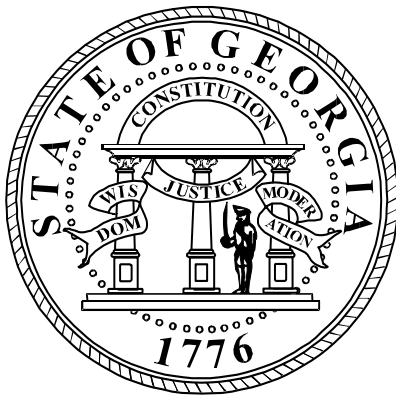




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Performance Audit

Consumer Protection Provided by the Residential Mortgage Program

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Performance Audit Operations Division
Department of Audits and Accounts

254 Washington St.
Atlanta, GA 30334

Background

The Georgia Residential Mortgage Program was established in 1993 to protect consumers through regulation of the mortgage industry. The Program was created within the Department of Banking and Finance in response to the **predatory lending** practices of companies (such as Fleet Finance) that had caused many Georgians to lose their homes to foreclosure. While there is no universal definition of predatory lending, it can be loosely defined as lending practices that are unfair, deceptive, or fraudulent in order to take advantage of consumers. Some of the characteristics that have been identified as potentially predatory or abusive include:

- High closing costs (i.e., origination fees and points),
- Credit life insurance that is paid in full at the time of closing,
- Balloon payments,
- Mandatory arbitration clauses, and
- Exorbitant prepayment penalty provisions.

The Department of Banking and Finance's primary focus has historically been on ensuring compliance with applicable state laws and regulations. However, as a result of recent national and local concerns about increasing problems with predatory lending practices, the Department has started reexamining its activities in order to make changes to provide better consumer protection.

The Program is responsible for regulating lenders and brokers that make loans of more than \$3,000 on real property used as a primary residence. The Program may also regulate certain lenders making mortgage loans under \$3,000 if they are not regulated by other entities. A **mortgage lender** makes, originates, purchases, or services mortgage loans directly or indirectly and a **mortgage broker** solicits, processes, places, or negotiates mortgage loans. The Program regulates the industry by:

- *Licensing mortgage lenders and brokers,*
- *Examining licensees,*
- *Enforcing requirements through the use of administrative actions/ fines/ penalties, and*
- *Handling consumer complaints.*

The Program has offices located in Atlanta and has a staff of 18 employees, of which 10 are examiners who travel throughout the state.

Licensing Lenders and Brokers

The Program's primary method of regulating the mortgage industry is through the annual licensing of mortgage lenders and brokers. Mortgage lenders and brokers that make more than five mortgage loans in a calendar year (and that are not banks, credit unions, or otherwise exempt) are required to be licensed. Licensing provisions specify requirements for an applicant's net worth, credit worthiness, minimum education/experience, and prohibit felons from obtaining a license or working in the industry.

Registrants and *notificants* can be mortgage lenders and/or brokers, but are exempt from licensing because of their organizational structure, which provides for regulation by other entities. Registrants are lenders or brokers that are 100% owned by a bank holding company, or in the case of notificants, are lenders or brokers in operations that are 100% owned by a bank. As of September 30, 2000 the Program had 2,227 licensed mortgage brokers, 644 licensed lenders, 108 registrants, and 36 notificants.

Examining Licensees

The Program conducts periodic examinations of licensees to ensure compliance with applicable state laws and regulations. During on-site examinations, the Program's examiners review the licensee's books and records (including a sample of loan files), to document that various legal requirements have been met. The Program also conducts fraud investigations if it suspects that a licensee or registrant is involved in fraudulent activities.

The Program is not required to examine registrants or notificants if it has been determined that they have been adequately examined by another bank regulatory agency, such as the federal Office of Thrift Supervision or state bank examiners. Generally, the Program does not conduct examinations of licensees in business for less than 12 months or individual examinations of licensed employees of certain organizations meeting strict supervisory criteria and limits on the functions performed by employees.

As of September 30, 2000 the Program was responsible for examining 2,871 licensees. During fiscal year 2000, the Program conducted 420 mortgage broker/lender examinations and 33 fraud investigations.

Fines and Penalties

The Department has established fines and penalties for violation of applicable laws or its rules. In fiscal year 2000 the Program assessed **fines** of \$553,011. Fines cannot be appealed through a hearing and are due 30 days from the date of assessment.

The Department can issue a **Cease and Desist order** to any licensee, registrant, notificant or any person/business required to be licensed or registered, requiring them to immediately stop practices that are in violation of applicable laws or Department rules. It may also issue Cease and Desist orders to non-licensed persons if they are employees of a licensee.

Under a Cease and Desist order, a licensee can still conduct business, but an unlicensed individual is barred from employment in the industry for a year after the order is issued. In fiscal year 2000, the Program issued 15 Cease and Desist orders to licensees for violations such as doing business with an unlicensed person and employing a felon. The Department also issued an additional 50 Cease and Desist orders to unlicensed lenders and brokers.

Minor violations are often handled with agreements; however, the Department can issue a **Notice of Intent to Revoke** for any violation of the Georgia Residential Mortgage Act or the Department's rules. If the licensee does not request a hearing within 20 days, the license is revoked. If the licensee agrees to correct the violations, pays whatever fine is assessed, and enters into a Consent Agreement, the Department will usually rescind the Intent to Revoke.

In fiscal year 2000, the Department issued 437 Notices of Intent to Revoke. Of these, 305 (70%) were rescinded. (The majority of these Notices of Intent to Revoke were issued for bond cancellations and the majority of the rescissions were made because the bond was reinstated and the violation corrected.) In addition, the Department revoked 153 licenses (including notices issued in prior years that became final in fiscal year 2000).

As an additional enforcement tool, in an emergency situation, if the Department finds the welfare of the public is in jeopardy, it can issue an immediate suspension of license. In special situations a Consent Order or Consent Agreement may be issued formalizing corrective action agreed to by the Program and the licensee. Cease and Desist orders and license revocations automatically become final unless a hearing is requested within 20 days. A hearing is not required when a person is cited for doing business without a license. In other cases, hearings are required when requested.

