

Exam Management

By James D. Russell, CPA

It is obvious that the Texas Savings and Loan Department (TSLD) has beefed up their examination staff. Every day, I receive phone calls from panicked brokers requesting last-minute advice on what to do and what to say when they get notified about their upcoming examination.

While there are many things that can be done at this point in the process, we highly recommend that brokers not wait until the eleventh hour to develop or fix their compliance program. Ideally, a compliance program should be a daily part of any broker's operations. The misconception is that a compliance program is expensive and time-consuming, but it's not. A little bit of resources spent today will allow you to sleep better and might prevent a costly poor examination in the future.

However, if you're the procrastinating type, I have provided some of the more frequently asked questions that I receive from brokers who find themselves on the other end of a gut-wrenching call from a TSLD examiner.

Where does the Texas Savings and Loan Department get the authority to come review my records?

Look at Section 80.13 of the Texas Mortgage Broker Regulations, which states in part:

Each mortgage broker and each loan officer shall maintain such other books and records as may be required to evidence compliance with applicable state and federal laws and regulations including, but not limited to, the Real Estate Settlement Procedures Act, the Equal Credit Opportunity Act and the Truth in Lending Act.

Each mortgage broker and loan officer shall maintain such other books and records as the Commissioner or the Commissioner's designee may from time to time specify in writing.

Each and all of the foregoing books and records must be maintained in good order and shall be produced for the Commissioner or the Commissioner's designee upon request. Failure to produce such books and records upon request, after a reasonable time for compliance, may be grounds for suspension or revocation of a license.

The foregoing books and records shall be maintained for three years or such longer period(s) as may be required by applicable state and/or federal laws and regulations.

Why was I selected for an examination?

Several factors are used by regulators to select offices for examination, including 1) loan volume; 2) sub-prime loan volume; 3) number of loan officers; 4) loan officer churning; 5) complaints; 6) time period since your last examination; and/or 7) random luck. (With regard to complaints, you will know if you have one since the regulators are typically required to notify the broker.)

What are they looking for?

This is an assessment of consumer compliance, and TSLD is basically interested in your compliance with applicable state and federal consumer laws and regulations. Basically, they want to know if you are deceiving or cheating the consumer. These state and federal laws and regulations were created to insure that a consumer is 1) given accurate and timely disclosures; 2) charged appropriate and reasonable fees; and 3) treated fairly in the mortgage origination process. Examples of consumer compliance issues include fair treatment of minority applicants and timely delivery of accurate Good Faith Estimates and Truth in Lending disclosures.

This is not an assessment of underwriting compliance. Underwriting compliance is concerned with whether the borrower or originator accidentally made errors, or purposefully committed fraud in the underwriting process. This is the U.S. Department of Housing and Urban Development's first concern. Examples of underwriting compliance issues include proper reflection of the borrower's credit history, income, property value, etc. Underwriting compliance is often measured by default rates and HUD's quality control reviews.

Many originators believe that sound underwriting compliance automatically means sound consumer compliance. However, I have seen many instances where underwriting compliance was very sound, while consumer compliance was deficient.

What is the process for being notified about an examination?

Typically, the examiner will call the licensed mortgage broker at least one to three weeks prior to the examination. They will inquire about the number of loan officers, number of locations, whether or not the broker keeps an accurate mortgage transaction log, etc. They will explain that they will look at about 15 files from each broker/loan officer+five completed files, five denied files and five files in process. They will indicate that they need to talk to the broker and compliance officer (if applicable) for about two hours at the beginning of the examination; they will inquire about the accuracy of the mortgage transaction log; they will ask about a working space; and lastly, they will estimate the time they will spend at your location. Sometimes

they will come in a few days before the actual beginning of the examination for an initial meeting with the broker and compliance officer.

Make sure you get the examiner's phone number and e-mail address, just in case you need it either before the exam starts or after the examiner leaves.

Should I "doctor" my files to get into compliance?

