



MICHIGAN

OFFICE OF THE AUDITOR GENERAL

AUDIT REPORT



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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Michigan
Office of the Auditor General
REPORT SUMMARY

Performance Audit

*Consumer Finance Activities
 Office of Financial and Insurance Regulation (OFIR)
 Department of Labor and Economic Growth*

Report Number:
 641-0144-07

Released:
 June 2008

OFIR, formerly known as the Office of Financial and Insurance Services, was created in April 2000 by merging the Michigan Insurance Bureau; the Financial Institutions Bureau; and portions of the Corporations, Securities, and Land Development Bureau. OFIR's mission is to grow Michigan by creating a regulatory climate that promotes consumer protection and education and ensures that the financial services industry is safe, sound, and entitled to the public trust. OFIR regulated 8,370 nondepository consumer finance entities during fiscal year 2005-06.

Audit Objective:

To assess the effectiveness of OFIR's efforts to identify and reduce predatory lending practices.

Audit Conclusion:

OFIR's efforts to identify predatory lending practices were moderately effective; however, OFIR's efforts to reduce predatory lending practices were not effective. We noted one material condition (Finding 1).

Material Condition:

OFIR had not implemented sufficient prevention and intervention approaches to combat predatory lending (Finding 1).

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Audit Objective:

To assess the effectiveness and efficiency of OFIR's efforts in resolving consumer finance complaints.

Audit Conclusion:

OFIR was effective and efficient in its efforts to resolve consumer finance

complaints. However, we noted one reportable condition (Finding 2).

Reportable Condition:

OFIR had not initiated all business-to-business complaint investigations in a timely manner (Finding 2).

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Audit Objective:

To assess the effectiveness of OFIR's efforts to ensure that licensees and registrants are in compliance with statutory requirements.

Audit Conclusion:

OFIR was effective in its efforts to ensure that licensees and registrants are in compliance with statutory requirements. Our audit report does not include any reportable conditions related to this audit objective.

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Audit Objective:

To assess the effectiveness of OFIR's efforts in conducting consumer finance examinations and investigations.

Audit Conclusion:

OFIR's efforts to conduct consumer finance examinations and investigations were moderately effective. We noted one material condition (Finding 3) and one reportable condition (Finding 4).

Material Condition:

OFIR had not completed sufficient consumer finance examinations and investigations to provide a regulatory presence (Finding 3).

Reportable Condition:

OFIR did not prioritize the selection of consumer finance licensees and registrants for examination or investigation according to its established risk-based approach (Finding 4).

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Audit Objective:

To assess the effectiveness of OFIR's efforts in initiating enforcement actions against consumer finance entities.

Audit Conclusion:

OFIR was effective in its efforts to initiate enforcement actions against consumer finance entities. Our audit report does not include any reportable conditions related to this audit objective.

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Agency Responses:

Our audit report includes 4 findings and 4 corresponding recommendations. OFIR's preliminary response indicates that it agrees with all 4 recommendations.

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A copy of the full report can be obtained by calling 517.334.8050 or by visiting our Web site at: <http://audgen.michigan.gov>



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AUDITOR GENERAL

June 24, 2008

Mr. Kenneth Ross, Commissioner
Office of Financial and Insurance Regulation
and
Mr. Keith W. Cooley, Director
Department of Labor and Economic Growth
Ottawa Building
Lansing, Michigan

Dear Mr. Ross and Mr. Cooley:

This is our report on the performance audit of Consumer Finance Activities, Office of Financial and Insurance Regulation, Department of Labor and Economic Growth.

This report contains our report summary; description of agency; audit objectives, scope, and methodology and agency responses; comments, findings, recommendations, and agency preliminary responses; two exhibits, presented as supplemental information; and a glossary of acronyms and terms.

Our comments, findings, and recommendations are organized by audit objective. The agency preliminary responses were taken from the agency's responses subsequent to our audit fieldwork. The *Michigan Compiled Laws* and administrative procedures require that the audited agency develop a formal response within 60 days after release of the audit report.

We appreciate the courtesy and cooperation extended to us during this audit.

AUDITOR GENERAL

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GLOSSARY

Glossary of Acronyms and Terms

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Description of Agency

The Office of Financial and Insurance Regulation (OFIR), formerly known as the Office of Financial and Insurance Services, was created in April 2000 by Executive Order No. 2000-4. The executive order merged the Michigan Insurance Bureau; the Financial Institutions Bureau; and portions of the Corporations, Securities, and Land Development Bureau.

