

Washington Department of Financial Institutions

MORTGAGE BROKER EXAMINATION MANUAL

**Chapter 19.146 RCW
Chapter 208-660 WAC**

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INTRODUCTION

The Mortgage Broker Examination Manual (MB Manual) is a reference guide for licensees under the Mortgage Broker Practices Act (MBPA) licensed by the Department of Financial Institutions, Division of Consumer Services (department). Licensees are expected to have read the MBPA and the rules (chapters 19.146 RCW (Revised Code of Washington) and 208-660 WAC (Washington Administrative Code). This MB Manual is designed to assist licensees in preparing for an examination and does not replace the licensee's obligation to read and comply with the requirements of the MBPA. This manual is not intended to itemize every document, question, or review the department conducts during an exam; rather, it is a tool to assist the licensee by providing common questions or reviews the examiner may ask or conduct during the examination. Reliance on this manual does not absolve the licensee from violations of the MPBA discovered by the department during an examination.

The main purposes of mortgage broker examinations are to:

- Support the department's mission to protect the public, educate industry, and promote economic vitality.
- Assess the licensee's compliance with applicable state laws and federal regulations.
- Determine if the licensee is being managed in a safe and sound manner.
- Commence supervisory corrective action when internal controls are deficient, when prohibited practices are identified, or when significant violations of law are discovered.

This MB Manual is subject to periodic revision based on changes in examination techniques, Washington laws and administrative rules, and applicable federal laws and regulations.

RATING SYSTEM

The rating system is a guide. Department management may consult with the examiner to modify the rating based on any number of factors known to the department at the time. Ratings may also be modified in cases demonstrating consumer harm, systematic problems, or other serious deficiencies. Finally, ratings may also be modified in cases demonstrating the opposite.

EXAMINATION RATING MATRIX

The Exam Rating Matrix includes an evaluation of the two components of the mortgage broker examination program, Management and Compliance, to which a risk rating is assigned. The management risk rating is an integral part of the composite rating included in the Report of Examination (ROE). The Risk Assessment is weighted by the number of violations and the severity of findings.

EXAMINATION COMPONENTS

1. Management

An effective organizational structure, demonstrating sound and clear policies and procedures, is the foundation of strong management in an institution. Clear operational controls demonstrate a culture of accountability. The Designated Broker and management should demonstrate their commitment to maintaining an effective compliance management system and to setting a positive climate for compliance that will include:

- Demonstrating clear expectations about compliance.
- Appointing a compliance officer with authority and accountability.
- Allocating resources to compliance functions matching the level and complexity of the institution's operations.
- Conducting periodic compliance audits and providing for recurring compliance reports.

- Including compliance topics in management meetings and communicating those compliance matters to employees.
- Developing policies and procedures on compliance topics that demonstrate management’s compliance intentions.
- Creating and implementing reasonable and effective plans related to:
 - Financial Condition
 - Operations
 - Regulatory Compliance
 - Consumer Contact
 - Cooperating with the department on Exams and Investigations
 - Resolving Complaints

2. Compliance

Management should demonstrate a compliance culture in its daily operations. Employees should demonstrate an understanding of and willingness to comply with state and federal laws and rules regulating the mortgage broker industry. In addition to well-trained employees, the licensee’s compliance program should be clearly written and well-structured. Periodic internal audit and quality control review programs should be in place to facilitate the correction of any exceptions found in the loan origination process. These policies and procedures should be understood and practiced by all employees.

The department considers effective compliance management an integral component when evaluating the quality and effectiveness of an institution. An effective compliance management program should include a process for training, assessing, and monitoring compliance performance, and for implementing corrective action based on identified deficiencies.

COMPOSITE RATINGS

Composite Ratings are disclosed in the ROE as a subsection of the “Comments and Conclusions” section. Licensees receive a rating on a scale of “1” to “5” depending on the number and severity of violation(s) cited and other issues or problems discovered during an examination. The ROE will contain comments that explain the particular deficiencies noted in the licensee’s compliance program that support the rating.

The department primarily uses the Composite Rating System to help identify licensees that display weaknesses relating to non-compliance with state and federal laws and rules. In order to verify that the deficiencies noted have been resolved in a timely manner, the department may accelerate the timing of the next examination. In addition to the Composite Rating, the department may also rely on consumer complaints, harmful practices, fraud, and/or unlicensed activity disclosed or discovered during, or independently from, the examination process.

COMPOSITE RATING 1

A licensee with a composite rating of “1” has management with strong operational controls and a demonstrated compliance culture. It is better prepared to withstand changes in business cycles compared to licensees with lower composite ratings. The licensee also has a strong emphasis on compliance, as evidenced by a proactive compliance program with an independent review process or sufficient controls and confirmations.

