



MULTI-STATE MORTGAGE COMMITTEE
REPORT TO STATE REGULATORS
AUGUST 2009

INTRODUCTION

With the evolution of the originate-to-distribute model in which little or no interest or risk is retained by the originator, states have filled regulatory gaps in the system in order to protect consumers and oversee the origination process of residential mortgage loans. This was initially accomplished through the licensing and supervision of mortgage companies and professionals and anti-predatory lending laws and regulations. States have also recognized the need for greater uniformity and coordination among regulatory agencies to supervise multi-state companies and to track unscrupulous professionals in the industry. A responsive, modernized and uniform examination and enforcement approach completes the state mission of robust supervision.

In 2007, the Conference of State Bank Supervisors (CSBS) and the American Association of Residential Mortgage Regulators (AARMR) began a comprehensive initiative to bring greater uniformity, modernization and effectiveness to the mortgage examination process. The initiative is divided into a number of phases and subparts and although the genesis of the project predated the Safe and Fair Enforcement for Mortgage Licensing Act of 2008 (the S.A.F.E. Act) by more than a year, the timing of the S.A.F.E. Act and many of its objectives aligned almost perfectly with the examination project, and provided the states with the opportunity to re-envision the entire landscape of mortgage supervision.

The cornerstone of the examination initiative is the CSBS/AARMR Nationwide Cooperative Protocol and Agreement for Mortgage Supervision (Agreement).¹ The Agreement, discussed more thoroughly below, which launched the CSBS/AARMR mission to restructure the mortgage examination process, works in tandem with the Nationwide Mortgage Licensing System (NMLS)² launched to restructure the mortgage licensing process. These inseparable duties of examination³ and licensing are the core responsibilities of mortgage supervision.

¹ http://www.csbs.org/Content/NavigationMenu/RegulatoryAffairs/SupervisoryAgreementsApplications/regulatory_agreement.htm

² www.stateregulatoryregistry.org

³ The examination function encompasses investigation and enforcement functions.

CSBS and AARMR established the Multi-State Mortgage Committee (MMC) as the oversight body charged with implementing and directing processes under the Agreement. This CSBS/AARMR MMC Report to State Regulators is made under Article 3, Section 3.5(k) of the Agreement.

The purposes of the Agreement and the more comprehensive CSBS/AARMR examination initiative can be described broadly within the following areas:

UNIFORMITY

As a collective body, the states strive for examination uniformity in mission, supervision, processes and professional development of state regulators. Uniformity begins with agreed upon risk identifiers and standardized methods of examination and reporting. Information sharing, consistency in onsite and offsite review functions, employment of standardized tools such as the MMC Uniform Examination Manual and ComplianceEase[®] software, and advance notice and accountability with covered institutions are all contributors to uniformity.

MODERNIZATION

The MMC believes that successful regulation of the mortgage industry lies in the modernization of a century old approach to examinations and supervision. Modernization includes standardized processes tailored to a supervisory program that matches the inherent risk within each institution. While onsite reviews will remain an integral part of the states' examination program, the way in which these examinations are planned and conducted must be more effective and efficient and incorporate elements of safety and soundness and risk review with compliance testing and consumer protection. The MMC believes that institution reporting and offsite monitoring will aid the states in understanding and preparing for each institution's risk profile.⁴ The simultaneous employment of self regulation and accountability concepts verified through technology and traditional examination methods is the key to a modernized program of supervision.

EFFECTIVENESS

An effective examination and supervision program must be responsive and thorough in addressing perceived risk. Unfortunately, both industry and regulatory resources have been taxed and drained creating greater challenges than ever before in achieving internal and external efficacy in governance and institutional controls. Inefficiency results in inattention further resulting in control lapses and increased need for regulatory supervision at a time when such attention can be least afforded. Responsibility, accountability and verification must work in

⁴ Risk Profile means an outline or representation of a Multi-State Mortgage Entity's (MME) risk to the public and itself, based upon an analysis of certain standardized characteristics. MME is defined in footnote 5.

The Coordinated Goals of the state parties to the Agreement are to: (a) protect consumers; (b) ensure the safety and soundness of MMEs; (c) identify and prevent mortgage fraud; (d) supervise and examine in a seamless, flexible and risk-focused manner; (e) minimize regulatory burden and expense; and (f) foster consistency, coordination and communication among the state regulators. The agreement establishes the ten state representative body known as the Multi-State Mortgage Committee, or MMC comprised of regulators from states chosen by CSBS and AARMR.

