

**A SPECIAL PERFORMANCE AUDIT  
OF THE  
DEPARTMENT OF BANKING**

***NON-DEPOSITORY INSTITUTIONS***

**JANUARY 2010**

**Bureau of Departmental Audits**

January 27, 2010

The Honorable Edward G. Rendell  
Governor  
Commonwealth of Pennsylvania  
225 Main Capitol Building  
Harrisburg, PA 17120

Dear Governor Rendell:

This report contains the results of the Department of the Auditor General's special performance audit of non-depository institutions licensed by the Department of Banking (department) for the period July 1, 2002 through December 31, 2007, including follow-up procedures concluded as of October 22, 2009. A non-depository institution is a type of financial institution regulated by the department that does not have the authority to accept deposits.

The focus of the audit was on the duties and responsibilities of the department with regard to compliance with applicable law. This audit was conducted pursuant to Sections 402 and 403 of the Fiscal Code and in accordance with generally accepted government auditing standards (GAGAS). The aforementioned 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.

Our auditors disclosed deficiencies within the department that may result in the continuation of poor business practices by non-depository institutions. Specifically, the Consumer Services Division (since reorganized and now known as the Consumer Services Office) within the department failed to be proactive with regard to other consumers being affected by the same improprieties described by one consumer's complaint. In addition, it did not adequately review and monitor consumer complaints. The Consumer Services Division also failed to forward complaints regarding appraisers to the Pennsylvania Department of State. Moreover, the Consumer Services Division lacked written policies and procedures for processing consumer complaints.

We offer seven recommendations to address identified deficiencies and strengthen the department's policies, controls, and oversight with regard to non-depository institutions. We are confident that these recommendations, if fully implemented by the department, will help restore confidence in the safety and soundness of non-depository institutions conducting business within the Commonwealth of Pennsylvania.

Finally, this audit report would be remiss by not acknowledging that the department cooperated fully with our auditors throughout the performance of the audit, allowing them to conclude the process without impediments.

We will follow up at the appropriate time to determine whether and to what extent the department has implemented our recommendations.

Sincerely,

JACK WAGNER  
Auditor General

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*Department of Banking  
Non-Depository Institutions*

*Pennsylvania Department of the Auditor General  
Jack Wagner, Auditor General  
January 2010*

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***Results  
In  
Brief***

The Department of the Auditor General conducted a special performance audit of non-depository institutions licensed by the Department of Banking (department) for the period July 1, 2002 through December 31, 2007. The focus of the audit was on the duties and responsibilities of the department with regard to compliance with applicable laws and regulations. Our audit has resulted in one finding and seven recommendations.

**Finding**

We discuss and identify deficiencies within the department, including inadequate supervision, monitoring, and resolution of consumer complaints, which may result in the continuation of poor business practices by non-depository institutions, such as predatory lending. The U.S. Department of Housing and Urban Development defines predatory lending as “engaging in deception or fraud, manipulating the borrower through aggressive sales tactics, or taking unfair advantage of a borrower’s lack of understanding about loan terms.” Specifically, the following weaknesses were found:

- The Consumer Services Division (reorganized and now known as the Consumer Services Office) failed to be proactive with regard to other consumers being affected by the same improprieties described by one consumer’s complaint.
- The Consumer Services Division did not adequately review and monitor consumer complaints.
- The Consumer Services Division failed to forward complaints regarding appraisers to the Pennsylvania Department of State.
- The Consumer Services Division lacked written policies and procedures for processing consumer complaints.

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*Results in Brief*

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We recommend that the department be proactive in determining whether other consumers are being affected by the same improprieties described by a consumer's complaint and take appropriate action to conclude on any improprieties by non-depository institutions. In addition, management should sign/initial all complaint files and final correspondence in order to document approval. Moreover, the department should develop written policies and procedures for processing, recording, and resolving consumer complaints to include referring complaints or complaint issues to other divisions. Furthermore, the department should develop routine reports to monitor the status of open consumer complaints to ensure that they are timely marked closed in its computer system and that the complaint files are properly maintained. Finally, the department should consider limiting access to the department's BankWeb computer system for inputting consumer complaints to only those personnel in the Consumer Services Division. It should forward all complaints related to appraisers directly to the Department of State and obtain the results to determine appropriate subsequent action.

We discuss the aforementioned finding and recommendations in further detail in the main body of this audit report.

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***Background*** The Pennsylvania Department of Banking (department) was originally created by the Act of June 8, 1891 and evolved with the enactment of several significant laws over subsequent years. However, the Act of May 15, 1933, as amended, known as the Department of Banking Code, is the operational foundation for the department. Additionally, the Banking Code of 1965, as amended, which regulated the business of banking, also conferred additional powers and duties on the department.

The department retains cabinet-level status within the executive branch of state government; therefore, the Governor of the Commonwealth appoints the Secretary of Banking to administer the department. The Senate of Pennsylvania must confirm the appointment.

