



JENNIFER M. GRANHOLM
GOVERNOR

STATE OF MICHIGAN
DEPARTMENT OF LABOR & ECONOMIC GROWTH
LANSING

KEITH W. COOLEY
DIRECTOR

September 4, 2008

Mr. Michael J. Moody, Director
Office of Financial Management
Department of Management & Budget
Romney Building – Seventh Floor
111 S. Capitol, P.O. Box 30026
Lansing, Michigan 48909

Dear Mr. Moody:

We are enclosing our response to comments made in the Office of the Auditor General's Performance Audit of Consumer Finance Activities, Department of Labor and Economic Growth, Office of Financial and Insurance Regulation (OFIR) for the period October 1, 2004 through September 30, 2007.

If you have any questions regarding this report, please feel free to call me at 335-1953.

Sincerely,

Signature Redacted

Allen Williams, Director
Internal Audit & Monitoring Division

Enclosure

cc: Lisa Webb Sharpe, Director, DMB
Michael Becker, OAG
Keith W. Cooley
Rita Canady
Kenneth Ross
Susan Corbin
Allan Pohl

AUDIT RESPONSE SUMMARY

**Performance Audit of Consumer Finance Activities
Michigan Department of Labor and Economic Growth
Office of Financial and Insurance Regulation
(October 1, 2004 through September 30, 2007)**

- I. Citations complied with:
#1(d), #2, #3

- II. Citations to be complied with:
#1(a-c) - Estimated date of compliance is April 1, 2009

- III. Citations agency disagrees with:
#4

AUDIT RESPONSE

Performance Audit of Consumer Finance Activities
Michigan Department of Labor and Economic Growth
Office of Financial and Insurance Regulation
(October 1, 2004 through September 30, 2007)

1. OFIR's Effort to Combat Predatory Lending

OFIR had not implemented sufficient prevention and intervention approaches to combat predatory lending. 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.*
- 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.*

Agency Response:

- a. OFIR agrees with this citation and will conduct research, implement best practices and evaluate programs to ensure that OFIR's prevention and intervention approaches are effective in combating predatory lending. With regard to prevention, OFIR informally discusses best practices with sister states and seeks to implement those practices that we believe appropriate. OFIR employs several proactive public outreach approaches designed to make the industry and public aware of OFIR and its role as a regulator, and has been supportive of legislative efforts to pass laws to combat predatory lending. Outreach efforts 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 website. OFIR consumer assistance

staff regularly provides consumers with phone numbers for legal aid offices and the state bar referral hotline where appropriate.

- b. OFIR agrees that unlicensed activity should be investigated when discovered, but opposes the inference that unlicensed activity is a primary source of mortgage fraud or predatory lending. Staff members have been added to the Consumer Finance Section to carry out and improve work processes; this will include looking at ways to identify unlicensed activity as well as improve monitoring of the licensed population.

OFIR contends that it would be a less effective use of its limited resources to research register of deed filings than to investigate known complaints against licensed/registered entities. It should be noted that this audit concluded that 16 of 71 entities that had conducted mortgage business in five Michigan counties (based on register of deeds filings) were unlicensed to conduct the business and therefore were not subject to selection for examination. This conclusion seems to imply that all of the cited entities were required to be licensed or registered and that their unlicensed operation was unlawful. This is not necessarily true as there are numerous exceptions to the license requirements in both the first and second mortgage statutes. In fact, when OFIR staff investigated, it found that all but one of the cited companies were exempt from the subject license/registration statutes. The remaining company claims it does not have to have a license to conduct its business; that case has been referred to the Attorney General's Office for review of the claim. Because of the many exemptions from these statutes, OFIR questions the effectiveness of this methodology.

- c. OFIR agrees with this citation. OFIR has participated and will continue to participate in efforts to formulate stronger anti-predatory lending laws. Recent examples include Public Acts 59 through 71 of 2008, which establish professional standards for mortgage loan originators, and House Bills 5294 through 5310, which seek to eliminate abusive mortgage lending practices. It should be noted, however, OFIR should not be held accountable for the failure of some proposals to successfully navigate through the legislative process.
- d. OFIR agrees that greater regulatory presence is needed in the consumer finance marketplace. In 2008, OFIR is on track to double its mortgage examination/investigation production over 2007 levels. In addition, we are pleased that a supplemental appropriation in FY 2008 and the recently approved FY 2009 OFIR budget appropriation authorized additional staff for this program that will facilitate regular examination of mortgage companies on a 36-48 month cycle. Ten new mortgage examiners are in the process of being hired effective September 8, 2008.

2. Business to Business Complaints

OFIR had not initiated all business-to-business complaint investigations in a timely manner. OFIR did not initiate 52 (13%) of 395 business-to-business complaint investigations within five days of receiving the complaint. For 52 complaints, OFIR exceeded the five-day goal from 1 to 554 days for an average of 158 days per complaint.

Agency Response:

OFIR agrees that the Mortgage Examination and Investigation Section's handling of business-to-business complaints represents an opportunity for improvement. Program staff has reviewed all business-to-business complaints received and has implemented an aggressive action plan for each. Detailed procedures have been established for handling these complaints and documenting agency determinations and resolutions. Going forward, the Section is expected to respond to such complaints within 15 business days.

3. Completion of Examinations and Investigations

OFIR had not completed sufficient consumer finance examinations and investigations to provide a regulatory presence with 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.

Agency Response:

OFIR concurs that a broader regulatory presence in the consumer finance industry requires performance of more examinations and investigations. With the addition of newly hired staff, OFIR's mortgage examination production in 2008 is now on track to double 2007 production levels. In addition, OFIR anticipates that productivity will take another jump in 2010 as the 2008 hires become fully trained and capable of working independently.

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.

Agency Response:

OFIR disagrees with the portion of this finding that claims it did not prioritize the selection of consumer finance licensees and registrants for examination according to its established risk-based approach. OFIR's approach, documented in its March, 2005 Examination Plan amendments, established a rational basis for effective allocation of staff resources that were insufficient to support the preferred program of routine periodic examination of all program-regulated entities. In adherence with this plan, the highest-risk entities are selected for examination. While program staff use complaint data to assess risk, the number of complaints lodged against an entity is, without assessment of the merit of the complaints or the potential for harm to the public, an insufficient indicator of whether an examination is needed. Thus, an entity that was the subject of multiple complaints might not be an examination/investigation priority. This would be consistent with the OFIR risk-based approach to selecting entities for examination/investigation.

OFIR agrees that Examination Section determinations regarding consumer complaints referred by the Consumer Services Division should be documented and

has established procedures to assure that this is done. OFIR disagrees that a lack of documentation resulted in high-risk consumer finance entities not being selected for examination or investigation.
