Audit Report

Department of Labor, Licensing and Regulation
Office of the Commissioner of Financial Regulation

December 2015

OFFICE OF LEGISLATIVE AUDITS
DEPARTMENT OF LEGISLATIVE SERVICES
MARYLAND GENERAL ASSEMBLY

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DEPARTMENT OF LEGISLATIVE SERVICES
OFFICE OF LEGISLATIVE AUDITS
MARYLAND GENERAL ASSEMBLY

Warren G. Deschenaux
Executive Director

Thomas J. Barnickel III, CPA
Legislative Auditor

December 22, 2015

Senator Guy J. Guzzone, Co-Chair, Joint Audit Committee
Delegate Craig J. Zucker, Co-Chair, Joint Audit Committee
Members of Joint Audit Committee
Annapolis, Maryland

Ladies and Gentlemen:

We have conducted a fiscal compliance audit of the Department of Labor, Licensing and Regulation (DLLR) – Office of the Commissioner of Financial Regulation (OCFR) for the period beginning August 2, 2012 and ending July 19, 2015. OCFR is the primary regulator for financial institutions chartered in Maryland, including banks, credit unions, and State-licensed financial entities, including mortgage lenders. OCFR is responsible for licensing and supervising these businesses to ensure compliance with the laws and regulations of Maryland.

Our audit disclosed that OCFR did not adequately document its determination of the amounts of financial penalties assessed against mortgage licensees for violations of Maryland's mortgage laws.

DLLR's response to this audit, on behalf of OCFR, is included as an appendix to this report. We wish to acknowledge the cooperation extended to us during the course of this audit by OCFR.

Respectfully submitted,

Thomas J. Barnickel III, CPA
Legislative Auditor

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Background Information

Agency Responsibilities

The Department of Labor, Licensing and Regulation – Office of the Commissioner of Financial Regulation (OCFR) is responsible for supervising the activities of the following entities: Maryland State Chartered banks, trust companies, savings banks, credit unions, money transmitters, safe-deposit companies, sales finance companies, installment loan lenders, consumer lenders, credit services businesses, check-cashing outlets, debt collection agencies, debt management companies, mortgage lenders (including lenders, brokers, and servicers), and mortgage originators. OCFR also oversees retail accounts, retail installment contracts, and credit grantor contracts. Additionally, OCFR issues licenses for non-depository institutions after investigation of each applicant and approves charters for banking institutions and credit unions to form new institutions, open branches, make stock acquisitions, form affiliates, and merge with other financial institutions. According to the State's records, during fiscal year 2015, OCFR's operating expenditures totaled approximately $9.4 million.

Findings and Recommendations

Mortgage Licensee Penalties

Finding 1
The Office of the Commissioner of Financial Regulation (OCFR) did not adequately document its determination of the amounts of financial penalties assessed to mortgage licensees.

Analysis
OCFR did not adequately document its determination of the amounts of financial penalties it assessed against mortgage licensees (lenders and originators) that resulted from examinations conducted by its mortgage compliance unit. State law provides that a civil penalty of up to $5,000 may be imposed on a licensee for each violation of Maryland's Mortgage Lender Law and stipulates criteria to consider when determining the penalty amount. Criteria include the seriousness of the violation, the nature of previous violations, and the effect on the public and the mortgage industry. In addition, OCFR advised us that negotiations with the non-compliant licensee may affect the amount of the penalty. However, OCFR did not routinely document its consideration of the aforementioned criteria and the extent to which each of the criteria factored into the determination.

Our test of 10 penalties assessed against licensees that were paid during fiscal year 2015 disclosed that 8 of these penalties were reduced from the examiner's initial recommendations by a total of $232,200, including one penalty that was reduced from $105,000 to $25,000. Specifically, the assessed penalties had been reduced from an aggregate of $300,000 to an aggregate of $67,800. However, OCFR could not provide us with specific documentation as to how the aforementioned criteria were used to determine the initial or final penalty amounts.

Examinations are performed by OCFR's mortgage compliance unit for every licensee within 18 months of initial licensure and every 3 years thereafter. According to OCFR's records, penalty payments received in fiscal year 2015 totaled approximately $169,000.

Recommendation 1
We recommend that OCFR document its determination of penalty amounts assessed against mortgage licensees, including how criteria established in the law were used to determine the penalty amounts.