Findings identified during the exam are relatively minor and can be remedied quickly without further action by the department. The examination revealed no evidence of prohibited practices, violations requiring restitution to consumers, or practices resulting in repeat violations.

COMPOSITE RATING 2

A licensee with a composite rating of “2” is fundamentally sound, but may exhibit modest weakness in operational controls that are correctable in the normal course of business. The business is stable and can withstand business cycle fluctuations. Certain areas of weakness, however, could create concern. For example, an individual loan file may have multiple problems where checks and balances failed, but those problems should be isolated and not found repeatedly in other files.

Findings identified during the exam are relatively minor and can be remedied relatively quickly without further action by the department. The examination revealed little to no evidence of prohibited practices, violations requiring restitution to consumers, or practices resulting in repeat violations.

COMPOSITE RATING 3

A licensee with a composite rating of “3” exhibits a combination of weaknesses ranging from less than satisfactory to moderately severe. The overall operational controls however, are still such that its future viability is not impaired.

Findings identified during the exam are more serious and require the development of new policies and procedures to correct the identified violations. The examination revealed more than a few compliance and/or documentation problems but the violations are generally not egregious or widespread. Examples of such violations include, advertising issues, Mortgage Call Report inaccuracies, fee issues, or disclosure content deficiencies.

COMPOSITE RATING 4

A licensee with a composite rating of “4” exhibits widespread operational control deficiencies and/or a combination of other identified weaknesses that cause its overall condition to be considered unsatisfactory. Unless prompt action is taken to correct these conditions, the problems are likely to impair the licensee’s future viability.

Findings identified during the exam are egregious and/or widespread. For example, there may be significant advertising content issues, Mortgage Call Report discrepancies, disclosure content deficiencies, and loan applicants who are entitled to restitution. Licensees with this rating will be placed under some type of regulatory action with the department. Such action may include expanding the scope of the examination, follow-up examinations, and/or a referral to the Enforcement Unit, which may result in a license action and/or fines and/or restitution.

COMPOSITE RATING 5

A licensee with a composite rating of “5” exhibits an inordinate volume of identified weaknesses that cause its overall condition to be considered unsatisfactory.

Findings identified during the exam reflect a widespread documentation problem, numerous fee-related issues, inadequate records maintenance, and/or unlicensed activities. The volume and character of these weaknesses require immediate corrective action. Licensees with this rating will be placed under some type of regulatory action with the department. Such action may include expanding the scope of the examination, follow-up examinations, and/or a referral to the Enforcement Unit, which may result in a license action and/or fines and/or restitution.

EXAMINATION SCHEDULING

Several variables are used to determine when companies are scheduled for an examination: statutory examination requirements, prior ROE ratings, loan volume, compliance history, volume of complaints, tips from the public, “for cause” examinations, and any other information deemed by the department to be an indicator of risk. The examination schedule and the variables used are subject to periodic changes and updates. However, all companies will be examined at least once every five years.

RATING IMPACT ON FUTURE EXAMINATION SCHEDULING

Composite Rating	Next Exam – Timeframe	Comments
1	36 to 60 Months	Limited scope or desk review
2	24 to 48 Months	Limited scope or desk review
3	18 to 48 Months*	Depends on severity of issues
4	6 to 18 Months*	Verify resolution of violations
5	6 month Watch List or Enforcement Unit*	May perform investigation or targeted repeat exam

**Exams with Composite Rating of 3 to 5 may be included in a Supervisory Watch exam, which will take place within six months of the date of the Licensee’s response letter to the examination report.*

PRE-EXAMINATION PHASE

Licensees are generally provided advance notification of a scheduled exam via telephone, email, or regular mail. An entry package with an itemization of documents to be completed before the examination is provided to the licensee at least 30 days prior to the entry date. The packet includes the cover letter and the Designated Brokers Questionnaire (DBQ). The entry packet response is required back to the department within 30 days. Failure to complete and return the package may result in administrative action. During this pre-exam period, the licensee is also given the opportunity to discuss examination procedures and scheduling issues. Upon receipt of this information the MB Financial Examiner Supervisor will review the response information provided by the licensee to determine the number of files for review. Included in the items reviewed are bonding requirements, NMLS quarter and yearly filings, complaint history, tips, and other related activities in order to “risk focus” the examination scope on areas that present the greatest degree of risk. The previous ROE, if any, is also reviewed to identify deficiencies noted at the last examination and corrective actions the licensee was directed to implement.

The department will then notify the licensee of the start date of the exam and to collect information about the licensee and their facility where the exam will occur.

LOAN SAMPLE SELECTION

The department will review the licensee’s total list of applications and loans to select samples. The loan sample selection is generated from the entire population of applications and loans covering the examination period. The sample will likely include all originations, including those that were brokered and table-funded, if applicable. The loan sample for each category is created by using either statistical sampling or judgmental sampling techniques, or a combination thereof. In addition, the department will request a small sample of declined files in order to test for Equal Credit Opportunity Act (ECOA) disclosures and possible non-refunded fees from the application process. The loan sampling procedure and the variables used are subject to periodic changes and updates.