No. That would be extremely foolish, and the benefits gained will not outweigh the risks of "doctoring" the files. First, it's wrong. Second, you might not be thorough enough to fool the examiners. Third, the examiners may perform a consumer confirmation, where they call directly on the consumer to provide copies of their disclosures to compare with the disclosures in the broker's files. If the examiners find out that you deceived them, you might as well look for a new line of work.

Once the examiner has called, can I do anything to prepare for the examination?

Yes. Fix those things that can be fixed. If you haven't had the time to call a compliance expert to help "fine-tune" your operations, now is the time. There are several things they can do to help, such as reviewing the office signage, counseling loan officers on how to act, reminding loan officers about certain compliance issues, and reviewing the mortgage transaction log, policies and checklists. Some of these things might mean the difference between a "3" versus a "2" rating, or the difference between a "4" versus a "3" rating (ratings are discussed below.)

If you have the time and expertise, you can perform the role of the compliance expert yourself. I recommend reviewing the Texas Mortgage Broker Regulations at a minimum. Ideally, you should also review the sections of the Real Estate Settlement Procedures Act's Regulation X that pertain to mortgage brokers. If necessary, you should also review the general requirements of other applicable regulations, such as the Truth in Lending Act's Regulation Z, the Equal Credit Opportunity Act's Regulation B, the Gramm-Leach-Bliley Act and the Fair Housing Act.

How should I act?

Act respectful and polite, just as you should with a loan applicant. Do not be cocky, confrontational, critical or condescending.

Examiners are not loan officers, and as such, they do not have your experience. They were not hired to be loan officers, nor were they trained to be loan officers. Therefore, there will be many aspects of your job that are outside of their area of expertise. However, they probably know a lot more about consumer compliance than you do. Even so, if you think they might be wrong about a consumer compliance issue, be polite in your disagreement.

Be honest. Be helpful. The faster you provide them with what they want, the more organized they will perceive you to

be. (Also, the faster they will leave.) You can joke around if the mood seems right, but if the examination is not going well, this might not be a good idea.

The bottom line+do not worry too much. Examiners are people just like you, and they will understand your apprehension.

What if I am going to be out of the office (i.e. on vacation)?

Talk to the examiner about the situation; chances are, they will be understanding and willing to change their plans, especially if it is an unavoidable situation. However, do not expect a long delay. The best you will get is one or two weeks of extra time that will most likely be spent worrying about the exam. (There is not much that you can fix in one or two weeks.) If the examiner is on a tight time schedule, they might even offer to visit your shop while you are gone. (If this happens, however, I would definitely postpone your vacation; you most definitely want to be present to help insure the examination goes smoothly.)

Should I offer to take the examiner to lunch or dinner?

No. They will never accept the offer. The general rule of thumb is that they can participate in whatever office goodies are available, such as coffee and doughnuts, but only if they are available to all office employees. For example, if a lender happens to already be providing lunch, you could offer that to the examiner.

What happens at the end of the examination?

They will have a wrap-up meeting to discuss the findings, where they will provide you with a list of possible violations. Don't be defensive. I recommend verbally acknowledging any issues that they have found and assuring them that you will work on getting things right. Or, if appropriate, ask for their help or advice on how to best resolve the issue.

If there are any glaring errors on the part of the examiner, you can try to respectfully indicate the error. For example, if they indicate that the licenses are not posted in the lobby, you could apologize for the oversight and indicate that they are hanging in each loan officers' office.

Some violations will take a little time to research (such as a missing GFE). For these, I recommend doing the research as soon as the examiner leaves. Then, if the examiner made a mistake or overlooked a disclosure, you can send them the new information. You can ask, but they probably will not tell you the final rating (see below). However, they might give a range or indicate whether you should be worried.

At the conclusion of the meeting, be respectful and polite, and thank them for their visit.

What if I have violations?

I have never reviewed a perfect file, and I have never seen an Examination Report with no violations. *Every* examination has some violations.

How am I judged?