The department regulates financial institutions and financial service firms designated with a state charter, which conveys the authority to accept deposits. Conversely, various federal agencies are responsible for the oversight of all financial institutions and financial service firms that retain a federal charter or license.

In addition to overseeing state-chartered financial institutions and financial service firms authorized to receive deposits, the department is also responsible for the licensing, regulating, and supervision of non-depository institutions. A non-depository institution is a type of financial institution regulated by the department that does not have the authority to accept deposits. For example, some of the non-depository institutions requiring licensure and regulated by the department include:

- Mortgage Lenders and Brokers
- Pawnbrokers
- Check Cashers
- Sales Finance Companies
- Consumer Discount Companies
- Installment Sellers



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***Background***

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In an effort to ensure proper supervision of non-depository institutions, the Department of Banking Code established the Banking Department Fund (Fund), a special fund that receives monies from charges and penalties collected or recovered from persons, firms, corporations, or associations under the supervision of the department. Specifically, monies are received from fees charged on the actual costs of examining non-depository institutions. In addition, non-depository institutions also pay annual license fees into the Fund. Moreover, the Commonwealth is the recipient of fines and penalties collected from non-depository institutions rendered not in compliance with law. Furthermore, the Fund provides for the administration of the department, while supporting the continued regulation of non-depository institutions.

As part of its audit, the Department of the Auditor General examined numerous functions of the department with regard to non-depository institutions, including its response to the needs of consumers. Auditors also reviewed the licensing of non-depository institutions. Moreover, they scrutinized whether the department is ensuring that non-depository institutions within its mandated jurisdiction are compliant with applicable law.

**Consumer Services**

Individuals that have questions or complaints about a particular non-depository institution may direct their inquiries and comments to the Consumer Services Division (division), within the department's Bureau of Compliance, Investigations and Licensing.<sup>1</sup> According to management, the division receives approximately 4,900 complaints each year and handles only those complaints that fall within its mandated jurisdiction.

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<sup>1</sup> As of March 2008, the department reorganized the Consumer Services Division. It is now known as the Consumer Services Office and is directly under the Deputy Secretary of Banking for Non-Depository Institutions and Consumer Services.

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***Background***

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The department prefers that consumers try to resolve any grievance with a specific non-depository institution before filing a complaint. A department Consumer Services Specialist (specialist) is available to process each complaint from individuals that cannot obtain resolution by dealing directly with the non-depository institution. Specialists record incoming complaints on the department's BankWeb database (computer system). Management is responsible for overseeing all specialists and monitoring the progress of each complaint until it is finalized.

Consumers may direct their individual concerns to the division through several means, including telephone calls, letters, and e-mails. However, consumers must submit a written complaint before a specialist begins an inquiry. A specialist may not inform or disclose information to consumers about a licensed non-depository institution that is under review (e.g., examination, investigation, etc.), until a final determination has been made by the department. A specialist will then submit a written response to the consumer that originally initiated the addressed complaint. According to management, it attempts to resolve each consumer complaint within a period of 30 – 45 days.

**Licensing**

The department's Bureau of Compliance, Investigations and Licensing includes a Licensing Division, responsible for processing and approving new and renewal applications for licensure. Department personnel enter information contained on applications for licensure into its computer system, which includes new and/or updated information. Non-depository institutions submitting new or renewal applications must tender the required payment corresponding with the license that they seek.

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According to department management, its computer system also identifies incomplete applications. Moreover, the Licensing Division is able to detect expired licenses when the non-depository institutions exceed their required renewal date. An “Out of Business” notification is disseminated to the aforementioned non-depository institutions, which are allotted a two-week grace period to respond. If no response is forthcoming, the non-depository institutions must then complete and submit a new application for processing and approval and submit the appropriate fee. However, because the department sends the “Out of Business” notification after the expiration of the license, it considers such non-depository institutions to be unlicensed; therefore, they cannot conduct business transactions until their license is renewed.

Principals and officers of specific types of non-depository institutions must consent to criminal background checks and/or fingerprinting by law enforcement authorities with the processing of each new application for licensure. In addition, once the institution is in possession of a license, a criminal background check is required when new officers are appointed or there is a change in principals.

**Compliance**

The department maintains a Compliance Division, which is also located within the Bureau of Compliance, Investigations and Licensing. The Compliance Division depends on its examiners to perform an examination of each licensed non-depository institution in order to ensure adherence with applicable laws and regulations. The Licensing Division uses these examinations to verify attestations made by licensed non-depository institutions on their new and renewal applications for licensure.

According to management, it implemented a pilot program in early 2007 entitled the Risk Based Examinations Program. With the Risk Based Examinations Program, supervisors inform examiners as to which licensed non-depository institutions have been determined to be the highest risk. Examiners then arrange to begin examinations.