OFIR's mission* is to grow Michigan by creating a regulatory climate that promotes consumer protection and education and ensures that the financial services industry is safe, sound, and entitled to the public trust. The overall administration of OFIR activities is the responsibility of the Commissioner of OFIR, who is appointed by the Governor for a four-year term.

OFIR regulated 7,571 and 8,370 nondepository* consumer finance licensees* and registrants* during fiscal years 2004-05 and 2005-06, respectively, under the auspices of eight consumer finance acts:

- Consumer Financial Services Act
- Credit Card Arrangements Act
- Deferred Presentment Service Transactions Act
- Mortgage Brokers, Lenders, and Servicers Licensing Act (1st Mortgage)
- Motor Vehicle Sales Finance Act
- Regulatory Loan Act
- Sale of Checks Act (effective July 3, 2006, the Money Transmission Services Act)
- Secondary Mortgage Loan Act

OFIR provides consumer finance regulatory oversight through the following areas:

1. Consumer Services Division (CSD)

CSD is responsible for the majority of internal and external communications for OFIR and complaint handling. CSD's goal is to provide a consistent, accurate message throughout all OFIR communications, while providing OFIR customers with excellent customer service and ensuring regulated entities deliver on their promises to Michigan consumers.

* See glossary at end of report for definition.

2. Office of General Counsel (OGC)

OGC supports the Commissioner in the implementation and enforcement of insurance, lending, and securities statutes designed to protect the citizens and industries of Michigan. Also, OGC is responsible for issuing formal actions, such as probation, suspension, or revocation of license, against entities or persons who violate the statutes enforced by OFIR. Violations of statutes include fraud in lending, fraud in the sale of insurance and securities, and predatory lending* practices.

3. Mortgage Examination and Investigation Section (MEIS)

MEIS is responsible for regulating the Consumer Financial Services Act; Mortgage Brokers, Lenders, and Servicers Licensing Act (1st Mortgage); and the Secondary Mortgage Loan Act. MEIS conducts examinations* and investigations* of licensees and registrants in response to consumer complaints*, industry complaints, and routine compliance testing.

4. Consumer Finance Section (CFS)

CFS is responsible for investigating all mortgage and consumer finance applications for licensure, registration, renewal, and amendments. CFS is also responsible for the examinations and investigations for the consumer finance programs (i.e., Credit Card, Deferred Presentment, Motor Vehicles, Regulatory Loan, and Sale of Checks).

For fiscal year 2006-07, OFIR's consumer finance revenues totaled \$4,262,175 and expenditures totaled \$4,000,139. As of September 30, 2007, the Consumer Finance Fund balance was \$2,614,926. OFIR had 27 consumer finance employees as of September 30, 2007.

* See glossary at end of report for definition.

Audit Objectives, Scope, and Methodology and Agency Responses

Audit Objectives

Our performance audit* of Consumer Finance Activities, Office of Financial and Insurance Regulation (OFIR), Department of Labor and Economic Growth (DLEG), had the following objectives:

1. To assess the effectiveness* of OFIR's efforts to identify and reduce predatory lending practices.
2. To assess the effectiveness and efficiency* of OFIR's efforts in resolving consumer finance complaints.
3. To assess the effectiveness of OFIR's efforts to ensure that licensees and registrants are in compliance with statutory requirements.
4. To assess the effectiveness of OFIR's efforts in conducting consumer finance examinations and investigations.
5. To assess the effectiveness of OFIR's efforts in initiating enforcement actions against consumer finance entities.

Audit Scope

Our audit scope was to examine the program and other records of the Office of Financial and Insurance Regulation's consumer finance activities. Our audit was conducted in accordance with *Government Auditing Standards* issued by the Comptroller General of the United States and, accordingly, included such tests of the records and such other auditing procedures as we considered necessary in the circumstances. Our audit procedures, conducted from April through October 2007, generally covered the period October 1, 2004 through September 30, 2007.

Supplemental information was reproduced from the Mortgage Asset Research Institute's *Tenth Periodic Mortgage Fraud Case Report* and is presented as Exhibit 2. Our audit

* See glossary at end of report for definition.

was not directed toward expressing a conclusion on this information and, accordingly, we express no conclusion on it.

Audit Methodology

To establish our audit objectives, we conducted a preliminary review of OFIR's operations that included discussions with OFIR staff regarding their functions and responsibilities. In addition, we reviewed OFIR's policies and procedures and applicable laws and regulations, and we analyzed program data.

To assess the effectiveness of OFIR's efforts in identifying and reducing predatory lending practices, we interviewed OFIR management to obtain an understanding of OFIR's anti-predatory lending activities. Also, we reviewed program information and records, including county mortgage data, to identify potentially unlicensed entities. Further, we compared other states' efforts to combat predatory lending with Michigan's efforts.