You will receive a written Examination Report within six to eight weeks. (The time lag comes from the necessity to send all reports to TSLD for a supervisor's review.)

The report will assign you a rating from between "1" and "5," with "1" being the best. Simple definitions of the ratings are: "1" is excellent; "2" is satisfactory; "3" is unsatisfactory; "4" is poor; and "5" is unacceptable. If you get a "3," you can generally expect a follow-up visit or phone call within the following year. If receive a "4" or "5," you can expect a Cease and Desist Order, and you should immediately call a compliance expert or an attorney. Simply put, a "4" or "5" is going to be expensive.

What is a Cease and Desist Order?

A Cease and Desist Order is a legal action taken against a party to prohibit that party from doing or continuing to do a certain activity. A Cease and Desist Order typically means that TSLD believes that you have either 1) financially harmed the consumer; 2) denied the consumer the ability to shop the loan by providing deceptive disclosures; or 3) grossly disregarded consumer compliance. The order includes a determination by the regulators that you have done something wrong and that you must stop doing certain things. The Order can range from having to cease operations, to having to cease providing incorrect disclosures. Oftentimes, an Order will require that you implement a compliance program or hire an independent consultant to conduct quarterly compliance reviews. Sometimes, Orders will require you to pay a fine to the government and/or to reimburse customers. The repercussions do not end. The regulator will eventually publish your Order, and your lenders/investors may balk at doing business with you.

Ratings of "4" or "5" will typically include a Cease and Desist Order. If you get the sense that you are in this category, immediately call a compliance expert and/or an attorney. If you were unaware that you were in this category until you received your final report from the regulators, do not bury your head in the sand. Get compliance and legal representation. There is much that can be done to either mitigate or contest the Cease and Desist Order.

What if they are not fair?

First, it has been my experience that the examiners are fair—especially examinations that have been conducted in 2003 and beyond. Second, and as indicated earlier, all reports go to the home office for a review. All examinations receiving a bad rating will receive a close review by the home office. If you still think they were not fair, call a compliance expert or attorney to discuss the situation. There are several things that they can do to either mitigate the poor results or contest the examination.

Can I do anything after they leave?

Fix everything that can be fixed! If they discussed the need to put your license number on your Web site, fix it. If they want you to setup your Calyx Point default settings, fix it. If they want you to change

your procedures to hand out HUD's Settlement Cost Booklets at application, fix it.

Some stuff cannot be fixed such as missing or inaccurate consumer disclosures. Do not worry about these types of violations since they are unfixable. However, you should change office procedures so that this type of violation is not repeated.

As indicated above, review the files for any possible errors that the examiners might have made. The examiners are not used to your file system and might have overlooked one or more disclosures.

Respond to the examination as quickly as possible (ideally within one or two days) to try to influence the examiner before he/she sends the report into the home office. (I recommend e-mail since snail mail might take weeks to get to the examiner.) Once the report is sent to the home office, the examiner is put into the position of having to defend his/her work to a supervisor. Also, a quick response shows the examiner that you really cared about making the corrections.

If the examination has been adversarial and you are anticipating a "4" or "5" rating, I do not recommend any formal correspondence until you have hired a compliance expert or attorney.

**What should I do
when the report
comes back to me?**

If the rating is a "1" or a "2," you can have a party and pat yourself on the back for a job well done.

If the rating is a "3," carefully review the report, and make the necessary changes to ensure the same issues do not surface on subsequent visits or examinations. If these same issues resurface at a subsequent examination or visit, you can certainly expect a "4" rating.

After you get your report back with a rating of "1," "2" or "3," write a complimentary letter to the home office, being sure to mention several positive things about the examiner. Not only is this a nice thing to do, but in the event that you are examined by this same person in the future, they are likely to remember your kind words.

If you get a report with a rating of "4" or "5," do not acknowledge anything to the regulatory authorities until you have hired a compliance consultant or attorney. You are now in a fight for your livelihood.

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