In order to reveal trends and high-risk lending factors, the department will sort the data from the “Schedule P” of the DBQ or, if Schedule “P” data is not available, the department will request a loan list that covers the review period. If required, the licensee must provide the loan list in a Microsoft Excel spreadsheet format with the following separate column headings:

- Borrower last name
- Borrower first name
- Loan number, if applicable
- Property Address
- City
- State

- Zip Code
- Loan Type/Program (Fixed, ARM type, Conventional, Non-Conventional, VA, FHA, Reverse Mortgage, etc.)
- Lien Position (First, Second, or Other)
- Application Date
- Settlement Date
- Annual Percentage Rate
- Note Rate
- Credit Scores
- Loan amount
- LTV
- CLTV
- Status of loan (open, funded, withdrawn, denied, cancelled, rescinded)
- Amount of Compensation
- Mortgage Loan Originator Name
- Mortgage Loan Originator license number

Judgmental Loan Sampling

Judgmental sampling, also known as targeted sampling, involves an in-depth analysis of only a portion of a group. The basic purpose of the sampling is to draw conclusions about a “population” by testing a portion of that population. Items are not selected randomly but are selected based on the type of loan the department believes may have a higher risk. The loan list will be sorted, often by name, to look for predatory or abusive lending practices. Examples include reviewing for members of targeted consumer groups or multiple owner occupied loans which might indicate equity skimming or occupancy fraud. In addition, sorting by loan-to-value (LTV) ratio may be used to identify loans that may be predatory or abusive. Loans with LTV ratios of 65% or less may indicate loan approval based on the underlying collateral rather than the ability to repay the loan.

EXAMINATION PHASE

PROCEDURES UPON ARRIVAL TO THE EXAM LOCATION

The examination team will meet with the licensee’s point of contract (POC), which is generally the Designated Broker, owner, or compliance officer. In addition to introducing the examination team, the department will ensure that adequate resources are available for the duration of the examination. Such resources may include: sufficient workspace, internet connectivity, and access to loan file imaging system(s), if applicable. During this meeting the department will discuss the examination scope with the POC, obtain any entry letter package items that were still outstanding, and obtain or verify requested loan files. The department may also discuss broad subjects such as the licensee’s current products offered to the public and business practices in Washington.

PROCEDURES FOR OFF-SITE EXAMINATIONS

The department will contact Licensees selected for an off-site exam. The department will explain the exam process, clarify any questions about the licensee, products offered, location, and work location of MLOs. The licensee will receive the DBQ prior to the initial contact. Failure to complete and return the requested documents and/or information may result in an administrative action.

Please note the department does not accept original paper loan files from licensees; but does accept paper copies of loan files. Electronic files are preferred.

PROCEDURES DURING THE EXAM

If examiners need additional information during any exam, the licensee will be provided with a written list of items required and relevant due dates for a response.

LOAN FILE REVIEW

Credit Report

The credit report is reviewed for several reasons. The “Inquiries” section of the credit report contains the consumer’s historical efforts to secure financing and the broker’s history of pulling reports on the consumer. In addition, the credit report date can help identify the application date. A mortgage broker or loan originator must provide full written disclosures to the borrower within three business days of taking an application.

Loan Application

The loan application is reviewed to verify all sections were filled out correctly and that no sections were left blank without an explanation (a section may be marked “N/A”). The examiner will review, among other things:

1. Whether the loan product requested is the same as the loan product the borrower received.
2. The details of the loan to verify it matches the Loan Estimate (LE).
3. Whether the borrower received the required disclosures for each type of loan product for which they made an application.
4. Property information and the purpose of the loan.
5. Borrower information, including names, employment information, and assets and liabilities.

Loan Estimate (LE)

Examiners will review the Loan Estimate (LE), and verify the licensee delivered the disclosure to the borrower within three business days of application. The LE fulfills the requirements of the cost and fees disclosure required under the MBPA. A mortgage broker may rely on the lender to prepare and deliver the LE to the borrower but must maintain copies of all disclosures. If the lender prepared the LE, the examiner will review it and discuss any errors with the POC. The Examiner will review the following if the licensee prepared the LE:

1. That the “General Information” section is correct, the lender is identified, and a new LE was provided to the borrower within three business days of locking their interest rate, if required.
2. That the rate lock and closing costs dates, time, and time zone are completed.
3. That the loan terms and projected payments are accurate.
4. If the loan is an ARM, balloon, or negative amortization loan: that the correct payment information is disclosed and the Adjustable Interest Rate table is accurate.
5. That an escrow/impound account is disclosed on page one and the correct prepaids are disclosed on page 2.
6. If there was a lender credit on a locked LE, whether it was disclosed to the borrower and tied specifically to the interest chosen.
7. The origination fees are disclosed and made in “good faith”. And that the lender credits from the locked LE match the final Closing Disclosure.
8. That the “Additional Information About This Loan” section including the “Comparisons” is complete on Page 3.
9. If the licensee permitted shopping: whether a written list of settlement service providers was delivered to the borrower.

