



POLICY, PROCEDURES, AND EXAMINATIONS

PART I: MORTGAGE BROKERS

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Perhaps the most difficult task of the independent mortgage professional is to obtain and maintain a full set of policies and procedures. Too often, a broker's approach to compiling adequate policy statements is reactive; that is, the demand comes about in order to meet a regulator's expectations or in anticipation of a forthcoming examination.

Many brokers simply make it their business to always be prepared, especially in this highly regulated financial services industry. I have said many times, preparation is protection! Indeed, I have written extensively on this theme.¹

Nevertheless, all the policy statements in the world will not impress a regulator if that policy's stated requirements are not really implemented. In other words, the examiner will determine if a firm's procedures are actually being followed.

Let's put it this way: a policy statement, without implementation, is merely pontification!

Examiners have long since past the point where they're seriously willing to accept as viable a standardized policy from a 'manual mill.' In fact, some examiners keep a list of these one-size-fits-all policies, and they are keenly aware of the stratagem of using an off-the-shelf policy to satisfy a regulatory mandate.

I have a friend who is now a senior regulator with a federal agency. These days, he does not go to field examinations. However, he once told me that, when he previously conducted banking examinations, sometimes he would go from one institution to another and he found the same policies – only the company name had changed on the documents! When he saw that

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happening, it vexed him sorely, and he would then challenge the institution to prove that it was in fact following the guidelines specifically stated in the policy statements. Needless to say, the results were – to put it mildly – quite a bit mixed.

In this article, the first of a two-part series, I am going to provide a chart of certain core policies and procedures that a mortgage broker should obtain and continually update, as regulations change. I will also provide some useful policy implementation guidance relating to preparing for a state banking examination.² In part two of this series, I will address the central policies and procedures that are needed by mortgage bankers.

Before getting started, I feel constrained to offer a Caveat Emptor! (Buyer Beware!) Obtaining a boilerplate document with your company’s name on it is regressive, and it is a tactic that Examiners are now regularly criticizing in adverse findings. As I have intimated above, these days regulators are fully aware of this objectionable ‘short cut’ to compliance.

An insufficient policy statement may cause adverse examination findings.³ Indeed, in some cases, template-driven policy and procedures may cause Examiners to escalate their regulatory review. Drafting and implementing a policy statement that conforms to the way an institution does business is a priority responsibility of management, where the purchase price of a policy and procedure should not be an operative consideration.

**POLICIES AND PROCEDURES
MORTGAGE BROKERS**

This table⁴ provides an overview of the core policies and procedures needed by mortgage brokers.⁵

REGULATORY AREA	MORTGAGE BROKERS	TABLE-FUNDING MORTGAGE BROKERS
LENDING REGULATIONS		
TILA		√
TILA – LOAN ORIGINATOR COMPENSATION	√	√
HMDA ⁶		√
RESPA	√	√
FLOOD INSURANCE	√	√
APPRAISER INDEPENDENCE	√	√
MORTGAGE INSURANCE		√

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SAFE ACT (NMLS)	√	√
DISCRIMINATION		
ECOA	√	√
FCRA	√	√
FAIR HOUSING ACT	√	√
FAIR LENDING	√	√
SUBPRIME	√	√
ADVERTISING & MARKETING		
ADVERTISING	√	√
TELEMARKETING	√	√
CONSUMER PROTECTION		
FDCPA	√ if a debt collector	√ if a debt collector
PRIVACY ISSUES	√	√
HOMEOWNERSHIP COUNSELING	√	√
ANTI - MONEY LAUNDERING (BSA)	√	√
UDAAP (FTC)	√	√
LEGAL AND LIABILITY ISSUES		
LENDER LIABILITY	√	√
QUALITY CONTROL ⁷	√	√
ENVIRONMENTAL PROTECTION		√
BANKRUPTCY	√	√
ELECTRONIC SERVICES		
EFT ACT	√	√
INTERNET SERVICES & WEBSITES	√	√
STATE LAWS BANKING	√	√

PREPARING FOR AN EXAMINATION

Most state banking departments prioritize their administering of licensees on the extent to which these institutions implement their own policies and procedures. High on the list of such priorities are compliance with licensing regulations and specific mortgage acts and practices, such as the Real Estate Settlement Procedures Act (RESPA, Regulation X), Truth in Lending Act (TILA, Regulation Z, Loan Originator Compensation), Equal Credit Opportunity Act (ECOA, Regulation B), and the other alphabet soup of federal and state guidelines.

Generally, banking departments consider themselves to be consumer advocacy agencies and,

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as such, they approach examinations in a threefold process: (1) examining the licensee, (2) investigating allegations from consumers relating to the licensee, and (3) on-site or off-site visitations to audit a licensee's operations or its implementation of previously identified corrective actions.

The primary means of monitoring the licensee is through examinations. Therefore, banking departments seek to evaluate the following elements:

- Conduct a compliance review to determine implementation of relevant laws and regulations;
- Audit and assess the integrity of the compliance management with respect to implementing state and federal consumer protection statutes and regulations; and,
- Issue supervisory and administrative actions when compliance is defective, deficient, or actually produces significant violations of law.

MORTGAGE RISK MANAGEMENT

Assembling the appropriate policy statements and implementing them is a principal feature to risk management. My firm deals with such engagements all the time for our clients, and I can vouchsafe that banking departments these days understand fully a focus on mitigating risk. For instance, management's lack of such focus on risk inevitably leads, among other things, to consumer complaints, licensing violations, defective advertising, and disclosure deficiencies. Compliance and loan production are cemented together and the success of both is dependent on the success of each. Therefore, examiners will conduct both a loan level review of loan files and also consider many other aspects of the company's loan flow process.

