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Date: October 15, 2009

To: Licensed Mortgage Institutions

Re: Modernization and Enhancement of the Mortgage Examination Process

The purpose of this notification is to inform licensees of upcoming changes in the examination process. In particular, this notification describes:

- **New examination technology the Pennsylvania Department of Banking and Multi-State Mortgage Committee (defined on page 2) will use in the mortgage examination process;**
- **The responsibility of licensees to retain transaction level data sufficient to facilitate the employment of new examination technology; and**
- **Proposed timeframe within which all licensees are expected to retain transaction level data for use with the new technology.**

Background

In 2007, the states, through 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 review 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, which launched the CSBS/AARMR mission to restructure the mortgage examination process, is signed by all state agencies regulating the mortgage industry. It works in tandem with the Nationwide Mortgage Licensing System (NMLS)² launched to

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

² www.stateregulatoryregistry.org

restructure the mortgage licensing process. These inseparable duties of examination and licensing are the core responsibilities of mortgage supervision.

The initiative to enhance the examination process can be described broadly within the areas of Uniformity, Modernization and Effectiveness.

Uniformity in the Examination Process

Uniformity reduces regulatory burden and increases efficiency. Uniformity in the examination process occurs within two primary venues: multi-state examinations and single state examinations. Multi-state examinations fall under the Agreement and are selected and directed by the Multi-State Mortgage Committee (MMC)³ representing all states. Multi-state examinations are joint sharing arrangements of resources and information between two or more states when examining Multi-State Mortgage Entities (MMEs).⁴ Legally, each state examines the licensee under its unique statutory authority, however the joining states have agreed to share examination burden and examination information in order to reduce the overall regulatory burden to the entity, and achieve increased efficiencies relative to conducting single state examinations.

The Multi-state Exam Process

Multi-state examinations are scheduled and supervised by the MMC with actual examination work being conducted under the leadership of a single examiner in charge (EIC), typically from the institution's home state (headquarters). States may choose to participate either on-site or off-site. A single report of examination with state specific sections is published to institution management. The benefit to the institution is a single examination for all of the participating states rather than multiple examinations by independent states occurring at random intervals. In order for multi-state examinations to be successful, the examination team must operate under a uniform and standardized set of examination procedures. The goal is for examiners to possess equal skill sets and utilize the same processes regardless of the state or number of states involved in the multi-state examination. Such standardization and uniformity creates a familiar examination process and outcome with a single report format that can be shared and reviewed across jurisdictions.

The benefits to the industry, especially for those institutions operating in multiple states are many, with the most obvious being a single set of exam processes and

³ The MMC is a ten state committee appointed by the states to implement the Agreement and oversee the multi-state supervision process. Additional information about the MMC and national uniform examinations may be found in the document MMC Report to State Regulators August 2009 at <http://www.csbs.org/Content/NavigationMenu/Home/2009MMCREPORTTOSTATEREGULATORFinal.pdf>

⁴ Multi-State Mortgage Entities (MMEs) are institutions conducting business in two or more jurisdictions.

standards. Similar benefits exist for institutions operating in only one state as examiners will draw from and employ consistent and proven examination methods.

Modernization through Technology

One of the goals is to minimize regulatory burden for highly compliant institutions. The Pennsylvania Department of Banking intends to achieve this goal by utilizing technologies that assist examiners in reviewing loan transaction data (“Technology”). An automated compliance review system allows for computational and transactional review of a larger statistical sample. Such review includes an analysis of virtually every loan originated or funded by the institution. This ever improving automated system provides pre-screening for file review and assists in determining the ultimate scope of the examination.

Following an eight-month evaluation process, CSBS and AARMR selected ComplianceEase’s automated compliance system, ComplianceAnalyzer® as a technology solution for states for both multi-state and single state examinations. The Pennsylvania Department of Banking will be utilizing ComplianceAnalyzer offered through CSBS and AARMR for the examination process as well for the purposes of auditing loans against 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 Pennsylvania statutes such as the Mortgage Licensing Act and the Proper Conduct regulation based on license type.

Note: CSBS, AARMR, and the Pennsylvania Department of Banking, do not endorse or require any specific software program or analytical service. Numerous vendors offer sophisticated analytical tools for determining an institution’s compliance with applicable laws and regulations. ComplianceAnalyzer® is made available to the Department through CSBS and AARMR free of charge and our licensees do not need to be a customer of the system to upload their company loan data for our examination process.