To assess the effectiveness and efficiency of OFIR's efforts in resolving consumer finance complaints, we reviewed complaints for documentation adequacy, complainant resolution, and timeliness. In addition, we conducted a survey of individuals who had filed consumer finance related complaints with OFIR.

To assess the effectiveness of OFIR's efforts to ensure that licensees and registrants are in compliance with statutory requirements, we analyzed OFIR's licensing procedures and reviewed licensing records for documentation adequacy. We reviewed OFIR's timeliness of processing licensing applications.

To assess the effectiveness of OFIR's efforts in conducting consumer finance examinations and investigations, we reviewed OFIR's examination and investigation plan. We analyzed the number of examinations and investigations completed by OFIR during our audit period.

To assess the effectiveness of OFIR's efforts in initiating enforcement actions against consumer finance entities, we analyzed OFIR's enforcement policy and reviewed enforcement records for documentation adequacy. We reviewed OFIR's timeliness in initiating enforcement actions.

When selecting activities or programs for audit, we use an approach based on assessment of risk and opportunity for improvement. Accordingly, we focus our audit

efforts on activities or programs having the greatest probability for needing improvement as identified through a preliminary review. Our limited audit resources are used, by design, to identify where and how improvements can be made. Consequently, we prepare our performance audit reports on an exception basis.

Agency Responses

Our audit report includes 4 findings and 4 corresponding recommendations. OFIR's preliminary response indicates that it agrees with all 4 recommendations.

The agency preliminary response that follows each recommendation in our report was taken from the agency's written comments and oral discussion subsequent to our audit fieldwork. Section 18.1462 of the *Michigan Compiled Laws* and the State of Michigan Financial Management Guide (Part VII, Chapter 4, Section 100) require OFIR to develop a formal response to our audit findings and recommendations within 60 days after release of the audit report.

COMMENTS, FINDINGS, RECOMMENDATIONS,
AND AGENCY PRELIMINARY RESPONSES

PREDATORY LENDING PRACTICES

COMMENT

Background:

Each year, millions of American consumers take out mortgage loans through brokers or lenders to purchase homes or refinance existing mortgage loans. While the majority of these transactions are legitimate and ultimately benefit borrowers, some have been found to be "predatory" - that is, to contain terms and conditions that ultimately harm borrowers. Loans with these features, often targeted at the elderly, minorities, and low-income homeowners, can strip borrowers of home equity built up over decades and cause them to lose their homes.

This was reported by the United States Government Accountability Office (GAO) in its January 2004 report titled, *Consumer Protection: Federal and State Agencies Face Challenges in Combating Predatory Lending*.

The GAO further reported that:

While there is no uniformly accepted definition of predatory lending, a number of practices are widely acknowledged to be predatory. These include, among other things, charging excessive fees and interest rates, lending without regard to borrowers' ability to repay, refinancing borrowers' loans repeatedly over a short period of time without any economic gain for the borrower, and committing outright fraud or deception - for example, falsifying documents or intentionally misinforming borrowers about the terms of a loan. These types of practices offer lenders that originate predatory loans potentially high returns even if borrowers default, since many of these loans require excessive up-front fees. No comprehensive data are available on the incidence of these practices, but banking regulators, consumer advocates, and industry participants generally agree that predatory loans are most likely to occur in the market for "subprime" loans. The subprime market serves borrowers who have limited incomes or poor or no credit histories, in contrast with the prime market, which encompasses traditional lenders and borrowers with credit histories that put them at a low risk of default. Originators of subprime loans most often are mortgage and consumer finance companies but can also be banks, thrifts, and other institutions.

The Office of Financial and Insurance Regulation (OFIR) has stated that, over the past several years, mortgage fraud has become a devastating problem for homeowners in the United States. OFIR added that, in Michigan, it has become an epidemic with increasing numbers of complaints because of unscrupulous individuals becoming active

in the purchase and refinance of homes. In addition, OFIR stated that, with increased reliance upon third-party brokers by depository and nondepository institutions, opportunities for fraud have become increasingly more prevalent. The prevalence of mortgage fraud in Michigan has resulted in the State ranking consistently in the top 10 states for mortgage fraud activity during the past three years.

In December 2006, OFIR created a mortgage fraud workgroup to develop recommendations that address mortgage fraud in Michigan. As a result of the workgroup, OFIR identified various issues that need to be addressed, such as expanding current legislation and the need for additional staff to combat predatory lending.