Audit Scope, Objectives, and Methodology

We have conducted a fiscal compliance audit of the Department of Labor, Licensing and Regulation (DLLR) – Office of the Commissioner of Financial Regulation (OCFR) for the period beginning August 2, 2012 and ending July 19, 2015. The audit was conducted in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

As prescribed by the State Government Article, Section 2-1221 of the Annotated Code of Maryland, the objectives of this audit were to examine OCFR's financial transactions, records, and internal control, and to evaluate its compliance with applicable State laws, rules, and regulations.

In planning and conducting our audit, we focused on the major financial-related areas of operations based on assessments of significance and risk. The areas addressed by the audit included consumer credit and oversight of financial institutions, including examinations and licensing, and cash receipts.

Our audit did not include certain support services provided to OCFR by the DLLR – Office of the Secretary. These support services (for example, payroll, purchasing, maintenance of accounting records, and related fiscal functions) are included within the scope of our audits of the Office of the Secretary.

To accomplish our audit objectives, our audit procedures included inquiries of appropriate personnel, inspections of documents and records, observations of OCFR's operations, and tests of transactions. Generally, transactions were selected for testing based on auditor judgment, which primarily considers risk. Unless otherwise specifically indicated, neither statistical nor non-statistical audit sampling was used to select the transactions tested. Therefore, the results of the tests cannot be used to project those results to the entire population from which the test items were selected.

We also performed various data extracts of pertinent information from the State's Financial Management Information System (such as revenue data). The extracts are performed as part of ongoing internal processes established by the Office of Legislative Audits and were subject to various tests to determine data reliability. We determined that the data extracted from this source were sufficiently reliable for the purposes the data were used during this audit. Finally, we performed other auditing procedures that we considered necessary to achieve our objectives. The reliability of data used in this report for background or informational purposes was not assessed.

OCFR's management is responsible for establishing and maintaining effective internal control. Internal control is a process designed to provide reasonable assurance that objectives pertaining to the reliability of financial records, effectiveness and efficiency of operations including safeguarding of assets, and compliance with applicable laws, rules, and regulations are achieved.

Because of inherent limitations in internal control, errors or fraud may nevertheless occur and not be detected. Also, projections of any evaluation of internal control to future periods are subject to the risk that conditions may change or compliance with policies and procedures may deteriorate.

Our reports are designed to assist the Maryland General Assembly in exercising its legislative oversight function and to provide constructive recommendations for improving State operations. As a result, our reports generally do not address activities we reviewed that are functioning properly.

This report includes a finding relating to a condition that we consider to be a significant deficiency in the design or operation of internal control that could adversely affect OCFR's ability to maintain reliable financial records, operate effectively and efficiently, and/or comply with applicable laws, rules, and regulations. Our audit did not disclose any significant instances of noncompliance with applicable laws, rules, or regulations. Other less significant findings were communicated to OCFR that did not warrant inclusion in this report.

The response from DLLR, on behalf of OCFR, to our findings and recommendations is included as an appendix to this report. As prescribed in the State Government Article, Section 2-1224 of the Annotated Code of Maryland, we will advise DLLR regarding the results of our review of its response.

APPENDIX

STATE OF MARYLAND
DLLR
DEPARTMENT OF LABOR, LICENSING AND REGULATION

OFFICE OF THE COMMISSIONER OF FINANCIAL REGULATION
500 NORTH CALVERT STREET, SUITE 402
BALTIMORE, MD 21202

December 18, 2015

Mr. Thomas J. Barnickel III, CPA
Legislative Auditor
Department of Legislative Services
301 West Preston Street, Room 1202
Baltimore, Maryland 21201

Re: Legislative Audit Report for DLLR – Office of the Commissioner of Financial Regulation – Audit Period August 2, 2012 to July 19, 2015

Dear Mr. Barnickel:

I would like to acknowledge receipt of your most recent Legislative Audit of the Office of the Commissioner of Financial Regulation dated December 3 2015. This Audit contained one recommendation that the agency has already corrected. Our Agency performs a critical role ensuring the stability and viability of our financial institutions and protecting Maryland consumers. The Agency is particularly eager to ensure that our internal systems and processes are sound. We strongly believe that the audit process is a very useful tool in making these assessments.

I want to thank Audit Manager Bekana Edossa, Senior Auditor Edward A. Rubenstein, and Staff Auditor Kimberly J. Wagner for their professionalism, cooperation and assistance during this audit. Your team provided us with valuable advice and suggestions. Please express our gratitude to your audit team for their hard work during our audit.