Hearings are conducted by the Office of State Administrative Hearings in accordance with the Georgia Administrative Procedure Act. The Department's Legal and Consumer Affairs Division prepares documents, obtains evidence, and secures witnesses in preparation for the hearings. The Office of the Attorney General represents the Program in the hearings. The Program had 19 requests for hearings in fiscal year 2000.

Handling Complaints

Two Specialists in the Department's Legal and Consumer Affairs Division (LCA) are dedicated to processing complaints. The focus of the efforts of the two Consumer Affairs Specialists is resolving the specific problem about which the consumer is calling. The Specialists encourage consumers calling with complaints to first attempt to resolve their problem with the licensee. Advice is provided to these callers regarding the best way to approach the licensee about their

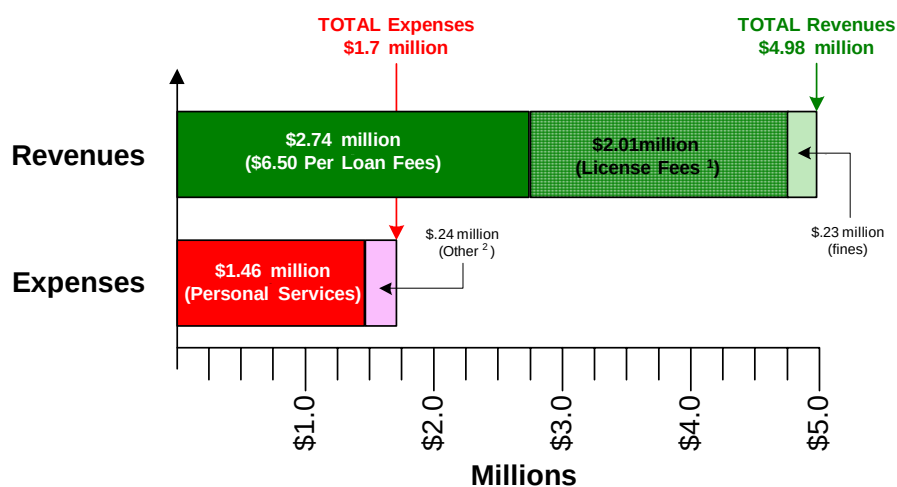
specific problem. The caller is requested to submit a written complaint with copies of supporting documentation if they are unable to resolve the problem directly with the licensee. Complaints are forwarded to licensees with a request for a response. Once a complaint has been satisfied, the file is closed. If a licensee fails to respond to the Program's letter, its license may be revoked.

In fiscal year 2000, the Department reported that its LCA personnel received 3,353 mortgage related telephone inquiries and complaints from consumers. The Department estimated that approximately 70% of the calls were complaints. The Department received 722 formal (primarily written) complaints against mortgage lenders or brokers (including 17 that were classified as verbal complaints) during this same period.

Funding

The operations of the Georgia Residential Mortgage Program are funded solely with state funds. As shown in **Exhibit 1**, the Program collected revenue of more than \$3 million in excess of its operating costs. In fiscal year 2000, the Program's budgeted expenditures totaled approximately \$1.7 million and its revenue from fees and fines was approximately \$5 million. The Program's legislation allows it to set fees at levels necessary to defray the costs and expenses incurred in providing the examinations and supervision. The Program collects application fees, license fees, and a fee of \$6.50 on every mortgage loan closed on real property in Georgia. The \$6.50 per loan fee is paid by the borrower, collected by the lender, remitted to the Program twice a year, and remitted to the state general fund.

Exhibit 1
Residential Mortgage Program Revenues and Expenses
Fiscal Year 2000



¹ Includes application fees

² All Other Expenses

SOURCE: Program Records

Audit Objectives Scope and Methodology

The primary objective of this audit was to evaluate consumer protection provided by the Program to the citizens of Georgia with mortgage loans. The audit was conducted in accordance with generally accepted government auditing standards for performance audits. The Audit focused on fiscal year 2000 but was expanded as necessary to identify trends and patterns. The audit methodology included reviews of Program records, interviews with Program personnel, interviews with experts in the mortgage industry, and interviews with mortgage regulatory personnel in five other states (California, Florida, New York, North Carolina, and Virginia). The Department of Audits wishes to express its appreciation for the cooperation and assistance of Program personnel during this audit.

The entire report was discussed with appropriate personnel at the Department of Banking and Finance and a draft copy was provided for their review. Department personnel were invited to provide a written response to the report and to indicate areas in which they planned to take corrective action. Pertinent responses from the Department are reflected in *italics* throughout the report as appropriate.

Findings

Monitoring

The Program needs to develop better systems to identify the extent of predatory lending in Georgia to enable it to better monitor its effectiveness in protecting consumers and the effectiveness of improvements that may come about as a result of changes in the Program or from new legislation.

At the start of this audit, Program personnel indicated that they knew that predatory lending existed in Georgia; however, they did not have evidence of a widespread problem. During the course of the audit, in recognition of information coming out of Federal Hearings and local meetings on predatory lending held by state legislators, Program personnel became concerned that predatory lending could be more prevalent than the Department had thought. As a result, the Department decided there was a need to attempt to discern the extent of the existence of predatory lending.

The Program then undertook a number of directed reviews specifically looking for predatory lending. The directed predatory lending reviews focused primarily upon identifying practices which could possibly violate one of the existing legally prohibited acts (i.e., misrepresentation, deception, fraud, making a loan with the intent to foreclose). The reviews involved a sampling of loans made in the last two years and looking at foreclosures during the last two years for possible abuses. In some cases loans prior to the last two years were reviewed.

At the end of this audit, Program personnel indicated that the directed reviews found instances of questionable actions and abuses, but no indicators of widespread predatory lending practices (i.e., practices that could possibly violate one of the existing prohibited acts). The directed reviews also pointed out that the absence of a clear definition of predatory lending made its identification more difficult than assessing compliance with laws and regulations.