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***Background***

Examiners enter pertinent information into the computer system, including a summary of each examination that contains various codes used to document violations disclosed while assessing the non-depository institutions. If the disclosed violations lead to an investigation, examiners would forward relevant information to the department's Investigation Division and coordinate their efforts to determine the extent of noncompliance and the need for penalties and fines.

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***Objectives,  
Scope, and  
Methodology***

**Objectives**

The objectives of this special performance audit were to determine whether:

- The Department of Banking (department) is in compliance with applicable law regarding consumer complaints of non-depository institutions and determine the adequacy of the department's response and methods for resolving consumer complaints (see finding);
- The department is ensuring that non-depository institutions are in compliance with the applicable licensing and fees provisions (no findings noted); and
- The department is proactive in monitoring predatory practices to identify illegal activity and enforce compliance with applicable law (see finding).

**Scope**

Our audit covered the department's duties and responsibilities with regard to non-depository institutions for the period July 1, 2002 through December 31, 2007, including follow-up procedures performed and concluded as of October 22, 2009.

**Methodology**

The methodology in support of the audit objectives included:

- reviewing appropriate statutes, regulations, department policy and procedure manuals, department budget, related information from the department's website, and newspaper articles;
- interviewing department management and staff and reviewing documentation to assess controls and gain an understanding of policies and procedures used in processing and administering non-depository institutions;
- conducting walkthroughs to gain an understanding of the processing of new and renewal licensee applications, including appropriate fee provisions and receipts, consumer complaints, and other key processes;

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***Objectives, Scope, and Methodology***

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- reviewing consumer complaints, Initial Intelligence Reports, assignment/enforcement meeting documentation, new and renewal applications and guidelines, fee provisions, information contained in the BankWeb database, and issues/items requiring additional follow-up in order to ensure compliance with the department's policies, procedures, and applicable law; and
- performing data-mining procedures on data files provided by the department to select non-depository license types for review and testing, including: First Mortgage Broker, First Mortgage Banker, Secondary Mortgage Broker, Secondary Mortgage Lender, Sales Finance Company, and Installment Seller. We stratified the population of consumer complaints and licensing activity by these license types and used targeted and random sampling methodologies. We selected 45 consumer complaints and 60 license applications for testing.

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***Finding      Inadequate Supervision, Monitoring, and Resolution of  
Consumer Complaints May Result in the Continuation of Poor  
Business Practices by Non-Depository Institutions***

According to its stated mission, the Department of Banking (department) is “committed to protecting the public from financial abuse, ensuring the safety and soundness of financial institutions, and fostering a strong and inclusive economy.”<sup>2</sup> However, with respect to consumer complaints, inadequate supervision, monitoring, and resolution may result in the continuation of poor business practices by non-depository institutions, such as predatory lending. The U.S. Department of Housing and Urban Development defines predatory lending as “engaging in deception or fraud, manipulating the borrower through aggressive sales tactics, or taking unfair advantage of a borrower’s lack of understanding about loan terms.” Predatory lending could occur with various financial instruments, such as sub-prime mortgages, home improvement loans, or refinancing to pay off debts. There are numerous predatory lending practices that leave borrowers with extreme financial burdens, including lending more than the borrower can afford, rushing a decision, encouraging repeated refinancing, and charging inflated closing costs, exorbitant fees, or high interest rates.

The department encourages consumers to attempt to resolve their complaints directly with the financial institution or licensee. However, if a consumer is not satisfied with the response, a written complaint may be filed with the department’s Consumers Services Division (division), which employs six Consumer Services Specialists (specialists) and one supervisor. To process complaints, department procedures require that the specialists record incoming complaints on the department’s BankWeb database (computer system), forward the complaint information to the respective non-depository institutions, obtain responses from the non-depository institutions, interact with each party as needed, and then draft a response back to the consumer. Management reviews the work of the specialists prior to issuing the final responses to the consumers, determines whether the complaints need to be forwarded to other divisions within the department that require further investigation, and/or communicates the possible illegality or abuse by a licensee with appropriate department management. For complaints that

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<sup>2</sup> Department of Banking website, [www.banking.state.pa.us](http://www.banking.state.pa.us) (see “Consumer Information”), accessed on June 18, 2009.

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***Finding***

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management forwards to other divisions within the department, it continues to monitor them until the investigation is completed.

Using department data, we selected eight open complaints from a population of 652 as of December 31, 2007 and 37 closed complaints from a population of 15,904 complaints that closed during calendar years 2002 through 2007. Based on interviews with management and our test work of 45 complaints, we found the following weaknesses with respect to the supervision, monitoring, and resolution of consumer complaints:

**1. The consumer services division failed to be proactive with regard to other consumers being affected by the same improprieties described by one consumer's complaint.**

According to management, it has discretion to determine whether a consumer complaint issue needs to be forwarded to other divisions within the department. The primary focus of resolving the complaint is to seek a satisfactory solution by both the consumer and non-depository institution, although this cannot always be achieved.