2009/2010 Multi-State Mortgage Committee		
Massachusetts	—	John Prendergast, Chair
Arizona	—	Tom Giallanza
Iowa	—	Rod Reed
Kansas	—	Kevin Glendening
Louisiana	—	Darin Domingue
Mississippi	—	Traci McCain
New York	—	Helen Hodge
North Carolina	—	Charlie Fields
Pennsylvania	—	Donald Debastiani
Wyoming	—	Joe Mulberry

MMC members must be Joint Examination States (defined further in this report) and serve two year staggered terms. The MMC is granted a wide array of responsibilities under the Agreement including establishing procedures for operations, identifying MMEs, setting examination schedules, managing a nationwide examiner pool, staffing multi-state examinations, reporting, examination oversight, and coordination of multi-state enforcement.

The Agreement establishes two categories of state regulators: Joint Examination States and Concurrent Examination States. Joint Examination States are states agreeing to the confidentiality sections of the Agreement. Concurrent Examination States are states signed to the Agreement, but due to state public disclosure laws may be unable to comply with the confidentiality provisions of the Agreement. Under the Agreement, Joint Examination States agree not to share confidential supervisory information with Concurrent Examination States. Despite these confidentiality protections the goal of the MMC is to facilitate to the greatest extent possible the sharing of resources among the two categories of state regulators. Under the 2009 amended Agreement, states are required to sign as either Joint or Concurrent Examination States.

At the heart of the Agreement is the sharing of resources and information. For this purpose, the MMC intends to establish a “pool” of state examiners allocated to conduct examinations of MMEs under the direct supervision of a single Examiner-in-Charge (EIC). The goal is for a multi-state team of examiners to conduct examinations on behalf of the collective states. A multi-state team may be comprised of one or more examiners from every state participating in the examination, or for example, a limited team of examiners representing a larger group of participating states. The purpose of such resource sharing is to facilitate an effective examination process while conserving examination resources and reducing the cost and burden of many states conducting many examinations during a given period.

Modernization through Enhanced Processes

Even prior to the 2007 mortgage meltdown and subsequent global credit crisis, CSBS and AARMR were beginning the process of envisioning a new mortgage supervisory structure that would be simultaneously flexible and comprehensive with a greater focus on risk rather than routine. The concept was one of applying skilled resources at the points of risk and stress rather than pursuing an examination schedule based primarily on regularity. In its simplest approach, the idea was to assign more resources to the institutions posing greater risk and fewer resources to institutions exhibiting less risk while maintaining a regulatory presence for all through advanced offsite reviews and limited scope visits.

During the 2007/2008 collapse, the states identified and acknowledged opportunities for improvement within the existing examination structure. One improvement was a rebalancing between compliance review and safety and soundness review. While compliance⁸ remains the center of the mortgage examination process, the MMC believes that elements of safety and soundness⁹ reviews, portfolio risk reviews, liquidity considerations, management controls and fraud investigations must be incorporated to a greater degree for a more effective system of supervision. The MMC acknowledges that many states currently incorporate these enhancements within the examination process, but seeks to create a national standardized examination approach that is more comprehensive in breadth, coverage and effectiveness than the current model.

Another opportunity for improvement in the present mortgage examination process is to utilize technology to assist in reviewing transaction and computation data. An automated compliance review system allows for computational and transactional review of 100% of the loan portfolio. Such review includes an analysis of virtually every loan originated or funded by the institution.

⁸ Compliance refers to an institution’s adherence to statute, rules and regulatory requirements.

⁹ In its simplest form, the term safe and sound means: free from danger or injury. Generally considered a depository examination term, an examination for safety and soundness is an examination of the institution’s strength and operating policies and procedures to determine whether the institution is being run in a safe and sound manner.

This ever improving automated system provides pre-screening for file review and assists in determining the ultimate scope of the examination.

The MMC recommends utilizing an automated compliance system to review the computation and transaction data of 100% of the loan portfolio whenever possible and practical, as is further discussed in the following section.

Modernization through Technology

The AARMR/CSBS Model Examination Guidelines (MEGs)¹⁰ published in July 2007 called for the adoption of a technology solution that could expedite targeted examinations by auditing loans against numerous federal, state, and municipal laws and regulations such as anti-predatory lending / high-cost legislation, the Truth-In-Lending Act (TILA), the Real Estate Settlement Procedures Act (RESPA), and state consumer credit laws and regulations based on license type. Following an eight-month evaluation process, CSBS and AARMR selected ComplianceEase's automated compliance system, ComplianceAnalyzer[®] as the technology solution under the MEGs. Subsequently, the MMC adopted ComplianceAnalyzer[®] as one of the foundational tools of the multi-state examination approach. States are offered the use of these tools at no charge through CSBS and AARMR.