10. That there are no tolerance violations. For example, a review of non-shoppable fees paid to an affiliate for applicable 0% tolerance violations(line item to line item), and for 10% tolerance violations when a service provider is selected off the list of providers (using a combined total of line items).

Licensees can refer to Regulation Z, 12 CFR, Section 1026.37 for the required content of an LE. The Consumer Financial Protection Bureau (CFPB) also published a document on how to complete the Loan Estimate. The booklet can be found here, [TILA-RESPA Integrated Disclosure \(TRID\) "Guide to the Loan Estimate and Closing Disclosure form."](#)

Good Faith Estimate (GFE) of Settlement Costs

For loans with application dates after October 3, 2015, the Good Faith Estimate (GFE) has been replaced by the LE (discussed above). After October 3, 2015, the GFE is mainly applicable to reverse mortgages.

The GFE lists the charges the buyer is likely to pay at settlement. This is only an estimate and some charges are allowed to change. If a lender requires the borrower to use a particular settlement provider, then the lender must disclose this requirement on the GFE. The MBPA requires licensees to disclose fees and costs within three days of receipt of a loan application (RCW 19.146.030(2)). The licensee can review Regulation X Part 1024.7 and Appendix C for completion of the GFE.

The examiner will review the GFE to verify that no sections were left blank without an explanation (a section may be marked "N/A") and also for the following:

1. The name and address of the mortgage broker/lender is indicated.
2. Comparison of important dates.
3. Summary of the loan section is complete and accurate.
4. Comparison of all GFEs issued to the borrower and changes of circumstance to determine if increases on the settlement documents are warranted.
5. Comparison of GFE charges for certain services to charges for the same services that were disclosed on the settlement documents.
6. That timing of the GFE disclosures are correct. The first GFE should be given within three business days of application. Additional GFE must be given within three business days of a change of circumstance. Any change of circumstance resulting in a new GFE must be documented in the loan file. These changes are identified by the Real Estate Settlement Procedures Act (RESPA) as:
 - Acts of God, war, disaster, or other emergency
 - Information particular to the borrower or transaction that was relied on in providing the GFE and that changes or is found to be inaccurate after the GFE has been provided, which information may include information about the credit quality of the borrower, the amount of the loan, the estimated value of the property, or any other information that was used in providing the GFE
 - New information particular to the borrower or transaction that was not relied on in providing the GFE
 - Other circumstances that are particular to the borrower or transaction, including boundary disputes, the need for flood insurance, or environmental problems.

Initial Truth in Lending Act (TIL) Disclosure

For loans with application dates after October 3, 2015, the TIL has been replaced by the LE (discussed above). This form will not apply to the majority of transactions. If the TIL is used, the Examiner will look for the following:

1. The TIL was provided to the borrower within three days of submitting a complete application.

- TIL is accurate compared to other documents in the file.
- The following are included:

Item Required	Authority
Name of Licensee/Preparer	Regulation Z, Part 1026.18(a)
Annual Percentage Rate	RCW 19.146.030(2) and Regulation Z Part 1026.18(e)
Finance Charge	Regulation Z 1026.18(d)
Amount Financed	Regulation Z 1026.18(b)
Total of Payments	Regulation Z 1026.18(h)
Number of Payments or Payment Schedule	Regulation Z 1026.18(g) Payment Schedule
Amount of Each Payment or Payment Schedule	Regulation Z 1026.18(g) Payment Schedule
Variable Rate Feature	Regulation Z 1026.18(f)(2)(i) and 1026.19(b)(1)(2)
Prepayment Penalty	Regulation Z 1026.18(k)
Demand Feature	Regulation Z 1026.18(i)
Insurances Required to Obtain Credit	Regulation Z 1026.18(n)
Security	Regulation Z 1026.18(m)
Late Payment	Regulation Z 1026.18(l)
Contract Reference	Regulation Z 1026.18(p)
Assumption Statement	Regulation Z 1026.18(q)
Itemization of Amount Financed**	Regulation Z 1026.18(c)

****Note:** *In a transaction subject to RESPA, the GFE may be substituted for the Itemization of the Amount Financed. Re-disclosure of the TIL when the APR changes due to the changes in the cost and fees is required within 3-days of consummation of the loan. Refer to Regulation Z Commentary 1026.18(C) (4).*