Based on our review of 45 complaints, we noted nine situations in which management decided that it was unnecessary to request additional information or to forward the situations to other divisions for potential follow up. As a result, although these situations may have been adequately resolved for the complainant, no effort was made to ensure that other consumers were not adversely affected by the same problem. Examples of these situations included:

- A consumer, who had expressed to the broker that she did not want to sign the loan, signed the loan anyway because the broker threatened the consumer by saying that she was going to pay for all the work that the broker had done. Additionally, she claimed that the broker had forged her signature to obtain non-loan documentation. Management concluded that this situation did not need to be forwarded to another division for action, noting that personnel within the department are not forgery experts. In this case, we believe management should have addressed the alleged threats and forgery in addition to satisfying the consumer.



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***Finding***

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- A consumer claimed that he had locked in a fixed interest rate with no prepayment penalties. However, two hours prior to loan settlement, he received a phone call stating that the interest rate would be 0.376 percent higher. Additionally, at closing, he discovered that, not only had the rate increased again, but the fixed rate loan was an adjustable rate loan and there was a two-year prepayment penalty. The consumer did not sign the loan. According to management, because the company had adequately addressed the consumer's concerns, this situation did not need to be forwarded to another division for further action. We believe management should have addressed the alleged abuse in addition to satisfying the consumer.
- A consumer complaint, forwarded by the Pennsylvania Office of the Attorney General, indicated that she contacted a broker regarding a mortgage for a mobile home. Although her credit history was poor, the broker claimed that she was preapproved for a mortgage loan. The broker estimated that the interest rate would be approximately nine percent without hidden fees. Just prior to closing, the broker informed the consumer that she would need \$5,000 to \$10,000 for closing costs, even though the broker had indicated that closing costs would be paid by the broker. At closing, the rate was almost 16 percent. Although information on the department's computer system indicated that this case would be forwarded to investigations, management was unaware of the referral due to the specialist sending the broker's response to the consumer and closing the complaint. Therefore, the department did nothing further in determining whether other consumers were victims of predatory lending practices by this broker.

Because the division does not consider itself an advocate for the consumer, the division considers its responsibility in resolving complaints to be limited to serving as a mediator attempting to create satisfactory solutions acceptable to both the consumer and non-depository institution. We disagree with this position. In order to protect consumers against abuse or improprieties by institutions, the department, through the division must be proactive, not only by ensuring that consumers who file complaints receive adequate resolution, but also by ensuring that other consumers are not victims of the same improper business practices.

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***Finding***

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**2. Consumer complaints are not adequately reviewed and monitored.**

- All complaints may not be reviewed by management.

According to management, it reviews the final response to the consumer prior to the correspondence being sent. If changes are needed, management uses post-it notes to make handwritten edits and returns the draft correspondence to the specialist for correction. The specialist, not management, signs the final correspondence, forwards it to the consumer, and closes the complaint in the computer system. There is no standard procedure for management, such as initialing or signing, to document that the correspondence had been reviewed and approved.

Additionally, without this evidence, along with a mechanism for tracking which complaints management reviewed and approved, management cannot be assured that all complaint responses have been reviewed and approved prior to being closed.

- Specialists are referring complaints to other divisions without management's knowledge or review.

We found that specialists were forwarding complaints directly to other divisions without management's knowledge. In one case, the specialist forwarded the complaint directly to the licensing division; in another case, the specialist forwarded the complaint directly to the compliance division. Management stated that it had no record of receiving copies of these files, even though management had indicated that it determines what is forwarded to other divisions.

With regard to the complaint that was directly forwarded to the compliance division without management's knowledge, management, as a result of our inquiry, found that no investigation or any other action was ever initiated by that division. In other words, the complaint had fallen through the cracks, demonstrating the importance of monitoring complaints forwarded to other divisions.

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***Finding***

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- Management does not monitor open complaints to ensure that they are closed timely.

Through interviews, we found that management relies on each specialist to ensure that open complaints are closed timely. The department does not have any routine computer reports generated or other procedures to verify that all complaints are closed timely and recorded as such in the computer system. We requested system data from the department and found that more than 50 percent of the open complaints had been open for more than six years:

Table 1  
*Open Complaints as of December 31, 2007*

<b>Number of Years Complaint was Open</b>					
<b>Less Than 1 Year</b>	<b>Between 1 and 2 Years</b>	<b>Between 2 and 4 Years</b>	<b>Between 4 and 6 Years</b>	<b>Greater than 6 Years</b>	<b>Total Complaints</b>
143	43	20	73	373	652

Of the 45 complaints reviewed, eight were classified as open complaints on the computer system. However, according to management, five open complaints dated between 2000 and 2005 should have been marked as closed in the system. Of the remaining three open complaints, which were all received during 2007, two had been misplaced (but eventually found based on our inquiries) and one was found to have no deficiencies. The department needs to have a mechanism for monitoring and accounting for open complaints.