The Program needs to better monitor its effectiveness in protecting consumers from abusive practices in the mortgage industry. As discussed in greater detail in other findings in this report, the Program needs to:

- Develop better information on loans made in the state (*see page 6*)
- Better monitor foreclosure information (*see page 8*)
- Continue efforts to improve the examination process by increasing its focus on consumer protection (*see page 11*)
- Improve the complaint process and better analyze complaint data (*see pages 15 and 16*)

In responding to the audit, the Program reported that its directed reviews did find some loan products and loan characteristics identified in the HUD/Treasury study as potentially predatory to be used extensively by some lenders. They noted that the existence of such loan products and loan characteristics alone does not violate Georgia law. Therefore, since these practices did not appear to involve misrepresentation, deception or fraud, the practices were not considered to be predatory. For example, the loan product identified in federal studies as predatory that was found to be the most widespread in these reviews was single premium credit life and other credit insurance (i.e., disability and unemployment). However, the Program noted that the sale of such products is currently legal in Georgia as long as they are properly marketed and offered in accordance with existing laws. The Program had documentation of their individual directed reviews, but had not developed any analysis or statistics regarding the extent of predatory lending practices in the state.

The Program needs to collect better information on the mortgage loans being made in Georgia to help it identify indicators of predatory lending.

Examples of basic information on loans that is not available to the Program include:

- The number of loans closed in the state annually¹,
- The loan interest rates that consumers are being charged,
- The type and amount of fees that consumers are charged for loans, and
- Other terms of the loans that might indicate predatory lending (i.e., balloon payments, prepayment penalties, mandatory arbitration clauses, etc.).

¹ The Program's Annual Written Report that included information on the number of loans closed in the state was eliminated by a change in the law made during the 2000 session of the General Assembly. The Program intends to start requiring that licensees provide data on the number of loans closed on future License Renewal Applications.

Analysis of information on loans made in the state could help the Program identify normal charges and loan terms which in turn would allow it to identify loans that lie outside normal parameters. This type of analysis could help the Program better define the attributes of predatory lending practices.

It should be noted that other regulators around the country have only recently recognized the need for better information on mortgage loans. The federal government is preparing to collect more information on individual loans in order to identify predatory lending and improve consumer protection. In addition, our review of five other states found only one state that already collected some individual loan information for analysis. We found that California collects six months of individual loan information from licensees prior to an examination. The loan information collected by California included interest rates, points, and fees and was used to select loans to review during examinations.

During the course of the audit, the audit team wanted to develop data on predatory lending in Georgia using statistics developed from information on individual loans. However, our discussions with a consulting statistician indicated that we could not even select a sample for review without at least basic information on the number of loans made in the state.

More information on the characteristics of loans made in the state is needed to monitor the Program's effectiveness in protecting consumers. Depending on the data that will be collected by the federal government, the Program might be able to collect data on loans in the state to supplement federal data. Loan data could be gathered from surveys of licensees or during examinations. Several statistically valid methods also exist for collecting information on loans made in the state. The Program could collect information on all loans made by a sample of licensees, it could collect information on a sample of loans across all licensees, or it could collect information on every loan closed by every licensee.

In its response to the audit, the Department reported that it plans to expand the license renewal application to require the submission of more mortgage loan information, particularly additional information regarding the licensee's involvement with loan products and loan characteristics identified in the HUD/Treasury study as potentially predatory. This information will be used to better prioritize examination scheduling and improve scoping of examinations. During examinations a sampling of loans will be selected for review based upon interest rates and points and fees charged on the loans made or brokered by the licensee, a similar selection procedure to that used by California.

The Department agrees that a database including all of the information recommended in the audit report on each residential mortgage loan made in Georgia could be a useful tool to help identify mortgage lenders and brokers that should be specifically targeted for predatory lending reviews. However, the cost to the industry of maintaining and providing such detailed information and the cost to the Department of gathering, maintaining and analyzing such detailed data would be significant. The Department believes that there are more cost effective methods available to target the same lenders and brokers and thereby accomplish the same purpose. It is generally acknowledged that predatory lending occurs primarily in the subprime market. There are a number of ways that subprime lenders can be identified. First, HUD maintains a list of subprime

lenders that is updated annually. We plan to cross reference this national list with the Georgia licensee list each year. Second, the Department collects information at least annually (in annual reports or renewal applications and during examinations) from each licensee regarding the range of interest rates and points and fees charged on mortgage loans by that licensee. This information provides an additional indicator of involvement in subprime lending. We also plan to add a question to the renewal application requiring a licensee to indicate their involvement in subprime lending and a question regarding whether they make loans subject to HOEPA. Finally, if implemented, the Federal Reserve's proposal to require the reporting of the APR for each loan and whether or not each loan is subject to HOEPA requirements will be another source of information for identifying subprime lenders. The Program will continue to explore these and other methods to assist it in identifying subprime lenders who should be targeted for predatory lending reviews.

One final thing should be noted regarding the collection of detailed residential mortgage loan data. The Department has no authority to require those mortgage lenders and brokers who are exempt from licensing to submit this type of loan information. Further, even if Georgia law required such reporting it is likely that federal law would preempt that requirement at least for national banks, federal thrift institutions and federal credit unions. It is estimated that at least 35% of the Georgia residential mortgage loans are made by those exempt from licensing and at least another 15% are made by registrants and notificants. Therefore, it is not possible for the Department to collect the full universe of loans desired by statisticians for analysis.

The Program needs to better monitor foreclosure information in order to identify potential predatory lending problems in the mortgage industry.

Foreclosures are a recognized indicator of possible predatory lending practices. A study conducted by the Department of Housing and Urban Development (HUD) and the Department of the Treasury in June, 2000 used foreclosure monitoring to identify fraudulent activities conducted by both lenders and appraisers. In Georgia, an August 2000 HUD analysis of foreclosures identified an extraordinary number in specific areas of DeKalb County. As a result, HUD imposed a 90-day moratorium on foreclosures of some federally insured loans in those areas in order to determine if predatory lending had occurred.