Sincerely,

Gordon M. Cooley
Commissioner of Financial Regulation
Department of Labor, Licensing and Regulation

Office of the Commissioner of Financial Regulation
Response to Draft Legislative Audit Report for the audit period beginning August 2, 2012 and ending July 19, 2015

December 18, 2015

As Commissioner of Financial Regulation, I am pleased to provide you and members of the Joint Audit Committee with the Office of the Commissioner of Financial Regulation's ("OCFR") response to the draft audit report dated December 3, 2015. We appreciate the thoroughness and consideration displayed by your staff in conducting the audit and trust that the process has and will assist OCFR in maintaining policies and procedures that ensure the highest performance standards.

The OCFR's responses to the finding and corresponding recommendation contained in the Audit report for the period beginning August 2, 2012 and ending July 19, 2015 are set forth below. The OCFR takes seriously the recommendation in the Audit and, as evidenced below, has corrected the issue noted in the Audit. This audit dated December 3 2015 has one finding and recommendation; mortgage licensee penalties.

Audit Findings and Recommendations

Mortgage Licensee Penalties

Finding 1
The Office of the Commissioner of Financial Regulation (OCFR) did not adequately document its determination of the amounts of financial penalties assessed to mortgage licensees.

Analysis

OCFR did not adequately document its determination of the amounts of financial penalties it assessed against mortgage licensees (lenders and originators) that resulted from examinations conducted by its mortgage compliance unit. State law provides that a civil penalty of up to $5,000 may be imposed on a licensee for each violation of Maryland's Mortgage Lender Law and stipulates criteria to consider when determining the penalty amount. Criteria include the seriousness of the violation, the nature of previous violations, and the effect on the public and mortgage industry. In addition, the OCFR advised us that negotiations with the non-compliant licensee may affect the amount of the penalty. However, OCFR did not routinely document its consideration of the aforementioned criteria and the extent to which each of the criteria factored into the determination.

Our test of 10 penalties assessed against licensees that were paid during fiscal year 2015 disclosed that 8 of these penalties were reduced from the examiner's initial recommendations by a total of $232,200, including one penalty that was reduced from $105,000 to $25,000. Specifically, the assessed penalties had been reduced from an aggregate of $300,000 to an aggregate of $67,800. However, OCFR could not provide us with specific documentation as to how the aforementioned criteria were used to determine the initial or final penalty amounts.

Examinations are performed by OCFR's mortgage compliance unit for every licensee within 18 months of initial licensure and every 3 years thereafter. According to OCFR's records, penalty payments received in fiscal year 2015 totaled approximately $169,000.

Recommendation 1

We recommend that OCFR document its determination of the specific penalty amounts assessed against mortgage licensees, including how criteria established in the law were used to determine the penalty amounts.

AGENCY RESPONSE

The OCFR agrees with Finding 1 and the corresponding recommendation. The Auditor noted that the OCFR failed to keep adequate documentation to determine how the fines recommended in examination reports ended up as a lesser amount. After review of the 10 penalty cases mentioned, we feel confident that the penalties issued were appropriate and the differing amounts were justified after consideration of the six factors. We note that the six factors were considered when the fines were originally imposed but agree that we did not fully and completely document their consideration.

In April 2015, the agency adopted a new policy, *Assessment of Fines and Penalties Resulting from Examination Findings Mortgage Compliance Unit***.** This policy confirms that it is more efficient and effective for the mortgage compliance unit to attempt to consensually resolve examination findings prior to formal enforcement action being taken. Examiners can and should recommend through the examination resolution process that a company be fined based on the examination findings, although as discussed above specific amounts are no longer placed into the reports of examination. In response to discussions with the legislative audit team, in October 2015, the agency adopted a Sample Memorandum that is to be completed if examination findings warrant a monetary penalty[1] and that the mortgage compliance unit determines that it should attempt to consensually resolve the matter. The six factors that will be considered when determining the amount of a civil penalty to be sought by the mortgage compliance unit are;

- seriousness of the violation,
- good faith of the violator,
- violator's history of previous violations,
- effects on the public and mortgage industry,
- the assets of the violator, and,
- any other factors that are considered relevant.

Both the policy and the new Memorandum will clearly document the reasoning behind the calculation of any monetary penalty negotiated by the mortgage compliance unit in an attempt to consensually resolve examination findings.

[1] Monetary penalties are levied based on F.I § 2-115, F.I. § 11-501 *et. seq.*, F.I. § 11-601 *et. seq.*, Title 12 of the Commercial Law Article, and any relevant regulation adopted thereunder.

AUDIT TEAM

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