Adjustable Rate Mortgage (ARM) Disclosure

If a loan is an ARM, the Examiner will verify the ARM disclosure was delivered. An application taken in person by the MLO requires the MLO provide the disclosure to the borrower at the time of application. An application taken by any other method requires the delivery of the document within three business days of the application date. A loan program disclosure for each variable-rate program in which the consumer expresses interest must be provided. The booklet entitled “Consumer Handbook on Adjustable Rate Mortgages” published by the CFPB, must also be provided. (This booklet is not part of the ARM disclosure, but an actual separate booklet given to the borrower with other early disclosures.) The examiner will:

- Verify that the disclosure was delivered within the timing requirements in Regulation Z, Part 1026.19(b).
- Verify the contents required under Regulation Z, Part 1026.19(b) are included. Regulation Z sets forth very specific requirements for the ARM disclosure.

Additional Federal Disclosures

Required Pamphlets

Special Information Booklet

The lender shall provide the special information booklet (HUD’s Settlement Cost and Helpful Information or CFPB’s Home Loan Toolkit¹) by delivering it or placing it in the mail to the applicant not later than three business days after the application is received or prepared. However, if the lender denies the borrower’s application for credit before the end

¹ CFPB’s Home Loan Toolkit booklet is required for loans with application dates after 10/3/15.

of the three-business-day period, the lender need not provide the booklet to the borrower. If a borrower uses a mortgage broker, the mortgage broker shall distribute the special information booklet and the lender need not do so. The intent of this provision is that the applicant receives the special information booklet at the earliest possible date.

HELOC Booklet

In the case of a federally related mortgage loan involving an open-ended credit plan as defined in 1026.2(a)(20) of Regulation Z, a lender or mortgage broker must provide the borrower with a copy of the brochure entitled "What You Should Know About Home Equity Lines of Credit." The above brochure or any successor brochure issued by the CFPB is deemed to be in compliance with this section.

Affiliated Business Arrangement (AFBA) Disclosure

Pursuant to Regulation X, Part 1024.15, the AFBA disclosure is required whenever a settlement service provider involved in a RESPA covered transaction refers the consumer to a provider with whom the referring party has an ownership or other beneficial interest. The examiner will review the licensee's organizational chart for affiliated businesses and ensure that the AFBA disclosure was given to the consumer when one of the affiliates was used.

Credit Score Disclosure & Notice to Home Loan Applicant

Any person who makes or arranges loans and who uses a consumer credit score in connection with an application that is to be secured by one to four units of residential real property must provide to the consumer, as soon as reasonably possible, a copy of the "Notice to the Home Loan Applicant." The disclosure must contain the name, address, and telephone number of each consumer reporting agency providing a credit score that was used. Additionally, creditors who engage in risk based loan pricing must provide certain information to applicants pursuant to Regulation V, 12 CFR, Section 1022.74(d).

During an exam, the examiners will verify the credit score disclosure was provided to the borrower(s) in a reasonable timeframe and ensure the required contents were included.

Privacy Policy Disclosure

Examiners will review the privacy disclosure to make sure it is compliant with the Gramm-Leach-Bliley Privacy Act, Regulation P, 12 CFR 1016. Specifically, the privacy disclosure will be reviewed for the following content:

1. Revision date.
2. The licensee identified itself.
3. The licensee disclosed six items in the "What?" section.
4. The licensee completed the disclosure table on page 1.
5. If the licensee shares non-public personal information with unaffiliated third parties, borrowers were provided the opportunity to opt-out.
6. The licensee included a telephone number or website for "Questions".
7. The licensee disclosed a minimum of five items in the "How does [name of financial institution] collect my personal information?" section. The licensee also included the required statement, "We also collect your personal information from others, such as credit bureaus, affiliates, or other companies".
8. The "Definitions" are accurately completed and *italicized*.

USA PATRIOT Act Information Form

Pursuant to USA PATRIOT Act, the examiner will verify that the Patriot Act Information Form includes a copy of the borrower(s) identification and information required in the USA PATRIOT Act Information Form. The examiner will also review the licensee's procedures to verify it includes, at a minimum, processes for:

1. Verifying the identity of any person seeking to open an account to the extent reasonable and practicable;
2. Notifying customers that their identity will be verified;
3. Maintaining records of the information used to verify a person's identity, including name, address, and other identifying information; and
4. Consulting lists of known or suspected terrorists or terrorist organizations provided to the financial institution by any government agency to determine whether a person seeking to open an account appears on any such list.

Notification of Adverse Action

The Equal Credit Opportunity Act (ECOA), 15 USC 1691, 12 CFR 1002.9 requires the **creditor** to disclose the principal reasons for denying or taking other adverse action on an application for an extension of credit. The creditor is a person, who in the ordinary course of business, regularly participates in a credit decision, including setting the terms of credit. Mortgage brokers who do not participate in the making of a credit decision are not required to give the notification of adverse action. If, however, the broker does make the credit decision and provides the disclosure, it must be accurate and complete.