The Program's Annual Written Report that included information on foreclosures was eliminated by a change in the law made during the 2000 session of the General Assembly. The Program intends to start requiring that licensed mortgage lenders provide data on the number and dollar amount of loans that ended in foreclosure on future License Renewal Applications. Program personnel also indicated that they intend to analyze this information to identify licensees with a high foreclosure percentage.

During on-site examinations, examiners are required to review foreclosure information for any indications that the licensee might be engaged in lending with the intent to foreclose (a prohibited act in the law). Examiners also review the number of foreclosures in order to determine if the foreclosure rate is reasonable in relation to the total volume of loans made by the lender. These

on-site reviews could be used to validate the foreclosure information to be provided with License Renewal Applications.

An additional source of independent foreclosure information is the *Atlanta Foreclosure Report*. This report includes information on advertised foreclosures in 13 metro-Atlanta counties (including approximately 45% of the population of the state) and is available in both hardcopy and electronic format. Information reported for each listing includes the original principal amount, lender, and the purchase price of the property. Program personnel indicated that they had not subscribed to the Report because of its cost of \$65 per month; however, in response to this audit they are now looking into subscribing to the publication.

The Program should follow through on plans to analyze foreclosure data to be provided in License Renewal Applications and should also analyze data in the *Atlanta Foreclosure Report* to identify patterns suggesting predatory lending. This information could be used to help monitor the effectiveness of the Program in protecting consumers, target examinations, or identify the need for other investigations of possible consumer abuses.

In response to the audit the Department noted that current standard examination procedures require the foreclosure information submitted by the licensee in the Annual Written Report to be verified at subsequent examinations. Plans are to carry this standard procedure forward in regard to the foreclosure information to be submitted in the future as part of the License Renewal Application. As indicated the Program intends to better analyze foreclosure data provided by licensees. The Department has subscribed to and plans to use the Atlanta Foreclosure Report to supplement the other default and foreclosure information we will gather, monitor and evaluate. The Department previously subscribed to the Report and found the value of the information provided to be limited for analyzing foreclosure rates and patterns since the information is on advertised, not actual foreclosures, and since the information covers only thirteen metro counties. The Report may however be useful in scheduling examinations of lenders with high default rates. The Program also intends to investigate the possibility of obtaining access to the default and foreclosure information maintained by the Department of Housing and Urban Development (HUD) for each of the HUD lending programs.

Licensing

The Program should take additional steps to ensure that convicted felons are not working in the mortgage loan industry.

Felons are prohibited from acquiring a license and licensees who have been convicted of a felony are subject to revocation of their license. In addition to restrictions on felons holding a license, licensees are also prohibited from employing felons. The following problems were identified with the Program's current procedures for ensuring that felons are not working in the industry:

- The Program does not run **national** background checks on out-of-state applicants or applicants that have recently moved to Georgia unless the Georgia Crime Information Center (GCIC) check indicates that the applicant is a multi-state offender. GCIC checks primarily provide information on criminal offenses committed in Georgia; however,

occasionally GCIC will identify a Georgia offender as a multi-state offender. In fiscal year 2000, the Program ran 2,181 GCIC background checks. In addition, the Program ran national background checks on seven applicants that were identified as multi-state offenders. Of the Program's 2,871 licensees, 670 were located out-of-state. It should be noted that statistics indicate that Georgia has a relatively large influx of new citizens (approximately 1.3 million people have moved into Georgia in the last 10 years). Our review of five other states found that New York takes fingerprint cards on applicants for licenses and runs national background checks on all applicants.

- Program personnel indicated that in 1998, problems with the GCIC background checks resulted in all background checks that were conducted during a four-month period showing no criminal records. During this time period, 489 criminal histories were checked. Program personnel indicated that some were later spot-checked, but not all were rechecked.
- The licensee is responsible for ensuring that his or her employees are eligible for employment in the industry (as discussed above, felons are prohibited from employment in the industry). While the Program performs background checks on employees that are listed on initial license applications, it does not verify that licensees are conducting employee criminal background checks since such checks are not legally required. In fiscal year 2000, based on information provided to the Department by informants, five licensees were fined for employing felons.

In response to this finding, the Program agreed to explore running national background checks on all out-of-state applicants and applicants who have recently moved to Georgia; however, it felt that the Department must be uniform in its seeking of background information. The Department reported that it is seeking permission from GCIC to obtain a more detailed background check, which would include information from all states, not just Georgia. In lieu of that approach, the Department felt it would need to run national background checks on all persons who did not show a Georgia felony, in order to be sure that out of state information is included. The Department felt that a statutory change should not be necessary, but the need for changes would be evaluated as this process continues. In addition, the Program has agreed to run new background checks for applicants that are still licensed that may have been incorrectly approved in 1998.

The Program also indicated that it would ask if background checks had been performed on a licensee's employees at the time of an examination; however, the Program noted that currently licensees are not required by law or Department rule to run background checks on employees. The Program indicated that a change in the law would be necessary before such documentation could be required.

The Program should develop a system to provide for better monitoring of the employees of licensees.

The Program roughly estimates that there are at least 12,000 employees of licensees in the mortgage industry in Georgia. While many of these employees have direct contact with consumers, this estimate also includes administrative personnel.

The Program does not have a system or method for ensuring:

- That employees involved in consumer abuses do not move between various licensees,
- That unlicensed individuals against whom a Cease and Desist order was issued in the proceeding 12 months are not employed in the industry, or
- That an individual whose license was revoked within the prior 12 months is not employed in the industry.

Our review of five other states found that Florida requires licensees to submit reports listing all of their employees. After the initial report is filed, quarterly reports must be submitted that detail all hiring and termination of employees. Florida officials indicated that this system is helpful in tracking problem employees and it does not take a lot of time or manpower to operate. Reports can be filed on-line on a web site.