Our audit procedures included a survey (see Exhibit 1) of 203 individuals who had filed consumer finance related complaints with OFIR from January through May 2007. We determined that approximately 26% of the survey responders were affected by predatory lending practices. Instances of predatory lending practices submitted via our survey are summarized below:

- A respondent stated that unscrupulous mortgage refinance practices resulted in the foreclosure of the home in which the respondent lived for 30 years. During the refinance, the respondent was charged a high interest rate of 10.5% and paid \$13,507 in fees, which caused the total monthly mortgage payment to increase from \$443 to \$659 plus taxes and insurance. The respondent rolled \$15,000 in credit card debt into the refinance and received \$493 cash at closing. After the refinance, the respondent indicated that the mortgage balance of \$43,000 increased to \$72,000.
- A respondent closed on a one-year interest only loan with a 1.6750% interest rate. The respondent stated that he was aware that this type of loan would not pay down any principal associated with the mortgage but wanted the liquidity that this loan provided. The respondent was unaware that the 1.6750% rate was effective only for the first month of the mortgage and that the rate would increase to 8.0830% within the first 12 months. The respondent indicated that the mortgage company did not inform him of this increase at any time during the loan process. Also, the respondent indicated that he was unable to get out of the loan because of a prepayment penalty. In addition, the respondent stated that the mortgage company grossly inflated the appraisal value of the home to \$625,000 for a

\$500,000 mortgage. The mortgage company suggested that the respondent let the loan go into foreclosure and informed the respondent that such an action would not affect the credit rating.

- A respondent wanted to refinance a mortgage because of unexpected health issues and the spouse's job loss. The respondent carried a credit card balance in addition to the mortgage with the mortgage company. The respondent stated that he was unaware that the mortgage company would combine both the credit card balance and mortgage during the refinance. As a result, the refinanced mortgage exceeded the value of the home resulting in a negative net worth position, which impaired the respondent's ability to qualify for other mortgage products.

The Federal Bureau of Investigation's 2006 Mortgage Fraud Report indicated that Michigan is ranked in the top 10 states for mortgage fraud activity. According to the Mortgage Asset Research Institute's *Tenth Periodic Mortgage Fraud Case Report*, Michigan has retained a number three ranking in mortgage fraud in both calendar years 2006 and 2007 (see Exhibit 2). OFIR stated that complaints of fraud, unlicensed activity, and predatory lending practices increased at an accelerating pace during our audit period. OFIR received 986 and 1,479 consumer finance related complaints during calendar years 2005 and 2006, respectively, representing a 50% increase.

OFIR's management indicated that it is the front line of defense against predatory lending practices; however, having a significant impact on the reduction of predatory lending practices requires the cooperation of the consumer finance industry, law enforcement agencies, consumer groups, legislative policy makers, and OFIR, who share the responsibility for combating predatory lending.

Audit Objective: To assess the effectiveness of OFIR's efforts to identify and reduce predatory lending practices.

Conclusion: OFIR's efforts to identify predatory lending practices were moderately effective; however, OFIR's efforts to reduce predatory lending practices were not effective. Our audit disclosed one material condition*. OFIR had not implemented sufficient prevention and intervention approaches to combat predatory lending (Finding 1).

* See glossary at end of report for definition.

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.

The Neighborhood Reinvestment Corporation and the Local Initiatives Support Corporation Center for Home Ownership's *A Practitioner's Guide to Combating Predatory Lending* states that prevention and intervention approaches are necessary components to combat predatory lending. 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.

Our review disclosed that OFIR employed basic approaches to combat predatory lending, such as providing quarterly informational seminars to the consumer finance industry; requiring the licensed consumer finance entities to complete annual surveys that would assist OFIR in identifying and targeting licensees that were engaging in predatory lending; requesting legislative changes that would strengthen OFIR's regulatory enforcement; and hiring seven additional examiners. However, OFIR needs to:

- a. Fully adopt additional prevention and intervention approaches to effectively combat predatory lending. For example, prevention approaches include increasing public awareness through various media outlets, providing consumer education, and strengthening regulatory enforcement through legislative policy changes. Examples of intervention approaches include making referrals for legal services and individual counseling to those affected by predatory lending practices.
- b. Implement proactive methods to identify and investigate unlicensed entities that could potentially be engaging in predatory lending practices. Proactive methods could include reviewing the licensing status of mortgage entities that had conducted business in Michigan and possibly including unlicensed entities as eligible to be selected for examination and investigation. OFIR relied solely

on complaints from consumers and businesses when investigating unlicensed activity. Such reliance can foster an environment for unlicensed entities to engage in predatory lending with little fear of retribution.