Additional Loan File Review Items

The following loan file items are reviewed to ensure they are appropriate to the transaction and do not indicate deceptive or fraudulent activity.

Refinance Transaction: Net Tangible Benefit

If the loan is a refinance, the examiner will compare the loan information on the payoff demand to the information on the new mortgage documents (i.e. application, note, closing disclosure) to ensure the consumer is obtaining a net tangible benefit from the transaction. The following are examples of net tangible benefits:

- Lowering the interest rate
- Lowering the monthly payment
- Getting rid of mortgage insurance premiums (based on home value appreciation)
- Converting from an ARM to a fixed rate loan
- Consumer debt consolidation via a refinance (i.e. credit card debt paid off and consolidated into a lower interest rate mortgage)
- Pulling out cash to pay for renovations or other expenses

If there is no discernable net tangible benefit, the examiner will likely seek an explanation from the POC to explain the apparent lack of tangible benefits for the borrower.

Title Insurance (Preliminary Commitment)

The examiner will review the title report to understand the transaction's original timeline and review the original loan amount requested.

Appraisal

The examiner will review the property valuation information provided and verify that it agrees with other loan file documentation. If the same appraiser is being used consistently, the examiner will request an explanation from the POC.

Hazard Insurance

The examiner will review loan files to determine the mortgage broker is not “steering” the borrower to any particular agent for homeowner’s insurance. If the same insurance provider is used consistently, the examiner will request an explanation from the POC.

Flood Certification

The examiner will verify that any flood certification is disclosed to the borrower. If the loan is a brokered loan, the examiner will check for the lender if the licensee is completing the flood insurance. The examiner will also verify that the flood insurance was acquired from a provider chosen by the borrower.

Funding Documents

Closing Disclosure (CD)

For mortgage loans with application dates after October 3, 2015, examiners will review the Closing Disclosure (CD) for compliance with Regulation Z, 12 CFR, Sections 1026.19 and 1026.38. Examiners will verify that all closing costs stayed within the applicable tolerances discussed in Regulation Z Section 1026.19(e)(3) by comparing the fees on the initial LE against the fees on the final CD. Fees may increase with a valid change of circumstance as long as the fee adjustment was re-disclosed within three days of the change. The examiner will request an explanation from the POC of any fee changes that are outside the tolerance limits (0% for origination fees, non-shoppable fees, fees paid to affiliates of creditor, or lender credits; 10% for shoppable fees).

Final TIL & Final HUD Settlement Statement

For the majority of loans with application dates after October 3, 2015, the Final TIL and HUD Settlement Statement have been replaced by the CD (discussed above). After October 3, 2015, the HUD is mainly applicable to reverse mortgages. The examiner will review the final or certified HUD to make sure it mirrors the GFE in the placement, type, amount, and payee on all fees in the transaction. The licensee can consult Regulation X, Part 1024, Appendix A for further instruction on the placement and disclosure of certain fees on the settlement statement. The examiner will request an explanation from the POC for any large discrepancies between the GFE and Final HUD.

Note(s) and Rider(s)

The examiner will review the Note as it contains information on the principal amount, interest rate, interest rate change information (if it is an ARM), consummation and maturity dates, first payment date, and other pertinent information. The examiner will often review the Rider to the Note as certain information, such as prepayment penalty terms and ARM terms, are often disclosed in a Rider to the Note rather than contained in the Note itself. The examiner will compare the Note and applicable Riders for discrepancies between the product originally disclosed and the product received at closing. If discrepancies are noted, the examiner will verify the next product was disclosed to the borrower or, if it was not disclosed, request an explanation from the POC.

Notice of Right to Cancel

A creditor is responsible for providing the borrower with a Notice of Right to Cancel on both first and second lien refinanced mortgages, including HELOCs, when the borrower’s primary residence is used to secure the loan. The examiner will verify that the Notice was provided and contains accurate dates as the borrower has three business days to rescind the transaction, starting the day of delivery. The instructions provided in Regulation Z Part 1026.23 outline the required disclosures that must be on the rescission document.

Reverse Mortgages

There are two main types of reverse mortgages that might be part of the loan files reviewed. One is a proprietary reverse mortgage program set-up and funded by a creditor. This type of reverse mortgage is less common. The primary reverse mortgage program is a Home Equity Conversion Mortgage (HECM) which is funded through a government-controlled program. The examiner will review the following for HECM loans:

- Counseling Certificate date
- Borrower's date of birth (the borrower must be over the age of 60 at the time of loan)
- Deed of Trust (DOT) states "This DOT secures a reverse mortgage"
- Affiliated Business Arrangement
- Total Annual Loan Cost (TALC) – see Reg .Z 1026.33 (b) & Appendix K
- Projected Cost of Credit Disclosure – see Reg. Z 1026 (c) & Appendix K
- Servicing payment timing (for example, are penalties paid if a payment is late?)
- Escrow of Taxes and Insurance
- Accuracy of Interest and fees charged

BUSINESS PRACTICES

Safeguarding Customer Information

The department is concerned with the security of consumer information as failure to maintain the confidentiality, integrity, and availability of information can result in direct harm to consumers and operational and reputational risk for the licensee. Since 2015 the department uses an Information Security Questionnaire to review the licensee's responses compared to the requirements in 16 CFR Part 314.3, the standards for safeguarding customer information.