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***Finding***

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- Management was not aware that individuals outside of the consumer services division could open a complaint within the department's computer system.

Even though management stated that only personnel from the consumer services division have the capability of entering complaint information into the department's computer system, we found that two of the 45 complaints we reviewed were opened and handled by an employee working in the investigations division. Management was not aware that anyone else could enter complaint information. Given that the responsibility of handling complaints is with the consumer services division, either the access for entering complaint information should be restricted to consumer services division personnel or management needs situational awareness to ensure that complaints are not entered inappropriately.

**3. The consumer services division failed to forward complaints regarding appraisers to the Department of State.**

The division periodically receives consumer complaints that relate, in whole or in part, to a possible infraction by an appraiser. However, the department does not license or have jurisdiction over appraisers; rather, the State Board of Certified Real Estate Appraisers within the Department of State licenses and regulates appraisers. Although complaints relating to appraisers are handled by the Department of State, the division does not forward complaints related to appraisers to the Department of State. According to management, in response to such a complaint, the division would recommend that the complainant file a separate complaint with the Department of State. Of the 45 complaints we reviewed, four related to potential improprieties by appraisers. Our review of the documentation for these four complaints found no evidence showing that the division, either verbally or in writing, made this recommendation to any of these complainants.

Furthermore, we disagree with this course of action. To be proactive, the department should not only forward complaints to the Department of State, but should also monitor the results to determine whether the department needs to take further action with respect to resolution.

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***Finding***

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**4. The consumer services division lacked written policies and procedures for processing consumer complaints.**

According to management, no written policies and procedures exist with respect to processing consumer complaints. Instead, management indicated that the specialists receive “extensive on-the-job training” for a period of time. This training consists of observing each specialist to gain job knowledge. Additionally, specialists have a Referral Manual, which contains appropriate laws for their use.

Although on-the-job training is a useful tool for training staff, management must develop written policies and procedures to ensure that all specialists understand how management expects consumer complaints to be processed, recorded, and resolved. Such a document reduces the risk that consumer complaints are processed inconsistently or inaccurately. Additionally, it should explain what should be forwarded to the supervisor, when it should be forwarded, and how the supervisor would review and approve how the complaint was resolved.

***Recommendations:*** We recommend that the department:

1. Be proactive in determining whether other consumers are being affected by the same improprieties described by a consumer’s complaint and take appropriate action to conclude on any improprieties by non-depository institutions;
2. Ensure that management signs/initials all complaint files/final correspondence in order to document approval;
3. Develop a mechanism for management to ensure that all complaint files/final correspondence are reviewed and approved prior to closing a complaint;
4. Develop written policies and procedures for processing, recording, and resolving consumer complaints to include referring complaints or complaint issues to other divisions;
5. Develop routine reports to monitor the status of open consumer complaints in order to ensure that they are timely marked as closed in the department’s computer system and that the complaint files are properly maintained;

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***Finding***

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6. Consider limiting access to the department's computer system for input or editing consumer complaints to consumer services division personnel only; and
7. Forward complaints related to appraisers directly to the Department of State and obtain the results to determine whether the department needs to take further action with respect to resolution.

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***Response  
to Banking's  
Management  
Comments***

What follows on subsequent pages is the verbatim response of the Department of Banking (department) in response to our finding and recommendations. We thank the department for its cooperation and commend it for its concurrence with the majority of our recommendations. Although the department indicated that the period of audit was a number of years and was also a time of significant change for the agency, it is important to recognize that the finding and recommendations were current as of October 22, 2009, the date of the exit conference. In addition, applicable weaknesses were communicated to the appropriate program point of contact during the audit.

Although the department agreed with recommendation 1, the department disagreed with the statement in the finding that it does not consider itself an advocate for the consumer, by explaining that it is paramount that the department remain fair and neutral in disputes between consumers and non-depository businesses unless circumstances warrant different. We believe that our position on this issue was appropriately explained in the finding. The department should take a more proactive position when evaluating in order to ensure consumers are safeguarded from abuse, which it did not dispute.

In the one instance where the department indicated that it was in disagreement, it clarified at the exit conference that it was in partial agreement. It disagreed with recommendation number 2 that management should initial all complaint files in order to document the review and approval process. However, it clarified that, instead it would implement a sampling methodology to review a limited number of complaint files.

In addition, the department was in partial agreement with our recommendation number 6, which indicated that access to edit or input consumer complaints should be limited to the consumer services division. Our audit found that individuals outside of the consumer services division were entering complaint information without the knowledge of the consumer services division. Management officials clarified that, although a limited number of individuals outside of consumer services will continue to have access to input complaints, it has implemented standard reports to monitor the status of complaint files that will ensure that the consumer services division will be aware of and monitor activity. Even though the department has not exclusively limited access to the system, we are encouraged that they have strengthened controls.