We reviewed the licensing status of 71 mortgage entities (i.e., brokers, lenders, and servicers) that had conducted business in five Michigan counties during the period October 1, 2005 through May 31, 2007. Of these 71 mortgage entities, 16 (23%) entities did not have licenses to conduct business in the State of Michigan and therefore were not identified by OFIR as a mortgage entity subject to selection for examination and investigation. Our testing was limited to only 5 of the 83 Michigan counties. If the business activity of each of the 16 mortgage entities was conducted only in the 5 counties, then none of the 16 mortgage entities would have been required to be licensed under Michigan licensing regulations.

- c. Continue to request legislation needed to strengthen anti-predatory lending laws. The enactment of anti-predatory lending laws would assist OFIR in its efforts to combat predatory lending.

The Center for Responsible Lending states that anti-predatory lending legislation should promote the elimination of incentives for lenders to make predatory loans; a fair, competitive market that ensures responsible lending practices to consumers; access to justice for families caught in abusive loans; and preservation of essential federal and state consumer safeguards.

The Consumer Mortgage Protection Act (Act 660, P.A. 2002) provided limited anti-predatory lending legislation. The Act banned negative amortization and financing credit insurance.

OFIR's continued promotion of legislation that addresses loan flipping, prepayment penalties, and high debt-to-income ratios would help combat predatory lending.

- d. Conduct additional examinations and investigations to establish a significant regulatory presence within the consumer finance industry (see Finding 3).

RECOMMENDATION

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

AGENCY PRELIMINARY RESPONSE

OFIR agrees that more prevention and intervention approaches would be helpful in combating predatory lending. In addition to conducting informational seminars, requiring licensed consumer finance entities to complete annual surveys, requesting legislative changes to strengthen regulatory enforcement, and hiring seven additional examiners, OFIR informed us that it has requested a supplemental appropriation to hire 34 additional mortgage industry regulators that will help prevent illegal activity in the mortgage industry.

OFIR stated that the Mortgage Brokers, Lenders, and Servicers Licensing Act (MBLSLA) and Secondary Mortgage Loan Act (SMLA) are the primary regulatory licensing statutes for Michigan's consumer finance industry. In OFIR's opinion, these statutes do not adequately equip OFIR with the tools needed to combat predatory lending to the degree that OFIR would like. Many of the most effective actions can only occur after the passing of strong legislation and the hiring of additional staff.

COMPLAINTS

COMMENT

Audit Objective: To assess the effectiveness and efficiency of OFIR's efforts in resolving consumer finance complaints.

Conclusion: **OFIR was effective and efficient in its efforts to resolve consumer finance complaints.** However, our audit disclosed one reportable condition* related to business-to-business complaints* (Finding 2).

* See glossary at end of report for definition.

FINDING

2. Business-to-Business Complaints

OFIR had not initiated all business-to-business complaint investigations in a timely manner. Timely investigations of complaints help ensure that the consumer finance industry in Michigan is "safe and sound" as described in OFIR's mission statement.

OFIR's Mortgage Examination and Investigation Section is responsible for initiating investigations for all business-to-business complaints. OFIR considers a complaint investigation initiated once letters are sent to the complainant and the respondent that inform each party of the nature of the complaint. OFIR's management informed us that the goal is to have all complaint investigations initiated within five days of receiving the written complaint.

We reviewed 395 business-to-business complaints received during the period October 1, 2004 through June 22, 2007. OFIR did not initiate 52 (13%) of 395 business-to-business complaint investigations within five days of receiving the complaint. For the 52 complaints, OFIR exceeded the five-day goal from 1 to 554 days for an average of 158 days per complaint. The following table summarizes the 52 business-to-business complaints for which OFIR initiated investigations more than five days after receiving the complaint:

<u>Days Late at Time of Complaint Initiation</u>	<u>Number of Business-to-Business Complaints</u>
1 - 50	7
51 - 100	12
101 - 150	7
151 - 200	12
201 - 250	4
over 250	10

RECOMMENDATION

We recommend that OFIR initiate all business-to-business complaint investigations in a timely manner.

AGENCY PRELIMINARY RESPONSE

OFIR agrees. OFIR concurs that its handling of business-to-business complaints represents an opportunity for improvement. OFIR, however, does not feel that the past management of these complaints represented a significant deficiency in our agency's ability to operate the regulatory function.

OFIR acknowledges the need to better document the handling of business-to-business complaints and to document policies and procedures for handling these complaints. OFIR stated that program staff have reviewed all existing and newly received business-to-business complaints and have implemented an aggressive action plan for each. In addition, OFIR informed us that it has established a specific performance measure regarding the handling of these complaints, requiring that 85% be responded to within 15 business days.