How the Technology Works

The Pennsylvania Department of Banking intends to use the Technology to “pre-screen” the entire portfolio. This will be accomplished through the uploading of 100% of the institution’s portfolio prior to the start of the examination. By pre-screening the entire portfolio via an electronic upload of transaction data by the licensee, the EIC can adequately allocate the appropriate resources to the examination, and make the best file review selection prior to an on-site visit. The Pennsylvania Department of Banking also intends to employ the Technology to identify overall institution risk and as an off-site examination tool to further reduce examination time and burden.

The EIC will instruct the licensee to upload file data before the onsite examination is scheduled to begin.⁵ The electronic upload is then run through ComplianceAnalyzer® by the EIC, 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. An example flow chart of this process is included at the end of this notification.

The Pennsylvania Department of Banking 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® software).
- 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.

Effectiveness

In its simplest approach, the initiative accomplishes effectiveness by assigning 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.

Licensee Preparation

The Pennsylvania Department of Banking understands that licensees may need time to prepare for these technological innovations and changes in examination approach. To facilitate this, the Pennsylvania Department of Banking is conducting a process of notification, education and phase in of these changes.

We encourage you to proactively review and modify your information system data retention and data extraction capability in order to effectively and efficiently participate in the new examination process. Further, the concept of licensee self-monitoring and accountability coupled with the Pennsylvania Department of Banking review is an integral part of modernization. The expectation is that licensees will be able to identify problems and begin proactive correction for the majority of problems without the need for regulatory intervention. Training, tools and technology for compliance are

⁵ This process does not require a licensee to purchase any specific software program or be a customer of any specific vendor and the data upload is free of charge. The Pennsylvania Department of Banking expects licensees to exhibit sufficient sophistication in internal technologies and monitoring processes of data for retention and extraction to be able to participate in this new examination approach.

being made available to licensee management and outside auditors and consultants that will assist in this process.

The Pennsylvania Department of Banking will begin these modernized examination processes on a limited basis in early 2010. A gradual phase in for all licensees to be fully capable of participating in the examination process no later than early 2011 is desired.

In preparation for these changes, we provide the following direction:

- For institutions operating in ten or more states, expect and cooperate with examination requests made by the CSBS/AARMR Multi-State Mortgage Committee on behalf of The Pennsylvania Department of Banking. States participating in a multi-state examination do so under each state's independent 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.
- Expect a more comprehensive 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. Additional guides and tools are available on the CSBS website at:
<http://www.csbs.org/Content/NavigationMenu/RegulatoryAffairs/MortgagePolicy/MMCEXamTool.htm>
- Licensees should become more adept at self-monitoring and self-identification and correction of problems. State processes and tools are available to institutions desiring to better understand and facilitate the examination process.
- Complete and return no later than November 2, 2009 the attached Survey of Licensee Technology Readiness.

Licensee System Readiness

The Pennsylvania Department of Banking strongly encourages you to begin a system readiness review and technology preparation process as soon as possible. Again, the Pennsylvania Department of Banking does not endorse or encourage you to employ any specific analytical tools; however, the expectation is that all licensees will be able to participate fully in modernized examination processes no later than early 2011.

The following information is provided to assist you in this process:

1. Complete and return the attached survey to palender@state.pa.us no later than November 2, 2009.
2. Email palender@state.pa.us and request the licensee's registration code which will allow you to register at RegulatorConnect.org. Once registered, you will be able to see what data elements are required for the data upload, practice the data upload, and verify your data integrity. Practice uploads are not transmitted to your state regulator and can be performed multiple times.

3. If pre-built export capabilities do not yet exist for your key technology platforms, you can configure a data extract from your systems by referring to the specifications downloaded from RegulatorConnect.org.
4. You may also wish to contact your technology providers to encourage them to build exports to the necessary format.
5. If you are currently employing a vendor program to analyze regulatory compliance (e.g. Mavent, Interthinx, etc.), consider contacting your vendor for possible assistance in the upload of data to RegulatorConnect.org.
6. Additional guides and tools are available on the CSBS website:
<http://www.csbs.org/Content/NavigationMenu/RegulatoryAffairs/MortgagePolicy/MMCEXamTool.htm>