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The department indicated that it is exploring recommendation number 7, to forward complaints related to appraisers directly to the Department of State. We are encouraged that the department is considering this recommendation.

We are confident that this report will further strengthen the management controls within the department because of the cooperation demonstrated throughout this audit by its management staff.





**pennsylvania**  
DEPARTMENT OF BANKING

MARKET SQUARE PLAZA | 17 N SECOND STREET, 13<sup>TH</sup> FL | HARRISBURG, PA 17101  
PH 717.787.6991 FX 717.787.8773 W [www.banking.state.pa.us](http://www.banking.state.pa.us)

SECRETARY OF BANKING

October 20, 2009

The Honorable Jack Wagner  
Auditor General  
Department of the Auditor General  
229 Finance Building  
Harrisburg, PA 17120-0018

Re: Special Performance Audit – Non-Depository Institutions – Department of Banking

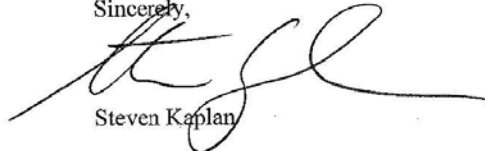
Dear Auditor General Wagner:

We are in receipt of cover correspondence over the signature of Randall R. Marchi, dated September 4, 2009, and the accompanying draft "Finding and Recommendations" relating to a special performance audit of non-depository institutions licensed by the Department of Banking.

As the protection of the public from financial abuse is a critical aspect of our department's mission, we are constantly engaged in efforts to improve our effectiveness in accomplishing that goal.

We are grateful, therefore, for your staff's efforts and suggestions as well as the opportunity to respond to their observations.

Sincerely,



Steven Kaplan

Enclosure

Response to Auditor General's Special Performance Audit  
Department of Banking – Non-Depository Institutions

We are pleased that your introductory comments confirm that the Department of Banking had met its duties and responsibilities “with regard to compliance with applicable laws and regulations” and that “the department ensured that non-depository institutions were in compliance with applicable licensing and fee provisions.” We appreciate your commendation of our performance in your primary area of focus.

We are also appreciative of, and in general agreement with, the suggestions you've made regarding opportunities to further improve our processes. In this regard it is important to note that the period of this audit was July 1, 2002, through December 31, 2007, a period of 5 ½ years. Additionally, although your office initiated the audit in late January 2007 and the last communication with department staff was in October 2008, its conclusions were not communicated to the department until September 2009. This period of over 7 years is significant because it covers the most dynamic period in the evolution of non-depository financial services regulation in history. In fact, the period extends to a time prior to the Rendell administration, when state banking departments across the nation were primarily concerned with regulating banks and ensuring compliance with legal licensing requirements for non-depository institutions. It has only been, therefore, during the period of the audit that the department has been engaged in transforming itself from a traditional bank regulatory organization to a modern consumer protection agency.

During this period, the department has been responsible for leading a variety of initiatives that have placed Pennsylvania in the vanguard of state regulatory innovation for the nation. These initiatives have included advocating for a variety of statutory and regulatory enhancements in the mortgage industry as well as enhancements of its examination and enforcement capacity, as referenced below. These are merely a few examples demonstrating how the department has reached beyond its traditional role as a regulator to protect consumers with mortgage and other financial service provider issues.<sup>1</sup>

We are happy to provide a response to your secondary findings and associated recommendations to further our goal of strengthening oversight of non-depository institutions to ensure that the public is protected from financial abuse. This response will re-state each observation made in the Auditor General's report followed by our response.

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<sup>1</sup> [This is an original footnote from the Department of Banking's response] The Department of Banking mission statement in effect at the beginning of the audit period and immediately prior to the Rendell administration read as follows:

The mission of the Department of Banking is to ensure the safety and soundness of state-chartered deposit-taking institutions; to ensure compliance with state laws and regulations which impact other financial service entities; and to provide a flexible regulatory environment that will facilitate development of a sound financial services industry that adequately meets the needs of industry and the public, while efficiently and effectively managing the agency's resources.

The Department of Banking protects the public through the supervision, regulation and examination of records, accounts and policies of state-chartered financial institutions.

It is noteworthy that a consumer contact and grievance resolution process seems to have been hardly contemplated.

In 2004 the Department of Banking mission statement was revised to read:

To protect the public from financial abuse, ensure the safety and soundness of depository institutions and foster a strong and inclusive economy.

In 2008 the mission statement was updated to read:

The Pennsylvania Department of Banking protects the public from financial abuse, promotes financial education, ensures the safety and soundness of depository institutions, and fosters a strong economy for all Pennsylvanians.

