



MICHIGAN

OFFICE OF THE AUDITOR GENERAL



THOMAS H. McTAVISH, C.P.A.
AUDITOR GENERAL

The auditor general shall conduct post audits of financial transactions and accounts of the state and of all branches, departments, offices, boards, commissions, agencies, authorities and institutions of the state established by this constitution or by law, and performance post audits thereof.

– Article IV, Section 53 of the Michigan Constitution

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October 30, 2013

Mr. R. Kevin Clinton, Director
Department of Insurance and Financial Services
Ottawa Building
Lansing, Michigan

Dear Mr. Clinton:

This is our report on our follow-up of the 2 material conditions (Findings 1 and 3) and 2 corresponding recommendations reported in the performance audit of Consumer Finance Activities, Office of Financial and Insurance Regulation (OFIR), Department of Labor and Economic Growth. That audit report was issued and distributed in June 2008. Additional copies are available on request or at <<http://audgen.michigan.gov>>. In January 2013, subsequent to our performance audit, Executive Order No. 2013-1 created the Department of Insurance and Financial Services (DIFS) and transferred all authority, powers, duties, functions, and responsibilities of OFIR to DIFS.

This report contains an introduction; our purpose of follow-up; a background; our scope; follow-up conclusions and results; and a glossary of acronyms and terms.

Our follow-up disclosed that DIFS had complied with the 2 recommendations.

If you have any questions, please call me or Scott M. Strong, C.P.A., C.I.A., Deputy Auditor General.

Sincerely,


Thomas H. McTavish, C.P.A.
Auditor General

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OFFICE OF CONSUMER FINANCE
DEPARTMENT OF INSURANCE AND FINANCIAL SERVICES**

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**FOLLOW-UP REPORT
CONSUMER FINANCE ACTIVITIES
OFFICE OF CONSUMER FINANCE
DEPARTMENT OF INSURANCE AND FINANCIAL SERVICES**

INTRODUCTION

This report contains the results of our follow-up of the material conditions* and corresponding recommendations reported in our performance audit* of Consumer Finance Activities, Office of Financial and Insurance Regulation (OFIR), Department of Labor and Economic Growth (641-0144-07), which was issued and distributed in June 2008. That audit report included 2 material conditions (Findings 1 and 3) and 2 reportable conditions*. This report also contains OFIR's plan to comply with our prior audit recommendations for the 2 material conditions, which was required by the *Michigan Compiled Laws* and administrative procedures to be developed within 60 days after release of the June 2008 audit report.

In January 2013, subsequent to our performance audit, Executive Order No. 2013-1 created the Department of Insurance and Financial Services (DIFS) and transferred all authority, powers, duties, functions, and responsibilities of OFIR to DIFS. As a result, DIFS has sole responsibility as the lead agency for consumer finance activities for the period of our follow-up. Therefore, our follow-up conclusions are directed to DIFS.

PURPOSE OF FOLLOW-UP

The purpose of this follow-up was to determine whether DIFS had taken appropriate and effective corrective measures in response to the 2 material conditions and 2 corresponding recommendations noted within our June 2008 audit report.

* See glossary at end of report for definition.

BACKGROUND

The mission* of DIFS is to provide a business climate that promotes economic growth while ensuring that the insurance and financial services industries are safe, sound, and entitled to public confidence. In addition, DIFS provides consumer protection, outreach, and educational services to Michigan citizens. DIFS is composed of 9 program and regulatory offices, including the Office of Consumer Finance. The Office of Consumer Finance is responsible for the licensing, regulation, examination*, and investigation* of entities and individuals doing business under various Michigan consumer finance statutes. These entities and individuals include mortgage brokers, lenders, and servicers; mortgage loan originators (MLOs); money transmitters; deferred presentment providers; direct loan companies; motor vehicle installment sellers; sales finance companies; and other consumer finance providers. The Office of Consumer Finance supervises these entities and individuals to ensure that they operate safely, responsibly, and in accordance with applicable laws. DIFS's supervisory activities include conducting on-site examinations of books and records, investigating consumer complaints, and initiating enforcement action in accordance with applicable laws. DIFS regulated 7,819 and 9,783 licensed or registered entities or individuals under the consumer finance statutes during calendar years 2011 and 2012, respectively.