Several state agencies participated in a pilot program and began in varying degrees incorporating ComplianceAnalyzer[®] and RegulatorConnect^{™11} into their examination workflow in 2008. These states include North Carolina, Wyoming, Michigan and Connecticut.

As stated previously, modernization of the mortgage examination process must include a more comprehensive review, both in numbers and content, of transaction data. Just as an examination team cannot be expected to review by hand every loan in the portfolio, examiners cannot be expected to identify all possible violations residing in the thousands of loans making up the portfolio. Automation is the solution to these challenges.

With the adoption of a technology-based examination process, the examination team can utilize a suite of applications throughout various points in the workflow (pre-examinations, on-site examinations and off-site examinations or monitoring) to screen and review the company. Primarily, the MMC intends to use this technology to "pre-screen" the portfolio prior to the start of the examination to better allocate the team resources. By pre-screening the entire portfolio via an electronic upload of transaction data, the EIC can adequately prepare for the time allocated to the examination, and make the best file review selection prior to an on-site visit.

¹⁰ http://www.csbs.org/Content/NavigationMenu/RegulatoryAffairs/MortgagePolicy/MEGs_HOME1.htm

¹¹ RegulatorConnect[™] found at www.regulatorconnect.org is the website established to assist institutions in the electronic upload of portfolio data to be reviewed by state examiners.

In practice, the EIC will instruct the licensee to upload file data before the onsite examination is scheduled to begin. The electronic upload is then run through ComplianceAnalyzer[®], which reviews the data for violations of federal and state law or regulation. A report is generated from which the EIC can determine the files to be reviewed during the onsite examination using traditional methods.

The MMC will employ the following automated tools for multi-state examinations:

- RegulatorConnect.org portal for licensees to prepare the electronic data and deliver to the EIC.
- RegulatorDirect for licensees to deliver ComplianceAnalyzer[®] reports to the EIC (for licensees already using ComplianceAnalyzer[®]).
- ComplianceAnalyzer[®] application for examiners to perform loan-level audits (single loan or batch).
- Examination Dashboard report for the EIC to review a licensee's risk profile and overall trend analysis.

Advanced Offsite Reviews and Limited Scope Visits

The same technology that allows a more complete review also provides the tools necessary for sophisticated offsite reviews which when necessary may be accompanied by limited scope visits.¹²

The MMC will establish a protocol for offsite institution monitoring through electronic data uploads, document imaging and examiner desk review. A few states are currently pursuing pilot programs of offsite monitoring. The MMC will incorporate the methods of these programs into its national protocol for offsite monitoring.

Uniformity on a Single State Basis

Although the Agreement and associated processes are focused on multi-state examinations, the MMC encourages standardization and uniformity for all state mortgage examinations. Uniform approaches and standardized methods of examination are as relevant for a single state as when a state joins efforts with other states. A few reasons include:

- Consistency across states and examination types.
- A single set of standardized templates regardless of the state conducting the examination.
- A uniform training program.
- The ability to use a uniform examination manual.
- The realization of a unified and uniform state system of supervision.
- The ability of examiners to move seamlessly from a single state to multi-state format.
- Increased effectiveness and efficiency.
- A single approach that provides industry with a standard format for supervision.

¹² Limited scope visits are onsite reviews limited to specific issues or reduced in time and coverage from full scope examinations.

States needing to meet statutory examination requirements or states desiring to modernize a standalone examination program may adopt the MMC protocol for advanced offsite reviews and limited scope visits currently in development.

The MMC is developing a number of other CSBS/AARMR approved processes and tools, discussed at the end of this report that will benefit all state mortgage regulators. The MMC intends to seek adoption and implementation of these processes by all states, whether exams are conducted on a multi-state or single state basis.

Industry Expectations

The MMC understands that industry must not only be psychologically prepared, but technologically prepared as we undertake the process of modernization. Each state is strongly encouraged to inform its licensees of the following expectations:

- Acceptance and cooperation with the multi-state examination approach. States participating in a multi-state examination do so under each state's examination and information sharing authorities. The combination of state resources is expected to elevate the quality of regulatory supervision while reducing the regulatory burden on all parties.
- A more rigorous and detailed pre-examination request for information, including inquiries into issues of safety and soundness, policies and management controls, consumer complaints and other more generalized areas of operations.
- Loan portfolio information should be maintained in a format that allows electronic extraction of information. Institutions following this expectation will benefit from a more streamlined and efficient examination flow.
- Institutions should become more adept at self-monitoring and self-identification and correction of problems. The MMC processes and tools will be available to institutions desiring to better understand and facilitate the examination process.