Consider this: unlicensed loan activity is a significant challenge to mortgage brokers. An institution's risk management should contain a formal policy and procedure that outlines the requirements for conducting licensed activity. The Examiner always has the edge, because the department is able to reconcile the field examination findings with actual licensable activity, which, by comparing the two, may inevitably uncover unlicensed activity. A "loan processor," who is acting as a loan officer without having obtained a license, is conducting unlicensed activity. Management demonstrates a clear failure to prevent unlicensed activity, when an employee loan officer takes a loan application prior to the licensing date or during a period of time when the license was allowed to expire before renewal. The policy statement associated with licensing, therefore, must state the requirements and boundaries to the company's licensing procedures.

If the mortgage broker is not involved in its first examination, previous examinations will provide indicia for the Examiner to consider in the current review. The review does include an evaluation of the management, because it is management that is accountable for administering the institution's risk.

Questions that Examiners consider in determining management's effectiveness include:

- What is the knowledge level and commitment of the company and its personnel?
- How does the broker respond to compliance deficiencies and potential violations?
- Are the information and loan origination systems providing reliable and secure data?
- Does management maintain and fully implement its own policies and procedures?
- To what extent and how often are training programs offered to affected employees?

Where weaknesses exist, it is not unusual for an Examiner to use the exit interview as a means to highlight these defects and underscore the need for management to ensure compliance with consumer protection laws, regulations, or policy statements.

EXAMINATION FINDINGS

It should be evident that a mortgage broker should never wait for a notice of a banking examination before ratifying a comprehensive set of policies and procedures. The exit interview is not the place to find out that a commitment for corrective actions is going to be required!

The examination report consists of several parts, more or less varying state to state, with each part contributing to a general outline of a licensee's qualifications to continue being licensed.

Generally, the examination report includes:

- Scope of Examination
- Compliance Rating or Similar Description
- Loan Sample Outline used for the Examination

- Summary and Detail of Significant Violations (where applicable)
- Evaluation and Management of the Compliance Program
- Assessment of Policies and Procedures
- Summary of the Exit Interview
- Management Response to Findings and Corrective Actions (where applicable)

POLICIES AND PROCEDURES

The list of policies and procedures that I outlined in this article are part of an overall culture of compliance that an independent mortgage professional must adopt in order to run a safe and sound firm.

Look at it this way, using an automobile for an analogy: policies and procedures are the chassis, implementation is the superstructure, and training is the driver. All three must be intact and reliable for the car to be safe to drive; and all depend on one another for their very subsistence.

A policy statement must address the company's business philosophy, goals, objectives, procedures, required actions, remedies, and, of course, the metrics with which to judge them. The policy and procedure does not have to be extensive in length, but it does have to be comprehensive in detail, based on the size, complexity, and risk profile of the company. Furthermore, I believe certain policy statements should be converted into Employee Manuals, such as an Advertising Manual, with attestation of receipt thereof by the affected employee.

Additionally, a policy and procedure must be updated when regulations change or the company changes its way of doing business with respect to legal and regulatory requirements. This means that not only should citations and definitions be included, where needed, but also procedures should highlight forms, disclosures, and other documents inherent in carrying out mandated guidelines.

Finally, management should monitor all aspects of the loan flow process in order to mitigate, reduce, or eliminate risk. To a considerable extent, training plays an important role in risk management, but the monitoring must go beyond training employees. When exposure to risk is identified, management should document the event and immediately implement corrective actions.

For the most part, depending on the deficiency, a banking department may understand a mortgage broker's affirmative action in endeavoring to prevent any further defects; however, the one thing that no banking department will tolerate is a deficiency that, once discovered, remains unresolved.

Lenders Compliance Group, Inc. is a mortgage risk management firm, providing professional guidance and support to financial institutions in all areas of residential mortgage compliance, including the following: Mortgage Compliance • Legal and Regulatory Compliance • Compliance Administration • HUD Exam Readiness • Licensing Compliance • HMDA/CRA • Information Technology & Security • Portfolio Risk Management • Quality Control Audits • Prefunding Audits • Retail, Wholesale, and Correspondent Lending • Investor and Servicer Compliance • Loss Mitigation Strategies • Forensic Mortgage Audits • Sarbanes-Oxley Compliance • Due Diligence Audits • Credit Risk Management • Loan Analytics Audits • Compliance Audits and Reviews • Banking Exam Readiness • Fannie/Freddie Applications • Ginnie Mae Applications • Training & Education • CFPB Exam Readiness • Anti-Money Laundering Exam Readiness.

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¹ Foss, Jonathan, *Anti-Money Laundering Program: Preparation is Protection*, National Mortgage Professional Magazine, August 2012, Volume 4, Issue 8, pp 22-34

² Community Reinvestment Act (CRA), tie-in restrictions, insider lending, may apply if the mortgage broker is affiliated with a depository institution.

³ Ibid.

⁴ Portions of this table are adapted from Pannabecker, James H., *Mortgage Lending Compliance (With Federal and State Guidance)*, Volume I, Second Edition, xv-xvi, A. S. Pratt, 2012

⁵ The table is based on legal and regulatory compliance requirements as of February 28, 2013.

⁶ Purchase Money Mortgage and Refinances on 1-4 Units

⁷ Many lenders now require quality control audits to be conducted by their third-party originators.