SCOPE

Our fieldwork was conducted primarily from April through August 2013. We interviewed DIFS personnel and reviewed their corrective action plans to help determine the status of compliance with our recommendations for Findings 1 and 3. We reviewed and obtained an understanding of current federal and State laws applicable to DIFS's consumer finance activities. We obtained an understanding of DIFS's policies and procedures for the prevention and intervention of predatory lending*. We obtained an understanding of DIFS's policies and procedures related to the selection and completion of examinations and investigations of licensed entities and individuals doing business under various Michigan consumer finance statutes. We reviewed DIFS's selection and completion processes for examinations and investigations and reviewed selected examinations and investigations conducted for the period October 1, 2010 through March 31, 2013.

* See glossary at end of report for definition.

FOLLOW-UP CONCLUSIONS AND RESULTS

PREDATORY LENDING PRACTICES

SUMMARY OF THE JUNE 2008 FINDING

1. OFIR's Efforts to Combat Predatory Lending

OFIR had not implemented sufficient prevention and intervention approaches to combat predatory lending. Such approaches would help ensure that OFIR's techniques reduce instances of predatory lending and protect consumers against unlawful actions. Prevention approaches aim to reduce the number of predatory lending victims by stopping abusive practices, closing information gaps, and offering lending alternatives. Intervention approaches seek to help homeowners who have been victimized by abusive lending practices keep their homes.

OFIR needs to:

- a. Fully adopt additional prevention and intervention approaches to effectively combat predatory lending.
- b. Implement proactive methods to identify and investigate unlicensed entities that could potentially be engaging in predatory lending practices.
- c. Continue to request legislation needed to strengthen anti-predatory lending laws.
- d. Conduct additional examinations and investigations to establish a significant regulatory presence within the consumer finance industry.

RECOMMENDATION (AS REPORTED IN JUNE 2008)

We recommend that OFIR implement sufficient prevention and intervention approaches to combat predatory lending.

AGENCY PLAN TO COMPLY*

The *Michigan Compiled Laws* and administrative procedures required OFIR to develop a plan to comply with our audit recommendations within 60 days of the release of the June 2008 audit report. OFIR indicated in its September 4, 2008 plan to comply that it would conduct research, implement best practices, and evaluate programs to ensure that OFIR's prevention and intervention approaches are effective in combating predatory lending. OFIR also indicated that its outreach programs include quarterly informational industry seminars and, for the public, staff presentations to community groups, press releases advising of new initiatives or warning of scams, and informational postings on its Web site. In addition, OFIR indicated that it has added staff to improve work processes, which will identify unlicensed activity, improve the monitoring of the licensed population, and continue to strengthen its regulatory presence. OFIR further indicated that it will continue to participate in efforts to formulate stronger anti-predatory lending laws.

FOLLOW-UP CONCLUSION

We concluded that DIFS had complied with this recommendation.

FOLLOW-UP RESULTS

Our follow-up disclosed that DIFS has provided seminars to educate the mortgage industry about laws and best practices and outreach programs to consumers to let them know their rights and options. Also, DIFS has made educational information available on its Web site. DIFS explained that the demand for the mortgage related seminars has decreased since the mortgage crisis in 2007 and, therefore, the industry seminars are currently performed on an annual basis.

In addition, we determined that several federal and State laws were implemented since the June 2008 audit report. For example, after the mortgage crisis, the federal Secure and Fair Enforcement for Mortgage Licensing Act was passed, which provided a federal registration requirement for MLOs to provide increased accountability and tracking and enhance consumer protection. Also, the Mortgage Loan Originator Licensing Act (MLOLA) (Sections 493.131 - 493.171 of the *Michigan Compiled Laws*), which was enacted in 2009, required MLOs to be licensed by DIFS in order to regulate the businesses and practices of MLOs.

* See glossary at end of report for definition.

We further determined that the Office of Consumer Finance has significantly increased the number of examiners and, as a result, increased the number of examinations and investigations conducted (see Finding 3).

EXAMINATIONS AND INVESTIGATIONS

SUMMARY OF THE JUNE 2008 FINDING

3. Completion of Examinations and Investigations

OFIR had not completed sufficient consumer finance examinations and investigations to provide a regulatory presence within the consumer finance industry. As a result, OFIR's examination and investigation efforts had not established, within the consumer finance industry, accountability and fear of retribution for engaging in illegal activities. OFIR examined and investigated 74 (0.98%) of 7,571 and 121 (1.45%) of 8,370 of the entities licensed or registered under the consumer finance statutes during fiscal years 2004-05 and 2005-06, respectively. OFIR management stated that limited staff resources had impaired its ability to conduct additional consumer finance examinations or investigations.