LICENSING ACTIVITIES

COMMENT

Audit Objective: To assess the effectiveness of OFIR's efforts to ensure that licensees and registrants are in compliance with statutory requirements.

Conclusion: **OFIR was effective in its efforts to ensure that licensees and registrants are in compliance with statutory requirements.** Our audit report does not include any reportable conditions related to this audit objective.

EXAMINATIONS AND INVESTIGATIONS

COMMENT

Audit Objective: To assess the effectiveness of OFIR's efforts in conducting consumer finance examinations and investigations.

Conclusion: **OFIR's efforts to conduct consumer finance examinations and investigations were moderately effective.** Our audit disclosed one material condition. OFIR had not completed sufficient consumer finance examinations and investigations to provide a regulatory presence (Finding 3).

Our assessment also disclosed one reportable condition related to selection of examinations and investigations (Finding 4).

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 is responsible for ensuring that licensees and registrants operate responsibly and in compliance with applicable Michigan statutes. OFIR's examination and investigation plan states that conducting routine examinations of all licensees and registrants is a fundamental way to ensure compliance with applicable laws and to manage risk. In addition, OFIR is statutorily responsible for conducting examinations of entities licensed under the Regulatory Loan Act. In addition, the *Michigan Compiled Laws* authorizes OFIR to conduct examinations and investigations under the rules of the following consumer finance statutes: Consumer Financial Services Act; Credit Card Arrangements Act; Deferred Presentment Service Transactions Act; Mortgage Brokers, Lenders, and Servicers Licensing Act; Motor Vehicle Sales Finance Act; Sale of Checks Act; and Secondary Mortgage Loan Act.

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 informed us that limited staff resources have impaired its ability to conduct additional consumer finance examinations or investigations. OFIR also informed us that it has repeatedly requested from the Legislature the authorization to hire additional staff during the past several years. OFIR hired seven additional examiners who began employment on July 3, 2006 and more than doubled OFIR's examination and investigation staff. Even with its enhanced staffing, it would take OFIR over 40 years to examine or investigate each licensee and registrant.

The significance of OFIR's examination and investigation efforts is magnified further by the fact that approximately 67% and 52% of the examinations and

investigations completed in calendar years 2005 and 2006, respectively, were forwarded to OFIR's Office of General Counsel for enforcement actions because of statutory violations noted during the examination or investigation.

RECOMMENDATION

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

AGENCY PRELIMINARY RESPONSE

OFIR agrees that more examinations and investigations need to be performed in order to adequately regulate the consumer finance industry. OFIR informed us that in 2005 it established and began utilizing a risk-based approach for selecting entities for examination. OFIR believes its selection of entities for examination was in accordance with its risk-based approach. OFIR concludes that the combination of increasing the quantity of entities examined coupled with risk-based prioritization will provide an adequate regulatory presence.

FINDING

4. Selection of Examinations and Investigations

OFIR did not prioritize the selection of consumer finance licensees and registrants for examination or investigation according to its established risk-based approach. As a result, some high-risk consumer finance entities were not selected for examination or investigation.

OFIR's examination and investigation plan uses a risk-based approach to determine examination or investigation priority. OFIR's risk-based approach considers the type of business, prior examination history, consumer and business complaints, and the potential risk posed to the consumers.

We reviewed OFIR's examination and investigation plan, examination and investigation records, and consumer and business complaint data. Our review disclosed:

- a. OFIR had not conducted examinations or investigations for 17 (42.5%) of the 40 companies with the most complaints filed with OFIR during the period

October 1, 2004 through May 22, 2007. The 17 companies collectively had 703 complaints. Some of the more significant and prevalent complaints categorized by OFIR for the 17 companies included fraud (45 complaints), predatory practices (20 complaints), misrepresentation (54 complaints), and inflated appraisals (44 complaints).

- b. OFIR did not examine or investigate 4 (20%) of 20 referrals by OFIR's Mortgage Examination and Investigation Section. OFIR's Consumer Services Division refers consumer complaints that require a more extensive examination or investigation to the Mortgage Examination and Investigation Section. The 4 referrals related to complaints alleging fraud, misrepresentation of facts, foreclosure, collection practices, balance disputes, and payment issues. OFIR dismissed these referrals without any work completed and without documented approval.

It is notable that our survey disclosed that 53% of the respondents indicated that they were somewhat unsatisfied to very unsatisfied with the resolution of their complaint (see Exhibit 1).

RECOMMENDATION

We recommend that OFIR prioritize the selection of consumer finance licensees and registrants for examination and investigation according to its established risk-based approach.