Pilot Program for Pennsylvania

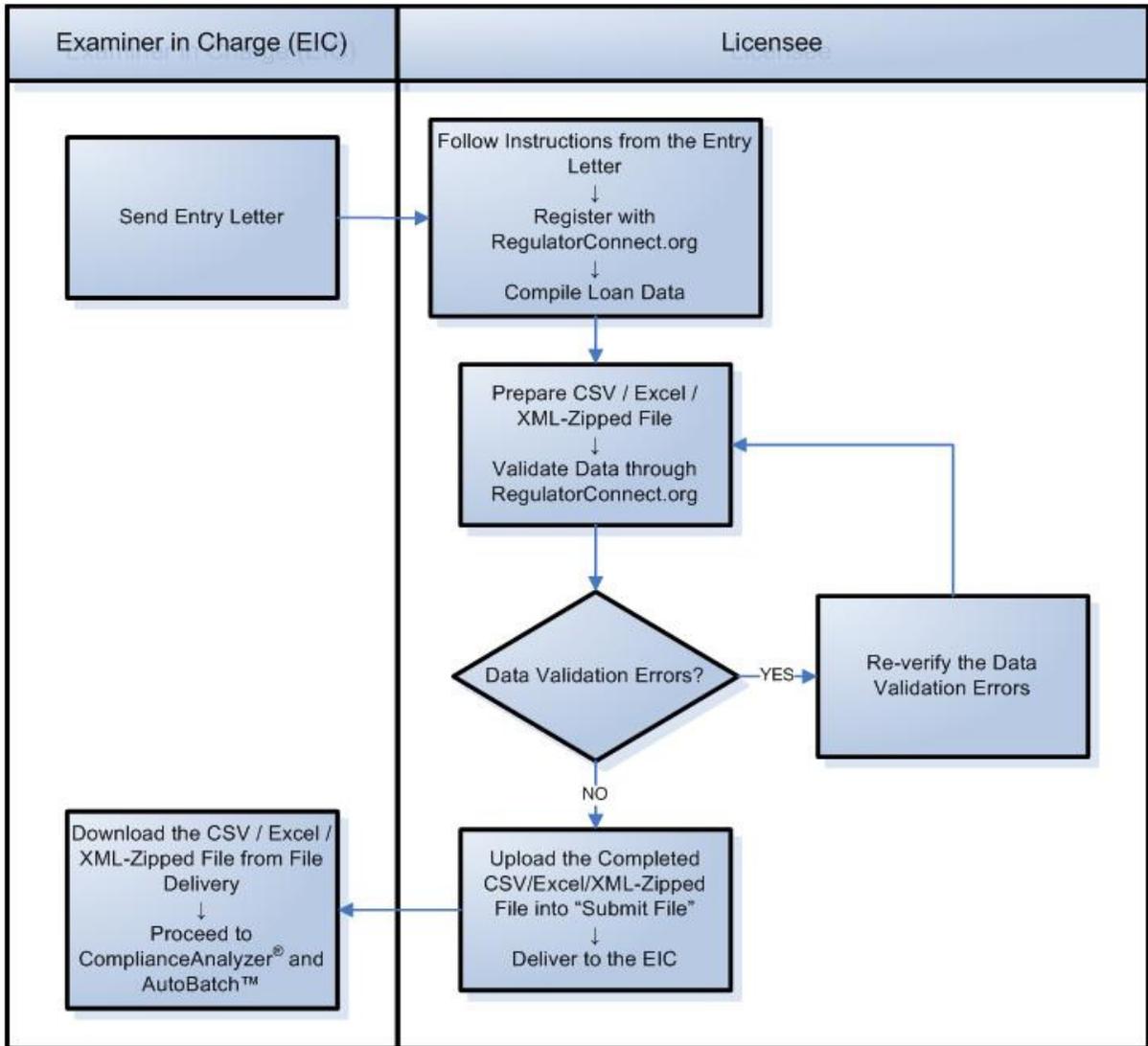
The Pennsylvania Department of Banking communication outreach program relating to technology will include a pilot testing phase. The initial testing includes ten lenders participating in the technology driven enhanced examination. **This phase will begin shortly after receiving the Survey of Licensee Technology Readiness which should returned by email to palender@state.pa.us no later than November 2, 2009.** Additional testing phases will follow in 2010. This initiative will require effective communication.

The Pennsylvania Department of Banking looks forward to working with you to enhance the examination process to create uniformity, modernize through technology, and increase the overall effectiveness of regulatory supervision. In an effort to alleviate multiple questions and to provide a platform for questions we will create a working document to house frequently asked questions. If you have questions relating to any aspect of this initiative, please send them to palender@state.pa.us. Additionally, Senior Financial Institutions Examiner Tim Knopp can be reached tknopp@state.pa.us or by telephone at (717) 425-5470.

Sincerely,

Don DeBastiani
Director, Bureau of
Non-Depository Examinations

Illustration of Examination Information Flow



Modified: 12/01/08