The concept of industry self-monitoring and accountability coupled with regulatory review is an integral part of modernization. Training, tools and technology¹³ for compliance are readily available to institution management and outside auditors and consultants. The expectation is that institutions will have identified problems and begun proactive correction for the majority of problems before the examination team ever arrives.

Institution management and outside auditors or consultants can stay abreast of mortgage examination modernization by accessing the MMC's uniform tools and templates at www.csbs.org¹⁴ or www.aarmr.org.

¹³ A variety of automation and technology solution vendors exist in the marketplace today. CSBS/AARMR do not endorse any particular vendor or product for institution self-monitoring.

¹⁴ See MMC Examination Tools at http://www.csbs.org/Content/NavigationMenu/RegulatoryAffairs/MortgagePolicy/_Content_NavigationM.htm

COMPANION INITIATIVES

Nationwide Mortgage Licensing System (NMLS) and the S.A.F.E. Act

Planning and creating the NMLS¹⁵ was a keystone for CSBS and AARMR in the effort to drive uniformity, increase consumer protection and enhance supervision. On July 30, 2008, the President signed into law the Housing and Economic Recovery Act of 2008. Title V of this Act, entitled *The Secure and Fair Enforcement for Mortgage Licensing Act of 2008*, recognizes and builds on states' efforts by requiring all mortgage loan originators to be either state-licensed or federally registered through the NMLS. Under the S.A.F.E. Act, all states must license mortgage loan originators according to minimum standards through NMLS. To participate in NMLS, each state is required to pass enabling legislation in order to use the uniform license application forms and definitions and renew licensees at calendar year-end. Many other elements of NMLS, including the assignment of a unique identification number (to all licensed companies, branches and mortgage loan originators), are providing efficiency and uniformity to state licensing and regulation.¹⁶

The S.A.F.E. Act set forth specific objectives for uniformity and effectiveness related to licensing; tracking; accountability; reporting; information sharing; consumer protections and anti-fraud measures; responsible behavior; training; examination; and complaint management. In 2008, CSBS/AARMR developed the Model State Law (MSL) as a template for states to use in passing legislation and implementing these objectives. The MSL expands on the S.A.F.E. Act objectives by addressing enforcement authorities; examination and investigation authorities; information sharing among regulators; modernization of the examination process, including the use of technology; and prohibitions on certain practices. As of July 31, 2009, the vast majority of states had implemented some or all of these additions.

Federal/State Subprime Mortgage Lending Pilot

In 2007 and 2008, the states were joined by the Federal Reserve System, the Office of Thrift Supervision and the Federal Trade Commission in a pilot effort to simultaneously examine the credit practices of nonbank lenders with significant subprime mortgage operations known as the "Pilot Project to Improve Supervision of Subprime Mortgage Lenders." The multi-agency partnership conducted consumer compliance reviews of independent mortgage lenders and nonbank subsidiaries of bank and thrift holding companies, as well as mortgage brokers doing business with, or working for, these entities. CSBS/AARMR considered the Pilot to be a

¹⁵ The NMLS initiative began in 2004 and the system was officially launched in January 2008.

¹⁶ For more information please refer to the State Regulatory Registry LLC Nationwide Mortgage Licensing System 2008 Annual Report at http://www.stateregulatoryregistry.org/AM/Template.cfm?Section=About_SRR1

successful exercise in joint agency examination relationships. Future such undertakings would logically fit within the established MMC processes and models.

Regulatory Guidance and the Model Examination Guidelines

In 2006 and 2007 respectively, CSBS/AARMR released the Guidance on Nontraditional Mortgage Product Risks (Guidance) and the Statement on Subprime Mortgage Lending (Statement). Released parallel to the federal agencies' guidance to depository institutions, the states' guidance covered state-licensed mortgage entities as a means of promoting consistent regulation in the mortgage market. These documents described practices deserving increased scrutiny due to higher than normal risk to both the lender and to the borrower and directed specific examiner attention to these practices.

Shortly following the 2007 Statement, CSBS/AARMR published the Model Examination Guidelines (MEGs) as a uniform examination tool for conducting examinations under both the Guidance and Statement. The guidelines were developed to:

- Protect consumers by providing comprehensive examination procedures that states can use to determine compliance with the Guidance and Statement.
- Establish uniform standards applicable for multi-state examinations and enforcement actions or for review by one state of another state's report of examination.
- Provide consistent and uniform guidelines for use by lender and broker in-house compliance and audit departments.

