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Is your mortgage origination operation ready for a CFPB Exam?

New rules by the CFPB requires all Mortgage Originators to have an effective

Compliance Management System

Since the creation of the Consumer Finance Protection Bureau (CFPB) in July 2011, the CFPB has the authority to regulate the non-bank mortgage originators. In January 2012, the CFPB published an update to the Supervision and Examination Manual titled *Mortgage Origination Examination Procedures*. In this update, the CFPB states that the objectives of mortgage originator exams are to:

1. Assess the quality of a supervised entity's ***compliance management system*** in its mortgage origination business.
2. Identify acts or practices that materially increase the risk of violations of federal consumer financial law, and associated harm to consumers, in connection with mortgage origination.
3. Gather facts that help determine whether a supervised entity engages in acts or practices that are likely to violate federal consumer financial law in connection with mortgage origination.
4. Determine, in accordance with CFPB internal consultation requirements, whether a violation of a federal consumer financial law has occurred and whether further supervisory or enforcement actions are appropriate.

This article addresses objective #1. So what does the CFPB expect from mortgage bankers in having an effective compliance management system (CMS)? Fortunately, CMS is not a new concept, as depositary institutions (i.e. banks) for many years have been required by their regulators, such as the FDIC, OCC, and Federal Reserve, to have an effective CMS in place. This means there are proven best practices that can be used in implementing an effective CMS.

When CFBP comes knocking on your door, it is highly likely that one of the first steps they will take is to assess the existence and effectiveness of your CMS. Most regulators follow a risk-based approach to their examinations. This means that they will focus on areas that have the greatest risk exposure and expand the scope of their examination to assess those areas of higher risk. By having an effective CMS system in place you significantly reduce risk and exposure. As such, your examination most likely will go more smoothly and quicker because the examiner will have confidence in the effectiveness of your CMS.

What is a Compliance Management System? Basically, CMS as stated in the CFPB handbook is how your organization:

- Establishes its compliance responsibilities;
- Communicates those responsibilities to employees;

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- Ensures that responsibilities for meeting legal requirements and internal policies are incorporated into business processes;
- Reviews operations to ensure responsibilities are carried out and legal requirements are met; and
- Takes corrective action and updates tools, systems, and materials as necessary.

An effective compliance management system commonly has four interdependent control components:

- Board and management oversight;
- Compliance program;
- Response to consumer complaints; and
- Compliance audit.

An institution will be successful at managing its compliance responsibilities and risks now and in the future when all elements are strong and working together.

While the formality and complexity of compliance management systems will vary greatly among institutions, the ***board and management*** are expected to have a system (a compliance program/framework) in place to effectively manage its compliance risk, consistent with its size and product mix. The CFPB states the ultimate responsibility for developing and administering an effective CMS is with the organization's board of directors or a controlling person/group that exercises similar oversight functions such as a board of directors. Basically, this means that the CFPB expects the board to set clear expectations regarding compliance, appoint a qualified and experienced compliance officer, and establish a compliance function with policies, procedures, and standards.

The CFPB states that having a ***sound compliance program*** is essential to the efficiency and success of the organization. The CFPB feels the organization's compliance program is just as important as the organization's business plan. In other words, CFPB is taking this very seriously. The compliance program basically consists of the following components:

- *Policies and procedures* – The compliance policies and procedures should be consistent with the board approved policies and address all the applicable Federal consumer financial laws.
- *Training* – Training is essential to an effective compliance program. Board members should receive sufficient information to understand their responsibilities, and the management and staff should receive specific and comprehensive training that reinforces and helps implement their written policies and procedures.

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- *Monitoring and corrective action* – Monitoring seeks in an organized and risk-focused way to identify procedural and training weaknesses promptly and correct these weaknesses. Monitoring and testing is generally more frequent and less formal than independent compliance audits (which is the fourth component of CMS). Monitoring may be carried out by the business unit or compliance function.

The CFPB states that an effective CMS should ensure that the organization is responsive and responsible in handling ***consumer complaints and inquiries***. Information gathered from consumer contacts should be organized, retained, and used as part of the organization's CMS. These processes will also apply to any third party services used by the organization. Analyzing complaints for trends and root causes can be a powerful detection measure which can ultimately prevent systemic issues from surfacing as well as demonstrating to the regulators the institution's commitment to correcting deficiencies.

The fourth and final component of CMS is the ***compliance audit***. The audit should be independent of the compliance function and the business unit, and should report directly to the board or a committee of the board.

The audit will assess the organization's CMS by:

- defining a comprehensive audit scope;
- identifying the number of transactions sampled by category or product type;
- identifying deficiencies;
- providing descriptions of or suggestions for corrective actions and time frames for correction; and
- establishing follow-up procedures to verify that corrective actions were implemented and effective.

An organization's compliance management system should be independently assessed annually. This assessment will assist the board and management in determining its effectiveness and the organization's level of adherence to the policies, laws, and regulations that it is subject to. When these elements are in place, an institution will be successful in managing its compliance risks. The team conducting this assessment must have the requisite knowledge and experience to assist the organization in its ongoing maintenance of an effective CMS.

An approach to assessing an organization's CMS environment will take into account the impact of the following risks:

Performance Risk - Historic effectiveness of the compliance management system, including the results of previous examinations and management's record of taking corrective measures, will impact its compliance risk profile and the scope of the audit.

Regulation Risk - The impact of noncompliance differs depending on the consumer law or regulation. Regulation risk is the measure of legal, reputation, and financial harm that noncompliance may produce. The level of regulation risk is affected by such factors as potential financial and/or reputation harm to consumers; potential legal, reputation, and financial harm to an organization; new laws, regulations, or amendments; and the amount of transaction activity subject to a specific regulation.

Product Risk - The organization's products and services impact the organization's compliance risk depending upon the financial institution's size, market share, and portfolio concentration. Third party affiliations, especially for product delivery, also present heightened risk. Finally, the organization's strategic plan for growth and for the introduction of new products and services should also be taken into account.

The mortgage industry is a top priority of the Consumer Financial Protection Bureau. By ensuring your institution has implemented a comprehensive Compliance Management System that is risk-based and addresses key origination functions, the organization will demonstrate its commitment to fulfilling the requirements of an effective management control.

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