Program personnel also noted that New Jersey registers all loan originators to ensure compliance with state laws and regulations. Registrations are valid for two years and noncompliance with the law can result in loan originators being barred from the industry for 10 years. New Jersey currently has 12,000 registered loan originators.

The Program should provide for better monitoring of employees of licensees in the mortgage industry. While the licensing or registration of all employees that have consumer contact is a possibility, a more cost effective method might be a system similar to Florida's which would help the Program ensure that problem individuals do not move from one employer to another. Examiners could review the employee listing for each licensee prior to the examination to verify that information is accurately reported. The Program indicated that a listing of employees would not require a change in the Program's rules; however, registering or licensing employees would probably require a change in the law.

In response to the audit, the Department noted that any persons proven to have been involved in consumer abuses are issued a Cease and Desist Order and/or a License Revocation. Final Cease and Desist Orders and License Revocations are published in the Department's Monthly Summary of Mortgage Activities and are posted on the Department's website. The fact that any persons against whom Final Orders and/or Revocations have been issued is public information provides licensees with an incentive not to employ persons who have been proven to have violated the law. Nevertheless, the Department plans to investigate and evaluate the systems used by other states for monitoring the employees of licensees.

Examinations

The Program should continue efforts to improve the examination process by increasing its focus on consumer protection instead of primarily ensuring compliance with laws and regulations.

During the course of the audit Program personnel indicated that they intended to revise the examination process to incorporate a review to identify if predatory lending practices were occurring. New training was provided to the Program's examiners to help them recognize predatory lending practices and abuses in the mortgage industry. The Program also performed 69 directed reviews as of December 2000 to help determine if abuses existed at the locations reviewed and how the Program's examination process could be revised to incorporate predatory lending reviews into future examinations.

Program personnel reported that they felt that the directed reviews identified questionable loans and abuses, but that the reviews did not reveal significant patterns of predatory lending. The directed reviews also found that the identification of predatory lending is not as clear-cut as evaluating compliance with laws and regulations.

The Program should continue their effort of incorporating more emphasis on testing and analysis to identify predatory lending in order to provide more consumer protection.

The Department noted in its response to the audit that it strongly believes that ensuring compliance with the Georgia Residential Mortgage Act (GRMA) and the related regulations does provide significant consumer protection. The GRMA contains a number of consumer protection provisions in the form of disclosure requirements, advertising restrictions and a listing of prohibited acts applicable to any person transacting a mortgage business in or from Georgia. The prohibited acts provisions prohibit in general language, fraud, deception, and misrepresentation in the transaction of a residential mortgage business. Additionally, the conduct of a residential mortgage loan transaction in a manner "not in good faith or fair dealing" and the making of a residential mortgage loan with the intent to foreclose are prohibited. Examination procedures require examiners to ensure compliance with the advertising and disclosure requirements and to be alert to possible violations of the prohibited acts in the loans they review during the examination. Within the authority provided by the GRMA, the Department has diligently attempted to enhance consumer protection through the examination process. We do however agree that the examination focus on identifying possible predatory lending practices can be increased and as indicated this is planned for the future.

Examinations of licensees are not being conducted in a timely manner.

State law requires the Program to examine licensees at least once every 24 months, unless the Program determines that a licensee should be examined less frequently. In June 1998, Program personnel established a normal examination cycle providing that most in-state licensees should be examined on a four year cycle with their initial examination being conducted a year after being licensed.

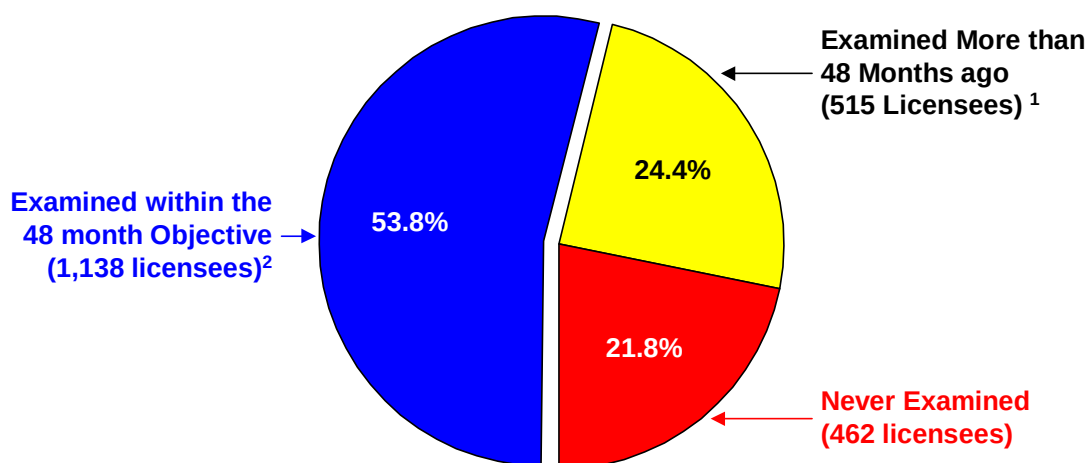
As of September 30, 2000, 2,115 of the Program's 2,871 licensees should have had examinations performed within the last 48 months since they had been licensed for more than 12 months. As shown in **Exhibit 2**, approximately 46.2% of these licensees had not been examined in a timely manner. (Including approximately 21.8% that had never been examined and approximately 24.4% that had not been examined within the last 48 months.) It should be noted that the Program

examined an additional 374 licensees during this 48-month period that no longer have active licenses.

Exhibit 2

Timeliness of Licensee Examinations

(2,115 Licensees Needing Examinations As of September 30, 2000)



¹ Includes 115 individual licensees and 400 licensed employees of a company for which the Department only requires examinations of the company's headquarters and of a sample of employees.

² Includes 80 "visits" and 104 contacts with licensees over the telephone (both of which are less comprehensive than a regular examination).

SOURCE: Program Records

The Program should identify improvements that might enable them to complete more examinations with available resources. The Program should also determine whether additional examiners are needed to conduct examinations in a timely manner.