In 2007, the federal and state agencies adopted the MEGs as the Review Guidelines for the Pilot Project to Improve Supervision of Subprime Mortgage Lenders, and in 2009, the MMC began incorporating the MEGs into the MMC Uniform Examination Manual.

Reverse Mortgage Examination Guidelines

In December 2008, CSBS/AARMR released the Reverse Mortgage Examination Guidelines (RMEGs)¹⁷ as a uniform tool for the review of institutions originating and funding reverse mortgages. CSBS/AARMR set forth three general uses for the RMEGs:

- A set of examination guidelines that regulators can use to determine whether entities in the reverse mortgage loan industry are operating in an appropriate manner.
- Uniform standards applicable for multi-state examinations and enforcement actions or for review by one state of another state's Report of Examination.
- Consistent and uniform guidelines for use by institution and broker in-house compliance and audit departments.

As with the MEGs, the MMC will incorporate the RMEGs into the MMC Uniform Examination Manual.

¹⁷ http://www.csbs.org/Content/NavigationMenu/RegulatoryAffairs/MortgagePolicy/RMEGs_Home.htm

AARMR Borrower Ability to Repay Standard

The purpose of the AARMR Borrower Ability to Repay Standard (BARS)¹⁸ is to provide state regulators with a standardized examination procedure for examining a lender's determination that its borrowers have a reasonable ability to repay a loan. The BARS was developed to:

- Protect consumers by providing comprehensive examination procedures to ensure that lenders are adequately evaluating whether borrowers have the ability to repay the mortgage loans offered to them.
- Protect communities from the problems that are associated with lenders not adequately assessing the ability of borrowers to repay their mortgage loans, including foreclosures.
- Establish uniform standards applicable to multi-state examinations and enforcement actions or for review by one state of another state's reports of examination.
- Provide consistent and uniform guidance for use by lender in-house compliance and audit departments.

As with the MEGs and RMEGs, the MMC intends to adopt BARS into the MMC Uniform Examination Manual.

Agency Accreditation and Examiner Training

CSBS and AARMR have embarked on an aggressive campaign of accrediting¹⁹ state mortgage regulatory divisions and professional development through certification²⁰ of mortgage examiners. The bulk of accreditation and certification are focused on the examination function of each state agency. The accreditation process includes review for examination policies and procedures, the ability to rate mortgage providers, recognize problems and initiate effective corrective procedures, and the coverage, frequency and quality of the actual examination function.

CSBS and AARMR have established a successful series of mortgage examiner training programs dating back to 1994. While these programs are vital for individual professional development and continuing education, combined they serve as the backbone of an emerging program on examiner certification and a skilled uniform examination force.

¹⁸ <http://www.aarmr.org/pdf/Ability%20to%20Repay%20Standard%20revised%2010-30-08.pdf>

¹⁹ http://www.csbs.org/Content/NavigationMenu/ProfessionalDevelopment/DepartmentAccreditation/department_accredita.htm

²⁰ http://www.csbs.org/Content/NavigationMenu/ProfessionalDevelopment/EFSBSExaminerCertification/efbs_intro.htm

MMC PROCESSES, METHODS AND TOOLS

The MMC has either developed or is in the process of developing various processes, methods and tools for examination by state regulators. Many of these same processes, methods and tools may be accessed and used by institutions and auditors as well. Some of these include:

- The suite of technology solutions offered by ComplianceEase. Licensing arrangements have been established by CSBS and AARMR that allow any member state unlimited free of charge access to these solutions. Examiner training and registration is required and available through CSBS and ComplianceEase.
- Examination Information Requests. These documents include extensive requests for information and data on the licensee, including instructions on the upload of data for automated review. The requests incorporate management questionnaires and other instructions to facilitate the examination process.
- Processes for pre-examination information extraction. These processes incorporate various databases such as the Nationwide Mortgage Licensing System, the FTC Consumer Sentinel Database, and others.
- MMC Uniform Examination Manual. A comprehensive manual of examination processes, instruction, guidance, templates and checklists. The manual includes chapters covering review for compliance, safety and soundness, using the ComplianceEase software, conducting file reviews, reporting to management, and many other areas.
- MMC Uniform Examination Report. A standardized template that creates a uniform report format for both single state and multi-state examinations.

To access the CSBS/AARMR MMC uniform processes, methods and tools, visit www.csbs.org or www.aarmr.org and look for this symbol:



For more information on this report contact:

Chuck Cross
VP Mortgage Regulatory Policy
Conference of State Bank Supervisors
1155 Connecticut Ave NW, Fifth Floor
Washington, D.C. 20036-4306
202-728-5745 direct
202-306-8710 cell