RECOMMENDATION (AS REPORTED IN JUNE 2008)

We recommend that OFIR complete sufficient consumer finance examinations and investigations to establish a regulatory presence within the consumer finance industry.

AGENCY PLAN TO COMPLY

OFIR indicated in its September 4, 2008 plan to comply that a broader regulatory presence in the consumer finance industry requires performance of more examinations and investigations. OFIR indicated that, with the addition of newly hired staff, its mortgage examination production in 2008 was on track to double 2007 production levels and that it anticipated productivity to continue to increase. OFIR concluded that the combination of increasing the quantity of entities examined coupled with risk-based prioritization would provide an adequate regulatory presence.

FOLLOW-UP CONCLUSION

We concluded that DIFS had complied with this recommendation.

FOLLOW-UP RESULTS

Our follow-up disclosed that DIFS significantly increased its staffing size since our prior audit. At the time of our follow-up, DIFS had approximately 27 field staff responsible for conducting examinations and investigations of licensees* and registrants* under the consumer finance statutes compared with the approximately 17 field staff during the prior audit.

Also, DIFS conducted 892 and 394 examinations and investigations in fiscal years 2010-11 and 2011-12, respectively. The number of examinations and investigations for fiscal years 2010-11 and 2011-12 represents a significant increase since our prior audit. We noted that there was a large decrease in examinations between fiscal year 2010-11 and fiscal year 2011-12. DIFS explained that the large number of examinations and investigations completed in fiscal year 2010-11 resulted from the implementation of MLOLA for which DIFS conducted examinations or investigations of numerous MLOs. At the time of our follow-up, DIFS examined MLOs in conjunction with the examinations of the mortgage entities because the MLOs must be sponsored by a mortgage entity.

In addition, as a result of the mortgage crisis that began in 2007, the number of mortgage entities licensed in Michigan decreased from over 3,000 during the previous audit to approximately 600 during our follow-up, resulting in fewer entities requiring examinations and investigations. DIFS's goal is to conduct examinations of mortgage entities every 3 to 4 years. We determined that DIFS had met this goal as of March 31, 2013.

Further, DIFS is not able to examine the non-mortgage entities and individuals licensed under the non-mortgage consumer finance statutes on a similar rotation because of the number of licensees. However, we determined that DIFS is using a risk-based approach to determine which licensees will be selected for an examination or an investigation. We determined that this risk-based approach was a reasonable and an effective way to select licensees for examination or investigation based on DIFS's resources.

* See glossary at end of report for definition.

Glossary of Acronyms and Terms

agency plan to comply	The response required by Section 18.1462 of the <i>Michigan Compiled Laws</i> and the State of Michigan Financial Management Guide (Part VII, Chapter 4, Section 100). The audited agency is required to develop a plan to comply with Office of the Auditor General audit recommendations and submit the plan within 60 days after release of the audit report to the Office of Internal Audit Services, State Budget Office. Within 30 days of receipt, the Office of Internal Audit Services is required to review the plan and either accept the plan as final or contact the agency to take additional steps to finalize the plan.
DIFS	Department of Insurance and Financial Services.
effectiveness	Success in achieving mission and goals.
examination	A review of a consumer finance entity's wide range of business practices and activities.
investigation	A limited scope engagement focusing on a complaint or a specific type of activity.
licensee	A person licensed or required to be licensed under a specific act.
material condition	A reportable condition that could impair the ability of management to operate a program in an effective and efficient manner and/or could adversely affect the judgment of an interested person concerning the effectiveness and efficiency of the program.
mission	The main purpose of a program or an agency or the reason that the program or the agency was established.

MLO	mortgage loan originator.
MLOLA	Mortgage Loan Originator Licensing Act.
OFIR	Office of Financial and Insurance Regulation.
performance audit	An economy and efficiency audit or a program audit that is designed to provide an independent assessment of the performance of a governmental entity, program, activity, or function to improve program operations, to facilitate decision making by parties responsible for overseeing or initiating corrective action, and to improve public accountability.
predatory lending	A wide range of unfair financial practices that include aggressive and deceptive marketing, loans without ample consideration to the borrower's ability to pay, excessive loan fees, higher interest rates than a borrower's credit allows, home improvement scams, and steering of borrowers toward the subprime market.
registrant	A person registered or required to be registered under a specific act.
reportable condition	A matter that, in the auditor's judgment, represents either an opportunity for improvement or a significant deficiency in management's ability to operate a program in an effective and efficient manner.