The Program indicated that it did not have sufficient staff to complete all the required examinations within their established timeframes. In addition, the Program noted that the directed reviews to identify predatory lending that were started in July 2000 redirected resources from the regular examinations. The Department agrees that conducting more frequent examinations would further enhance consumer protection. However, the Program has been unable to conduct examinations as frequently as desirable due to the current staffing level and examination staff turnover. Between June 30, 1999 and September 30, 2000 the Department experienced 40% turnover in the field examiner positions assigned to the Mortgage Program.

*The Department also noted that the company with 400 licensed employees referenced in footnote number one of **Exhibit 2** represents 19% of the total licensees that should have had examinations performed within the last 48 months. The examination on this company has been deferred due to a restructuring of the parent company of the licensee and was further deferred due to the directed predatory lending reviews. Plans are to examine this company in the first quarter of 2001 and that this would raise the percentage “examined within the 48 month objective” to over 72%.*

Finally, the Department noted that while it is not stated in the Program’s normal examination cycle memorandum, it is the practice of the Department to place low priority on examining licensees, who have no contact or very limited contact with the consumer. Since the Program’s purpose under the GRMA is to enhance consumer protection low prioritization of examinations for these entities is considered acceptable, especially in view of the limited resources of the Program. The Department plans to expand the Program’s normal examination cycle memorandum to specifically address the priority for examination on these types of licensees. The revised memorandum will memorialize past practice by stating that high priority will be given to examination of these licensees if a pattern of consumer complaints results in a concern about possible consumer abuse.

Fines and Penalties

The Program should continue its efforts to better utilize fines and penalties to reduce violations.

The Department has a number of written policies, guidelines and procedures for assessing, waiving, and reducing fines. Program personnel reported that professional judgment is used by Program management to ensure that fines are assessed consistently and fairly. Generally, violations noted during first exams do not result in fines, violations noted during subsequent exams may result in fines; however increases in fine amounts for repeated violations have not been formally established. The Program started fining licensees in the last few years and as a result, does not yet have trend data showing that the use of fines has resulted in a reduction of violations.

The Program has also started automatically fining all licensees for late submission of annual audits, license renewal applications, annual written reports, and the per loan \$6.50 fees. The Program believes that these “blanket” fines for violations have been useful in enforcing submission requirements. For example, in 1997, only 92 of the anticipated 1,195 renewal applications had been received by the October 15 due date. In 1998, the Program fined licensees for the late submission of renewal applications. In 1999, only 250 renewal applications were not submitted by the due date.

Program personnel indicated they would continue to develop more uniform policies regarding when and how fines should be assessed and would consider the development of a graduated system of fines to discourage repeat offenders. Program personnel noted that use of graduated fines may require an amendment to the current fine regulation.

Complaints

The Program's complaint system needs to be improved to better identify consumer abuses and predatory lending in the state.

Based on public hearings and newspaper articles, it appears that predatory lending is occurring to at least some degree in the state. During fiscal year 2000 the Program's complaint files did not target predatory lending. In July 2000, in response to publicity about specific abuses in mortgage lending, the Department added new, more specific categories to classify complaints. In November 2000, because management found that very few complaints were being recorded in the newer, "predatory" categories, LCA created four levels of classifications, to indicate the subject of the complaint as well as whether it contained other "predatory" issues. In January 2001, the Department reported that people are still not calling to complain about the newer, specific "predatory" practices.

The following factors may explain why the Program is not receiving predatory lending complaints:

- Other than its web site, the Program does not advertise its existence to the general public. The Program also recognized the need for more outreach in the area of establishing relationships with other consumer protection groups.
- The Program has recently made changes to its complaint classifications to include categories for identifying the characteristics of predatory lending; however, guidelines have not yet been established for using these categories. Program personnel noted that some categories require judgment, since they do not reflect violation of law and thus no clear standard has been established. As a result, staff may not be evaluating complaints consistently. For example, two employees involved with processing complaints thought that a loan with an origination fee of more than 10% of the loan amount (over \$17,000), a prepayment penalty of more than \$17,000 if the loan was paid off more than three months early, an annual interest rate of 10.98% (when the market rate was approximately 7.16%) and a mandatory arbitration clause did not indicate predatory lending. A third employee thought the prepayment penalty should be considered an indicator of predatory lending.
- Some attorneys handling predatory lending cases may be recommending that their clients not register complaints with the Department because of a legal concept called "Administrative Exhaustion". An Atlanta attorney who was a recognized expert in predatory lending practices indicated to the audit team that he did not report cases of predatory lending to the Department because of concerns that if reported, such cases might be limited to the Department's administrative remedies and he could jeopardize his client's ability to pursue the case through the judicial system.
- Department personnel indicated that they are already receiving more complaints than they can handle. The Department's two Legal and Consumer Affairs Specialists process all consumer complaints for the Department. The Department's goal for resolving a consumer

complaint is 30 days from the receipt of a written complaint; however, for fiscal year 2000, the average number of days to resolve a mortgage related complaint was 56 days (ranging from one to 352 days). Program personnel thought that much of this time is outside their control (e.g., waiting for a consumer to send information crucial to their problem).

In response to the audit, the Program reported that it is considering a change in their rules to require loan closing documents to disclose that the Program is available to handle consumer questions and complaints in order to better publicize its existence. The Program has also asked for a new budgeted position in its FY 2002 budget request to strengthen relationships with consumer groups. The Program also reported that guidelines for its complaint classifications had been developed subsequent to the audit's fieldwork. The Department also reported that it intends to work with the attorney who indicated a concern about Administrative Exhaustion to identify ways the Department might be informed about predatory lending practices without jeopardizing an individual's right to pursue a case through the judicial system. Finally, the Program reported that it would continue to analyze the workload of the Department's Legal and Consumer Affairs Specialists to determine if more resources are needed to handle complaints.

The Program needs to better analyze the complaints that it receives to identify patterns of abuse by specific licensees.