These revisions reflect the administration's approach to the primacy of the consumer protection mission.

***Finding – Inadequate Supervision, Monitoring, and Resolution of Consumer Complaints May Result in the Continuation of Poor Business Practices by Non-Depository Institutions***

The Department of Banking has historically been a regulatory agency. Under Governor Rendell, the agency transitioned toward a broader consumer protection focus and our mission statement was revised to reflect this change. As a result, the staffing for consumer services was increased to specifically improve the department's ability to protect and advocate for the consumer in Pennsylvania. Our goal is to continue to improve our focus on consumer protection and education, while continuing our history of excellence in regulatory oversight.

We accept this finding and will endeavor to improve our operations. However, we would like to point out that during most of the period covered by this audit, the department was in the beginning stages of re-tooling and strengthening our consumer services program. Policies and procedures are now in place to remedy earlier deficiencies noted. We also note that these improvements were implemented independently and proactively, without the benefit of these audit findings.

- 1. The Consumer Services Division failed to be proactive with regard to other consumers being affected by the same improprieties described by one consumer's complaint.***

***Recommendation #1 -Be proactive in determining whether other consumers are being affected by the same improprieties described by a consumer's complaint and take appropriate action to conclude on any improprieties by non-depository institutions.***

The findings appear to be based on a relatively small sampling of 45 complaints from the total of 652 open files and 15,904 closed files (16,556 total files) available for the five years covered by the audit. While we appreciate your comments, we think it is important to note that every consumer in your sample received satisfactory assistance from the department. In addition, based on the audit's own criteria, 80 percent of the cases sampled were handled in an appropriate way. Although we agree that the three examples noted could have benefited from additional action, the department believes that its continued operational improvements, including the implementation of a case and document management system, will address these concerns.

We take issue with the statement that the department does not consider itself an advocate for the consumer. As a regulator, it is of paramount importance that the department remains fair and neutral in disputes between consumers and the businesses under our jurisdiction until all of the facts are known. In the interests of efficiency, the department does try to resolve conflicts between consumers and businesses through mediation. However, if the circumstances warrant it, the department will definitely advocate for the consumer, and in some instances the complaint may result in an examination, investigation or an enforcement action being issued. To say that the department does not consider itself an advocate for the consumer mischaracterizes the appropriate role of the department and ignores the fact that on many occasions the department does advocate for a consumer.

In addition, non-depository examinations are now scheduled based on identified risk factors, including consumer complaints. For all non-depository examinations that are not prompted by a complaint, the complaints on file for that licensee are reviewed by the examiner and incorporated into the examination. The department has also launched a unit to monitor licensees remotely, identify risk factors and conduct limited examinations from the department's offices using a combination of advanced mortgage compliance software, document review, surveys to customers and other factors.

We further measure our effectiveness in consumer protection through a budgetary performance measure that tracks the dollar value of refunds and satisfactory restitution made to consumers as a result of complaints received about improper non-depository institution activities.

**2. *Consumer complaints are not adequately reviewed and monitored.***

***All complaints may not be reviewed by management.***

***Specialists are referring complaints to other divisions without management's knowledge or review.***

***Recommendation #2 -Ensure that management signs/initials all complaint files/final correspondence in order to document approval.***

While we do not dispute this finding, we disagree that this is a problem. Far from improving services to consumers, the audit's recommendation to have all complaints reviewed by management would drastically impede efficiency and response times. The employees in the Office of Consumer Services are all classified at the professional level of Administrative Officer 1 and are fully capable of working at this required level of independence and accountability.

However, the apparent purpose of the recommendation would seem to be to ensure quality control in the Office of Consumer Services. This purpose could be accomplished without sacrificing efficiency and response times by having a random sample of complaint files and related correspondence reviewed by management on a regular basis. To that end, the department has created a new procedure to randomly generate a list of complaints for management to review on a monthly basis. In this way, the department believes that it is able to achieve the apparent purpose of the recommendation without the inefficiencies inherent in the suggested process.

Similarly, we believe that the correct level of independence to refer complaints to other areas of the department is efficient and appropriate, provided that management is made aware of the referral.

- ***Management does not monitor open complaints to ensure that they are closed timely.***

***Recommendation #3 -Develop a mechanism for management to ensure that all complaint files/final correspondence are reviewed and approved prior to closing a complaint.***

***Recommendation #5 -Develop routine reports to monitor the status of open consumer complaints in order to ensure that they are timely marked as closed in the department's computer system and that the complaint files are properly maintained.***

We were aware of this system deficiency and recently were able to make modifications to the system to remedy deficiencies through enhancements to our Bankweb database. We utilize various reports to monitor the status of complaint files, and an information services technician is available to create any specialized report management may request. We have also purchased and implemented Interwoven case management software, which enables a complaint file to be tracked from the receipt of the complaint through to its resolution.