The examiner will review the licensee's systems for the following deficiencies, among others:

1. Computers are not password protected.
2. Employee safeguard of records training has not taken place.
3. Information systems, including network and software design, as well as information processing, storage, transmission, and disposal do not have safeguards in place.
4. Detecting, preventing, and responding to attacks, intrusions, or other systems failures are not addressed in internal policies.

The ROE lists the industry's best practices in addition to the licensee's answers to the Questionnaire to enable the licensee to compare their information security with the industry standards. In addition, in order to facilitate the licensee's on-going education in information security, the department provides various information security related resources on its website at <https://dfi.wa.gov/industry/consumer-services-security-resources>.

Telemarketing

The examiner will review any scripts, contracts, and procedures related to telemarketing for compliance. The Telemarketing Sales Rule requires a seller or telemarketer that participates in telemarketing activities to maintain records and have them available for examination. The licensee can get additional information from 15 USC Chapter 87 (Telemarketing and Consumer Fraud and Abuse Prevention), and 16 CFR Part 310.5

Advertising

The examiner will review any radio, television, telephonic, electronic, and written advertisements for compliance with the MBPA and Regulation Z Part 1026.24 (for closed end credit) and Part 1026.16 (for open end credit). In addition, all

web sites, social media pages, and any individual MLO web sites or social media pages will be reviewed during the examination. The MBPA requires licensees to maintain a copy of all advertising for three years.

Business Name Use

The examiner will review all signage, advertisements, letterhead, stationary, and forms to verify the licensee is using a name that was approved by the director. At branch offices, the examiner will verify that each branch office is identified as a branch or division of the main office on all signs, advertisements, letterhead, stationary, and forms.

PREDATORY LENDING

Predatory mortgage lending involves a wide array of abusive practices. For a more comprehensive discussion regarding mortgage lending fraud, refer to the Federal Financial Institutions Examination Council (FFIEC) web site at www.ffiec.gov. The FFIEC issued a White Paper in February 2010 entitled “The Detection, Investigation, and Deterrence of Mortgage Loan Fraud Involving Third Parties: A White Paper” can provide additional information.

Examiners will be on the lookout for the following common abusive practices during an examination:

Equity Stripping

The lender makes a loan based upon the equity in the home instead of taking into account whether the borrower can make the payments. If the borrower cannot make payments, the home may be lost through foreclosure.

Excessive Fees

Points and fees are costs not directly reflected in interest rates. Because these costs can be financed, they are easy to disguise or downplay. For competitive loans, fees below 1% of the loan amount are typical. For predatory loans, fees totaling more than 5% of the loan amount are common. The examiner will review the LE and CD or GFE and HUD for fees that exceed 5% in the aggregate of the loan amount (not including Brokers Compensation if it is Lender Paid). The trend of fees earned will be reviewed and noted in the ROE. Excessive fee trends pertaining to branches or specific MLOs may cause the department to expand the examination scope.

Abusive Prepayment Penalties

Borrowers with higher-interest subprime loans have a strong incentive to refinance as soon as their credit improves. Historically, a significant proportion of subprime mortgages have carried a prepayment penalty (a fee for paying off a loan early). An abusive prepayment penalty typically is effective more than three years and/or costs more than six months' interest. The examiner will review the LE, CD, or TIL, rate sheets, document request forms, and the Note for a prepayment penalty. If the prepayment penalty exceeds the fixed portion of an ARM the examiner will likely request an explanation from the POC.

Flipping

A lender or mortgage broker “flips” a borrower by refinancing a loan to generate fee income without providing any net tangible benefit to the borrower. The examiner will review the credit report lines and the lien history on the title report to verify any previous mortgage balances and loan history. If it appears the new mortgage payment did not benefit the borrower, the examiner will conduct a net tangible benefit analysis. If a net tangible benefit analysis reveals trends in this area, the scope of the examination may be broadened and other specialists may be utilized.

Bait-and-Switch Schemes

The broker may promise one type of loan or interest rate but, without good reason, give the borrower a different one or a higher (and unaffordable) interest rate that does not kick in until months after the borrower may have begun to pay on the loan. The examiner will review the loan documents to verify the terms on the initial disclosures are consistent with the final disclosures. In addition, the examiner will verify that the terms of the loan are consistent with the credit scores, income, and LTV of the borrower.

