request additional information or have questions that may arise throughout the examination process.

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## Compliance Management Program

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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

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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

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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
- State and federal consumer protection laws and regulations
- Third-party service provider operations
- Posted notices, advertising, and marketing literature
- Internal compliance communication systems that provide updates and revisions of the applicable laws and regulations

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 and disclosures 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

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At the conclusion of the examination, the examiner:

- Summarizes all findings.
- Defines and provides examples supporting violations and deficiencies.
- Communicates the recommended compliance rating.

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## Communicating Findings

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An exit meeting will be held, if possible, to communicate preliminary findings and the examiner's recommended compliance rating. The exit meeting should be attended by the qualifying individual or the person designated by the regulated entity. Following the exit meeting, the examiner will submit the Report of Examination (ROE), including the proposed rating, to SML management for review. SML management may adjust the rating based on additional supervisory considerations, including the presence of consumer harm, systemic compliance failures, or other significant regulatory deficiencies. Upon completion of this review, the ROE and final rating will be issued to the mortgage company. Both the ROE and the compliance rating are classified as confidential supervisory information.

The Report of Examination (ROE) 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's findings and conclusions
- Management's response to findings with proposed corrective actions (if needed)

## COMPLIANCE EXAMINATION RATING SYSTEM

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SML has adopted, with slight modifications, the regulatory compliance rating system established and implemented by the Federal Financial Institution Regulatory Agencies.

The Federal Financial Institutions Examination Council (FFIEC) developed and recommended to the member agencies for adoption a uniform consumer compliance rating system. The purpose of the rating system is to reflect in a comprehensive and uniform fashion the nature and extent of a company's compliance with consumer protection and civil rights laws and regulations.

The primary purpose of the rating system is a guide to help identify companies whose compliance with state and federal laws and rules displays weaknesses requiring special supervisory attention and which are cause for more than a normal degree of supervisory concern. In addition to the compliance ratings, greater supervisory concern and enforcement actions may result from consumer complaints and/or unlicensed activity disclosed either during or independent of the examination process.

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## COMPOSITE RATINGS

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### One

A mortgage company/banker and sponsored residential mortgage loan originators in this category are in a strong compliance position. The mortgage company maintains strong operational controls and takes action to prevent violations of law and consumer harm. Findings identified during the examination are relatively minor, have a minimal impact on consumers, and can be remedied quickly. The examination revealed no evidence of violations requiring restitution to consumers or practices resulting in repeat violations.

*Commentary - This rating would include companies exhibiting an equal emphasis on compliance with their focus on origination. This emphasis is evidenced by a proactive compliance program and limited violations. There is either an independent review process or sufficient controls and confirmations to provide ongoing assurance of quality.*

### Two

A mortgage company/banker and sponsored residential mortgage loan originators in this category are in a satisfactory compliance position. The mortgage company maintains operational controls that are satisfactory at managing consumer compliance risk and at limiting violations of law and consumer harm. Findings identified during the examination are the result of modest weaknesses in these operational controls and have a limited impact on consumers. The examination revealed little to no evidence of violations requiring restitution to consumers or practices resulting in repeat violations.

*Commentary - This rating is representative of companies who have a program of compliance, formal or informal, that is sufficient to prevent systemic violations on a given issue. An individual loan file may have multiple problems where checks and balances failed, but those problems are isolated and are not found repeatedly in other files. Despite the number of violations, there are no significant fee issues, and the examiner would not recommend a formal response delineating a requirement for corrective action to SML.*

### Three

A mortgage company/banker and sponsored residential mortgage loan originators in this category are in a deficient compliance position. The mortgage company's operational controls are insufficient to manage consumer compliance risk and limit violations of law and consumer harm. Findings identified during the examination are numerous and/or have a considerable impact on consumers.

*Commentary - This rating is indicative of an operation with systemic compliance and/or documentation problems. Some fee issues may be present, including underestimation of fees or rates, although these violations will not be egregious or widespread.*

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### **Four**

A mortgage company/banker and sponsored residential mortgage loan originators in this category are in a seriously deficient compliance position. The mortgage company exhibits fundamental and persistent weaknesses in its operational controls and severe inadequacies in core compliance areas necessary to operate within the scope of statutory and regulatory consumer protection requirements and to prevent consumer harm. Findings identified during the examination are numerous, widespread, and/or have a serious impact on consumers.

*Commentary - This rating is reflective of widespread documentation problems as well as numerous fee-related issues. Findings may include unlicensed activity, numerous and substantive repeat violations, and/or violations requiring substantial restitution to consumers. Formal enforcement action may be necessary.*

### **Five**

A mortgage company/banker and sponsored residential mortgage loan originators in this category are in a critically deficient compliance position. The mortgage company's operational controls are non-existent or critically deficient at managing consumer compliance risk and/or at preventing violations of law and consumer harm. Findings identified during the examination are numerous, widespread, and/or have a serious impact on consumers. "Critically deficient" indicates an absence of crucial operational controls and a demonstrated lack of willingness or capability to take the appropriate steps necessary to operate within the scope of statutory and regulatory consumer protection requirements and to prevent consumer harm.

*Commentary - This rating is reflective of widespread documentation problems, numerous fee-related issues, and/or severe failure to maintain adequate records. Lack of critical loan file documentation or entire loan files impedes the examiner's ability to effectively examine the company. The Department will take formal enforcement action, possibly including revocation, for failure to take prompt corrective action.*

## **MULTISTATE EXAMINATIONS**

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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.