- ***Management was not aware that individuals outside of the consumer services division could open a complaint within the department's computer system.***

***Recommendation #6 -Consider limiting access to the department's computer system for input or editing consumer complaints to consumer services division personnel only.***

The few examples cited in the audit are instances in which personnel from the department's investigative staff opened complaints initially directed to them. The department believes that it is acceptable for department personnel not housed in the Office of Consumer Services to open complaints provided that appropriate internal controls are in place. As a result of this finding, the department confirmed its policy to limit case-opening authority in the department's database to only authorized personnel, however, the department maintains that such personnel may include selected and authorized personnel outside the Office of Consumer Services, such as investigative staff.

3. ***The consumer services division failed to forward complaints regarding appraisers to the Department of State.***

***Recommendation #7 -Forward complaints related to appraisers directly to the Department of State and obtain the results to determine whether the department needs to take further action with respect to resolution.***

As a matter of practice and routine, the department advises consumers to contact the Department of State to lodge a complaint about an appraiser. This finding suggests that the department make the referral instead. The department will explore this possibility with appropriate personnel at the Department of State.

4. ***The consumer services division lacked written policies and procedures for processing consumer complaints.***

***Recommendation #4 -Develop written policies and procedures for processing, recording, and resolving consumer complaints to include referring complaints or complaint issues to other divisions.***

This issue is being remedied at present. Prior to reviewing this recommendation, the Department of Banking had already developed a three-year strategic plan to map out our priorities for the second term of this administration. A key deliverable of the plan is the development of desk manuals for all critical procedures. Critical procedures are the processes and procedures used by employees to prepare reports, research information and perform other daily tasks, which must be documented in order to ensure that they are performed consistently and can be replicated by others. The processing of consumer complaints is included as a critical procedure. This task will be completed by December 31, 2009.

### ***Auditor General Recommendations***

In the response narrative, the recommendations were listed corresponding to the appropriate observation or finding. In addition, we have summarized our agreement or disagreement to each of the recommendations below.

1 Be proactive in determining whether other consumers are being affected by the same improprieties described by a consumer's complaint and take appropriate action to conclude on any improprieties by non-depository institutions. We agree with this recommendation.

2 Ensure that management signs/initials all complaint files/final correspondence in order to document approval. We disagree with this recommendation but have found an efficient way to reach the goal of improved quality control through random sampling.

3 Develop a mechanism for management to ensure that all complaint files/final correspondence are reviewed and approved prior to closing a complaint. We agree with this recommendation.

4 Develop written policies and procedures for processing, recording, and resolving consumer complaints to include referring complaints or complaint issues to other divisions. We agree with this recommendation; we had already begun this process, which will be completed by December 31, 2009.

5 Develop routine reports to monitor the status of open consumer complaints in order to ensure that they are timely marked as closed in the department's computer system and that the complaint files are properly maintained. We agree with this recommendation.

6 Consider limiting access to the department's computer system for input or editing consumer complaints to consumer services division personnel only. We agree in part and disagree in part with this recommendation.

7 Forward complaints related to appraisers directly to the Department of State and obtain the results to determine whether the department needs to take further action with respect to resolution. We will explore this further with the Department of State.

*Department of Banking  
Non-Depository Institutions*

*Pennsylvania Department of the Auditor General  
Jack Wagner, Auditor General  
January 2010*

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***Distribution List***

The Honorable Edward G. Rendell  
Governor  
Commonwealth of Pennsylvania  
Harrisburg, PA 17120

The Honorable Steven Kaplan (3)  
Secretary  
Department of Banking  
17 North Second Street  
Suite 1300  
Harrisburg, PA 17101

The Honorable Pedro A. Cortés  
Secretary of the Commonwealth  
Department of State  
302 North Office Building  
Harrisburg, PA 17120

The Honorable Robert M. McCord (2)  
State Treasurer  
129 Finance Building  
Harrisburg, PA 17120

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Senate Banking and Insurance Committee  
286 Main Capitol Building  
Harrisburg, PA 17120

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Democratic Chair  
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543 Main Capitol Building  
Harrisburg, PA 17120

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Republican Chair  
House Commerce Committee  
213 Ryan Office Building  
Harrisburg, PA 17120

Mr. Phillip R. Durgin, Executive Director  
Legislative Budget and Finance Committee  
400 Finance Building  
Harrisburg, PA 17120

The Honorable Donald L. Patterson  
Inspector General  
Executive House  
101 South Second Street, 3<sup>rd</sup> Floor  
Harrisburg, PA 17101

Ms. Sharon Anderson (4)  
State Library of Pennsylvania  
Serials Records Section  
218 Forum Building  
Harrisburg, PA 17120

Mr. John J. Kaschak, Director  
Bureau of Audits  
Office of the Budget  
8<sup>th</sup> Floor, Forum Place  
Harrisburg, PA 17101



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