AGENCY PRELIMINARY RESPONSE

OFIR agrees that better prioritization is needed for its selection of consumer finance licensees and registrants to examine and investigate. In March 2005, OFIR recognized that routine examination of all licensees and registrants was not feasible in light of limited staff resources. Accordingly, OFIR informed us that it established and began utilizing a risk-based approach for selecting entities for examination.

OFIR stated that its risk-based approach to selecting examination targets allows for the review of reported adverse information such as a complaint and, importantly, a determination of whether an examination is warranted. Risk determination factors will continue to include the complaint volume relative to the licensees' business and merit factors that reflect the level of risk and/or harm to the public.

Regarding the comment in part b., OFIR agrees that complaints referred from the agency section responsible for consumer complaint intake (Consumer Services Division) should be documented. OFIR stated that it will establish procedures to ensure that this is done.

ENFORCEMENT ACTIONS

COMMENT

Audit Objective: To assess the effectiveness of OFIR's efforts in initiating enforcement actions against consumer finance entities.

Conclusion: **OFIR was effective in its efforts to initiate enforcement actions against consumer finance entities.** Our audit report does not include any reportable conditions related to this audit objective.

SUPPLEMENTAL INFORMATION

CONSUMER FINANCE ACTIVITIES
Office of Financial and Insurance Regulation
Department of Labor and Economic Growth
Summary of Survey Responses

Summary Overview

We surveyed 203 consumers who had filed consumer finance related complaints from January 1, 2007 through May 31, 2007 with the Office of Financial and Insurance Regulation (OFIR). We received 60 (30%) responses. Some respondents provided more than one response to an item and others did not respond to all items.

In general, the respondents indicated that they were satisfied to very satisfied with OFIR's complaint handling process. In regard to complaint resolution, 53% of the respondents indicated that they were somewhat unsatisfied to very unsatisfied with the resolution of their complaint(s). In addition, for the complaints not resolved in favor of the complainant, 57% of the respondents indicated that OFIR could have done more to help them understand why their complaint was not resolved in their favor. Following is a copy of the survey that includes the number of responses received for each question.

Background Information

1. How did you become aware of OFIR's role in handling complaints against mortgage companies (please check all that apply)?
 - a. 9 (13%) Mortgage company.
 - b. 2 (3%) OFIR.
 - c. 7 (10%) Other government entity.
 - d. 5 (7%) Public official.
 - e. 8 (12%) Attorney.
 - f. 16 (24%) Internet.
 - g. 21 (31%) Other.

Complaint Processing

2. From the time that you submitted your mortgage related complaint(s) in writing, how long was it before OFIR acknowledged receipt of your complaint(s)?
 - a. 10 (17%) 1 - 5 business days.
 - b. 19 (32%) 6 - 10 business days.
 - c. 13 (22%) 11 - 20 business days.
 - d. 15 (25%) More than 20 business days.
 - e. 2 (3%) OFIR did not acknowledge receipt of my complaint(s).

3. Did OFIR update you on actions taken in relation to your complaint(s)?
 - a. 38 (64%) Yes.
 - b. 21 (36%) No.

4. How satisfied were you with OFIR's processing of your complaint(s)?

	Very Satisfied	Satisfied	Somewhat Satisfied	Very Unsatisfied
Complaint Form	<u>19 (35%)</u>	<u>17 (31%)</u>	<u>4 (7%)</u>	<u>15 (27%)</u>
Complaint Submission Method	<u>15 (33%)</u>	<u>17 (38%)</u>	<u>4 (9%)</u>	<u>9 (20%)</u>
OFIR Friendliness	<u>17 (40%)</u>	<u>15 (35%)</u>	<u>3 (7%)</u>	<u>8 (19%)</u>

5. Has your complaint(s) been resolved?

- a. 31 (54%) Yes.
- b. 19 (33%) No, my complaint(s) is still open.
- c. 7 (12%) I do not know.

Complaint Resolution

6. How satisfied were you with the resolution of your complaint(s)?

- a. 14 (33%) Very satisfied.
- b. 6 (14%) Satisfied.
- c. 4 (9%) Somewhat unsatisfied.
- d. 19 (44%) Very unsatisfied.

7. If your complaint(s) was not resolved in your favor, did OFIR help you to understand why?

- a. 10 (43%) Yes.
- b. 13 (57%) No.

8. Did OFIR address the concerns identified in your complaint(s)?

- a. 29 (71%) Yes.
- b. 12 (29%) No.

9. Did OFIR require the mortgage company to justify its position?

- a. 28 (68%) Yes.
- b. 13 (32%) No.