While the Program maintains files on complaints that it receives and enters complaint information into a database, it does not analyze the complaints to identify patterns for specific licensees. Program staff indicated that if one of the two Legal and Consumer Affairs Specialists handling complaints notices a pattern of abuse or illegal acts, she can alert the other Program staff; however, no specific analysis or study by licensee is conducted to track the types of complaints being made. Such information could be useful for prioritizing examination scheduling and might provide better informed consumers if made available in some form to the public.

The Program should more actively monitor the complaints that it receives to identify patterns of consumer abuse by specific licensees. It should be noted that under current law complaint information is considered confidential and a change in the law would be necessary before any complaint information could be released to the public.

In response to the audit, the Department reported that, going forward, a periodic report indicating complaints by type and by lender will be generated and shared with Mortgage Program examination/supervision personnel. This report will be analyzed to identify licensees on which the examination priority should be raised due to the volume or the seriousness of complaints received. A change to § 7-1-1009 is currently proposed which would allow the Department to release information on the number of written complaints received and the number of loans made or brokered by each licensee.

Fine and Fee Collection

The Program is not collecting all of the \$6.50 per loan fees that are owed by licensees, and data does not currently exist to determine how much should be collected.

The Program acknowledges that it does not collect all of the \$6.50 per loan fees that are due on mortgage loans closed in Georgia, and that the submission of these fees is essentially done on the *honor system*. As mentioned in a previous finding, the Program does not know the number of loans closed in Georgia and as a result it cannot tell how much money is not being collected.

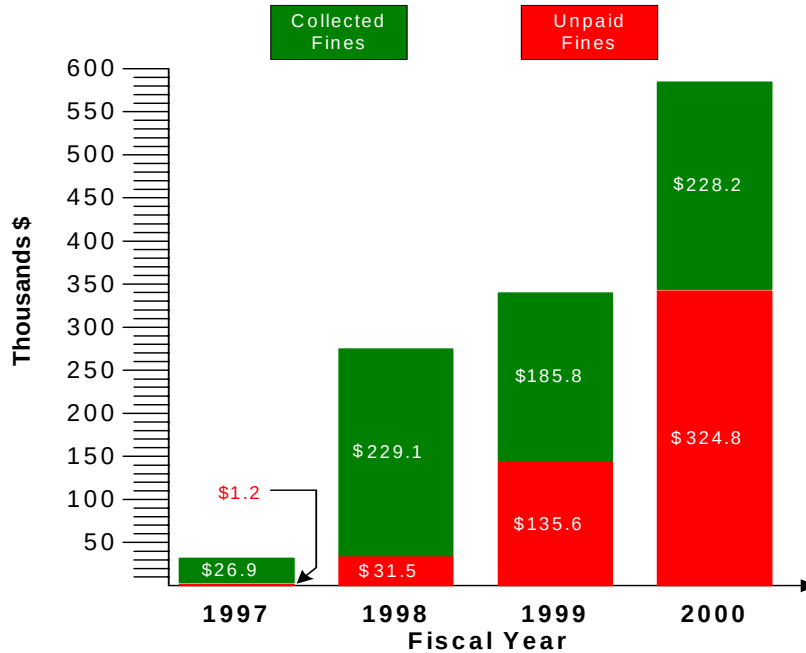
During fiscal year 2000, the Program fined 161 licensees and registrants for failing to submit \$6.50 fees. During the course of the audit the Program identified 624 lenders and brokers which did not submit **any** \$6.50 fees for at least one of the last three payments due in calendar years 1999 and 2000. The Program sent past due notices to these lenders and brokers in October/November 2000 and is awaiting responses as of December 2000. The Program has no way to determine the number of licensees that may have submitted some, but not all, of the fees due.

In response to the audit, Program personnel indicated that while the submission of \$6.50 per loan fees may be “essentially done on the honor system” it is not a totally undisciplined/unchecked “honor system”. The Program thought that the checks and balances in the current system provide reasonable discipline to assure that licensees and registrants are remitting \$6.50 fees appropriately; however they had a greater uncertainty regarding exemptees. The Program noted that it is constantly striving to find additional ways to provide discipline to the process and that it recently gained access to the database of information from security deed filings at the county court houses created by the Georgia Superior Court Clerks’ Cooperative Authority. The Program felt that the only shortcoming with this data appears to be the fact that there is nothing in the database to distinguish residential mortgage loans from other real estate secured loans, such as commercial real estate loans. The Program indicated that it plans to immediately begin experimenting with the database to audit the \$6.50 fees paid in September 2000, which are for loans closed in the first six months of the calendar year 2000. Although not perfect, the Program felt that the Clerks’ Authority database provides the best tool to date to audit the amount of \$6.50 fees due, particularly for non-licensees. The Program also indicated that it plans to investigate the feasibility of establishing a coding system for security deed filings when the loan is filed at the courthouse to distinguish residential mortgage loans from other real estate secured loans, which may require a legislative change.

The Program needs to collect fines in a timely manner.

The Department’s rules require payment of fines within 30 days after assessment; however, there is no penalty for a late payment and the Program does not actively pursue fine collections. As of September 2000, the Program had a total of \$533,369 in unpaid fines, of which \$189,800 (36%) has remained unpaid for more than one year. As shown in **Exhibit 3**, the Program’s unpaid fines have increased significantly since the Program expanded its use of fines in fiscal year 1997. Overall, the Program has a cumulative collection rate of approximately 57%.

**Exhibit 3
Collected and Unpaid Fines**



SOURCE: Program Records

Licensees that are not in compliance with laws and regulations are assessed fines of between \$250 and \$1,000 based on examinations. After notifying licensees of such fines, no further action is taken until licensees attempt to renew their licenses. Licensees that do not renew their licenses within established timeframes are assessed a late renewal fine of \$300; however, they are not notified until they attempt to renew their licenses and are required to pay any fines due in order to renew their licenses. While the Program assumes that licensees that do not attempt to renew their licenses are no longer in business it does not verify this; however it does publish the names of licensees who fail to renew their licenses. Any outstanding fines assessed against these licensees remain on the Program's listing of unpaid fines.