OTHER FRAUD

Some loan products are more consistent with fraudulent lending activity and provide a conduit for fraud because they lack essential elements for borrower qualification for the loan. The examiner will be reviewing loan files for trends in special loan products such as:

1. “No Doc” or “Low Doc” Loans (No or Low Documentation Loans) – This loan product is associated with higher rates and borrowing amounts for individuals that may have a source of income and assets but cannot prove it in a conventional manner.
2. “NINA” or No Income No Asset Loans – Like “No Doc” or “Low Doc” loans, borrowers may have funds and income but not the ability to prove it due to time on the job or the length of time and source of the assets being used to qualify for the loan.
3. Stated Income Loans – This loan product will be used frequently when the debt to income ratios for the borrower exceed qualifying ratios. Stated income may cause borrowers to qualify for more payment than they can actually afford. Coupled with an ARM product, this could put the borrower in a situation where they cannot afford their home later in the life of the loan.
4. Adjustable Rate Mortgages – ARM products are designed to assist borrowers that are educated as to how the products works and can afford them when market changes increase the payment. However, some consumers end up with a loan that creates an affordability issue for the consumer in the long run.

Bank Secrecy Act and Anti Money Laundering

The Bank Secrecy Act authorized the Secretary of the Treasury (Treasury) to issue regulations for entities and to keep records and file reports that the Treasury determines have a high degree of usefulness in criminal, tax, or regulatory investigations or proceedings, or in the conduct of intelligence or counter intelligence activities, including analysis, to protect against international terrorism. In addition, the Treasury is authorized to impose anti-money laundering (AML) program requirements on financial institutions. The authority of the Treasury to administer the BSA has been delegated to the Director of the Financial Crimes Enforcement Network (FinCEN). Licensees under the MBPA are subject to the BSA/AML regulations.

The pillars of the BSA/AML program are:

- Internal Controls and Procedures;
- Designation of a Compliance Officer;
- Training; and
- Independent Testing.

Examiners will review the licensee’s AML program to ensure it is in compliance with the regulation at 31 CFR Part 1029.210.

EXIT MEETING & EXIT REPORT

The exit meeting generally occurs after the department has completed the preliminary examination analysis and file review. The meeting generally takes place on the last day on-site of an exam and allows the department and licensee to clarify and/or potentially resolve outstanding issues. The department will orally present, and provide in writing, a summary of preliminary findings. If issues are discovered or arise after the exit meeting, the department will contact the licensee for additional discussion.

After the department's examination is complete, the licensee will be provided with the ROE setting forth the examination findings and citations to the laws and rules. If the licensee disagrees with a finding or applicability of law or rule, the licensee should address their points in their written response to the department.

If the licensee is being billed for the examination, an on-site Examination Hours Recapitulation form will be provided. The form details the on-site hours incurred by the department and explains that additional off-site hours may still be necessary. The licensee signs a copy of the Examination Hours Recapitulation form to acknowledging receipt, and is provided with a copy to retain for their records.

POST EXAMINATION PHASE

WRITTEN REPORT OF EXAMINATION (ROE)

The Report of Examination (ROE) is a comprehensive document that represents the examination process. The ROE will contain comments from the examiner. The examiner may prescribe actions for the licensee to take to remedy any deficiencies rather than referring the licensee to any formal enforcement action. Remedial action may be taken in some cases. The ROE generally consists of the following:

COVER PAGE

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- Examination Procedures and Summary
 - Loan Sampling
 - Exit Meeting

ROE & INVOICE SENT TO LICENSEE

Once the ROE has been finalized, a letter providing formal notice to the licensee regarding ROE findings and an invoice of travel costs (if applicable) will be created. These documents, in addition to the ROE, will be emailed to the licensee, along with a request for a response.

LICENSEE RESPONSE TO ROE

The licensee has 30 days from the ROE issuance date to provide a written response to the ROE. If the response is not received by the department in a timely manner, the Administrative Staff will follow up with a late letter. If a response is not received by the deadline provided in the second letter, the department may take further action. Occasionally, special situations may arise where a licensee requires additional time to compile a response to the final ROE. The licensee may request, in writing, an extension of the response deadline.

For each apparent violation, the licensee should indicate the proposed remedy and implementation date. If refunds are required, the licensee must provide copies of checks and accompanying letters sent to each borrower. If the licensee's response is adequate, a closing letter will be sent to the licensee, signaling the closure of the examination. If the licensee's response is inadequate, the department will contact the licensee and attempt to seek a resolution. If a resolution is reached, a closing letter will be sent to the licensee and the examination will be closed. If a resolution is not reached, the examination may be referred to the Enforcement Unit for further action.