10. Could OFIR have done more to help you?

- a. 28 (50%) Yes.
- b. 28 (50%) No.

Mortgage Fraud Index Report by State

This table and map present a comparative ranking of the 10 states with the most serious fraud problems in mortgage loans originated during calendar year 2007, as reproduced from the Mortgage Asset Research Institute's (MARI's) *Tenth Periodic Mortgage Fraud Case Report* (accessible at <http://www.marisolutions.com/pdfs/mba/mortgage-fraud-report-10th.pdf>). The table also shows the rankings and a numerical measure of the same 10 states from calendar years 2003 through 2006. The data was developed from fraud cases submitted to MARI by the Mortgage Industry Data Exchange subscribers.

Table 1

MARI Fraud Index (MFI) ^{iv} By State (2003-2007 All Originations)										
State	2007		2006		2005		2004		2003	
	Rank	MFI								
Florida	1	215	1	217	3	169	5	180	7	159
Nevada	2	204	6	120	14	85	37	27	13	112
Michigan	3	200	3	141	2	200	3	207	4	176
California	4	170	2	204	8	121	18	66	22	55
Utah	5	156	11	95	7	124	6	168	3	181
Georgia	6	125	4	123	1	311	1	417	1	499
Virginia	7	114	14	68	24	49	30	39	37	28
Illinois	8	107	8	102	4	159	7	134	10	145
New York	9	94	9	99	11	106	12	101	14	109
Minnesota	10	90	5	121	9	121	17	72	27	47

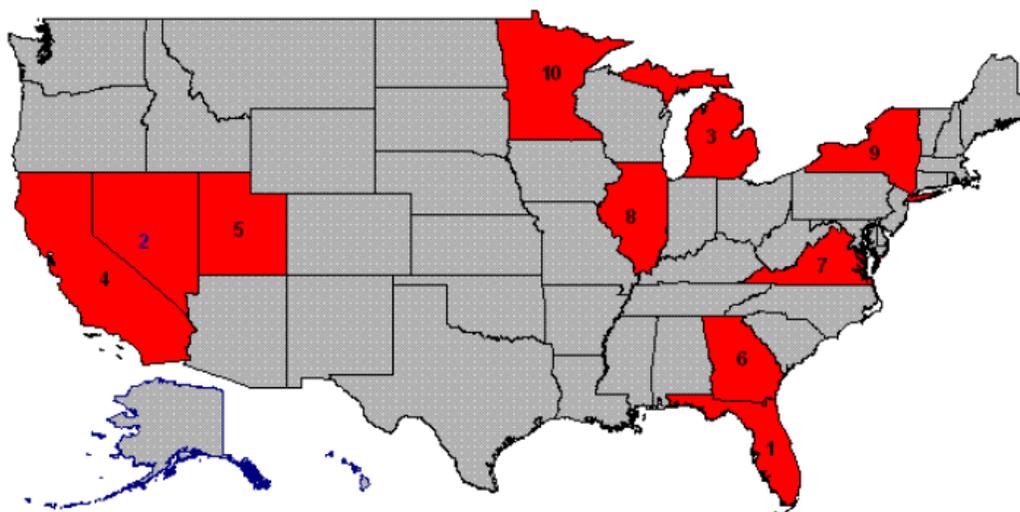


Figure 1 (Top Ten States Overall for 2007)

March 2008

^{iv} Readers that compare the MFI figures in Table 1 for the same states to those found in previous Reports in this series will find that the rates have changed. This is due to the fact that MDEX subscribers in 2007 continued to uncover and report fraud findings from 2003 through 2006. Therefore all numbers in this Report are dynamic and will undergo some changes as time passes.

GLOSSARY

Glossary of Acronyms and Terms

business-to-business complaints	The person making the complaint (the complainant) is a licensed person, agency, entity, or company. The person or company that is the subject of the complaint (the respondent) is another licensed person, agency, entity, or company.
CFS	Consumer Finance Section.
consumer complaints	Complaint submitted by the public.
CSD	Consumer Services Division.
effectiveness	Success in achieving mission and goals.
efficiency	Achieving the most outputs and outcomes practical with the minimum amount of resources.
examination	An examination includes a review of a consumer finance entity's wide range of business practices and activities.
GAO	Government Accountability Office.
investigation	An investigation is 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.
MEIS	Mortgage Examination and Investigation Section.

mission	The main purpose of a program or agency or the reason that the program or agency was established.
nondepository	Financial institutions that do not accept deposits and are subject to the jurisdiction of OFIR.
OFIR	Office of Financial and Insurance Regulation.
OGC	Office of General Counsel.
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 fees into loans, 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.