The Program has indicated that it is going to change the way it handles fines for late renewals. Late renewal fines for licensees that do not apply for renewal within the required timeframe will be removed from the Program's listing of unpaid fines. Any licensees that wish to renew their licenses after the allowed timeframe will be required to apply for a new license. The Program also indicated that it will be more proactive in collecting unpaid fines. It reported that it will be requesting legislative authorization to make a change in the bond form which would allow the Department to file a claim against the insurer for payment of past due fines. The Program should also send notifications to licensees demanding payment of the fines after the 30 days has passed. In addition, the Program should establish late payment penalties and interest for fines that are not paid within required timeframes, and consideration should be given to employing a collection

agency to pursue unpaid fines from inactive licensees. The Program should also consider requiring that their examiners verify that licensees that are assumed to no longer be in business are actually not in business.

In response to the audit, the Department reported that the decision to implement a system of fines was made after discussions with other state mortgage regulators indicated that they had found such fines to be an effective tool for improving compliance with mortgage laws, including consumer protection provisions. We believe that consumer protection is enhanced when licensees who were not making adequate efforts to operate their residential mortgage business in accordance with the law are no longer in business, even if their fines do not get paid. In the past, the Department has allowed fines owed by revoked, expired or withdrawn licensees to remain on the Program's books indefinitely. The primary reason for leaving such fines on the books was to ensure that the fines would be collected if the person applied for reinstatement of their license or for a new license. After discussions with the auditors the Program has now established a charge-off policy for such fines after they have been outstanding for more than one year. As of January 31, 2001 all fines owed by persons no longer licensed which are more than one year old will have been charged off. A record of these fines has been maintained and they will be collected if an opportunity arises.

The Department also reported that as of January 22, 2001, the outstanding fines and penalties owed to the Department by active licensees was \$20,500, which included \$19,000 owed by a licensee who is appealing the Department's revocation procedure, \$1,000 owed by a licensee in bankruptcy, and \$500 mistakenly not collected at license extension but the collection of which is now being pursued.

In addition, the Department reported that it will conduct a cost benefit analysis comparing the current method of collecting the fines (i.e. withholding the approval of renewal applications or other types of applications until the fine is paid) with the 30 day notice procedure the audit proposes. Careful attention will be paid to the timeline for collection as well as the hard and soft costs of the methods used for collection. The Department will also conduct a feasibility study on the use of a collection agency to pursue the collection of unpaid fines from persons no longer licensed and will consider the establishment of late payment penalties for fines not paid in the required timeframes. We also plan to explore other methods of improving the timeliness of the collection of fines.

Finally, the Department reported that each month it publishes a listing of those licensees whose licenses have been revoked, suspended, withdrawn or expired. The law requires persons in the industry to verify that the persons they do business with in the industry are licensed. Such verifications can be conducted by reviewing the Department's monthly summary or the Department's website or by calling the Department. Licensees are aware that their license may be subject to revocation if they do a mortgage business with unlicensed persons. The Department may also learn about unlicensed persons doing a mortgage business through complaints from competitors and/or customers. These checks and balances are believed to be sufficient to bring to our attention any persons continuing to operate a mortgage business after revocation, suspension, withdrawal or expiration.

Agency Response to the Audit

The Department indicated that it would like to express its appreciation to the Audit Department and its staff for the recommendations for improvement of the Mortgage Program. The implementation of the recommended changes will benefit the Program's internal operations and enhance the benefit of the Program for the citizens of Georgia. However, the Department also noted that, the predatory lending issue has been rapidly evolving over the last eighteen months including the entire time of this audit. During that timeframe anecdotal evidence of the existence of predatory lending has surfaced, other states have passed new laws and regulations on predatory mortgage lending, Congressional hearings have been held on the subject, government agencies have held public hearings and conducted studies on the issue, the federal banking regulators have issued guidance on the subject, public hearings on the subject have been held by elected officials at the local and state level and Georgia State Senator Vincent Fort has circulated draft predatory lending legislation. The Department has closely monitored these developments and has increased its emphasis upon predatory mortgage lending as noted in the audit report. Eliminating predatory lending from the mortgage industry in Georgia is certainly a laudable goal which is fully supported by the Department.

The audit report states that "the primary objective of this audit was to evaluate consumer protection provided by the Program to the citizens of Georgia with mortgage loans." From a reading of the audit it is apparent that the primary focus of the consumer protection evaluation is on determining the effectiveness of the Department in regard to protecting Georgia citizens from "predatory mortgage lending". The Georgia Residential Mortgage Act (GRMA) contains a number of consumer protection provisions in the form of disclosure requirements, advertising restrictions and a listing of prohibited acts applicable to any person transacting a mortgage business in or from Georgia. The licensing standards established by the GRMA are also designed to enhance consumer protection. They restrict the entry of convicted felons into the business and the net worth, bonding and education and experience requirements are some of the highest in the country. Within the authority provided by the GRMA, the Department has diligently attempted to enhance consumer protection by enforcing compliance with these consumer protection standards through its examination/supervision process, its licensing process and its consumer complaints process. In its pursuit to protect consumers the Department has used its full compliment of administrative actions against those that prey on Georgia consumers including the issuance of Cease and Desist Orders, the revocation of licenses, the issuance of emergency license suspensions and the assessment of fines and penalties.

The Department strongly believes that ensuring compliance with the GRMA and the related regulations provides significant consumer protection. However, the GRMA does not limit, restrict, or prohibit the use of loan products, loan terms, or loan characteristics, including those listed on Page 1 of the audit as potentially predatory or abusive to consumers. Additionally, there is no definition of predatory lending in the GRMA. In fact, the terms "predatory", "predatory lending", and "predatory practices" are not found in the GRMA. Therefore, any expectation that the Department should restrict or prohibit the use of the loan products, loan terms and loan characteristics listed on Page 1 of the audit report seems to measure the Department against standards that go beyond current law.

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