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**OFFICE OF THE STATE AUDITOR'S
REPORT ON THE EXAMINATION OF
INFORMATION TECHNOLOGY-RELATED CONTROLS AND
OVERSIGHT OF MORTGAGE BROKERS AND LENDERS
AT THE MASSACHUSETTS DIVISION OF BANKS**

July 1, 2005 through October 5, 2007

**OFFICIAL AUDIT
REPORT
NOVEMBER 27, 2007**

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INTRODUCTION

The Massachusetts Division of Banks (DOB) was established under the provisions of Chapter 204 of the Acts of 1906. The DOB's main office is located at One South Station, Boston with regional field offices located in Burlington, Lakeville and Springfield. The mission of the Division is to advance the public interest with the highest level of integrity and innovation by ensuring a sound, competitive, and accessible banking and financial services environment. The DOB is managed by a Commissioner who is appointed by, and serves co-terminus with, the Governor. The Commissioner chairs a policy group comprised of senior management who provide supervision of the day-to-day operations of the DOB, oversee all regulatory matters, and conduct strategic planning for the Division.

The DOB is responsible for the licensing and oversight of nearly 260 state-chartered banks and credit unions holding approximately \$225 billion in combined assets. The Division coordinates with the Federal Deposit Insurance Corporation (FDIC) and the Federal Reserve Bank of Boston to conduct approximately 70 bank examinations of state-chartered banks, and with the National Credit Union Association (NCUA) to conduct approximately 75 examinations of state-chartered credit unions, on an annual basis. The Division is also charged with licensing and examining over 5,000 non-bank entities, including mortgage lenders and brokers, check cashers and sellers, automobile sales finance companies, debt collectors, foreign transmittal agencies, insurance premium finance agencies, retail installment sales, and small loan agencies. DOB received appropriations of state funds of \$11,178,594 and \$12,000,812 for fiscal years 2006 and 2007, respectively.

The Massachusetts Office of Consumer Affairs and Business Regulation (OCABR) provides strategic and tactical planning as well as administrative oversight to DOB operations. DOB's Management Information Systems (MIS) department, in conjunction with OCABR, supports the Division's computer operations. Connectivity to computer operations are supported through the use of a Local Area Network (LAN) and through the Commonwealth's Wide Area Network (WAN). The LAN, consisting of four file servers and 150 notebook computers and 65 workstations, is used to process a variety of administrative and financial information.

The DOB utilizes the General Examination System (GENESYS) application provided by the Federal Deposit Insurance Corporation (FDIC) to perform examinations of state-chartered banks. The DOB also uses the Automated Integrated Regulatory Examination System (AIRES) developed and maintained by the National Credit Union Association (NCUA) to conduct examinations of state-chartered credit unions.

The NCUA is an agency of the United States Department of the Treasury whose mission is to insure the deposits in state-chartered credit unions.

The Office of the State Auditor's internal control examination was limited to a review of certain IT general controls over and within the DOB's IT environment and controls related to the monitoring and oversight of mortgage lenders and brokers under the authority of the Division of Banks.

AUDIT SCOPE, OBJECTIVES, AND METHODOLOGY

Audit Scope

In accordance with Chapter 11, Section 12, of the Massachusetts General Laws, we performed an information technology (IT) general controls examination of IT-related activities at the Division of Banks (DOB) for the period of July 1, 2005 through October 5, 2007. The audit was conducted from April 2, 2007 through October 26, 2007. Our audit scope included a general controls examination of internal controls related to the organization and management of IT activities and operations, physical security, environmental protection, system access security for the DOB's application systems, inventory control over computer equipment, business continuity planning, and on-site and off-site storage of backup copies of magnetic media. We also performed a review of the monitoring and oversight process of mortgage lenders and brokers under the regulatory authority of the Division of Banks.

Audit Objectives

The primary audit objective was to determine whether the IT environment has sufficient internal controls to support DOB's automated systems and to safeguard computer equipment. We sought to determine whether the IT-related internal control environment, including documented policies and procedures, provided reasonable assurance that IT control objectives would be achieved to support the Division's mission. We sought to determine whether adequate physical security and environmental protection controls were in place and in effect to prevent damage, unauthorized access to, or loss of IT-related assets. Our objective regarding system access security was to determine whether adequate controls were in place to ensure that only authorized personnel had access to DOB's automated systems and data files. We also determined whether the data was sufficiently protected against unauthorized disclosure, change, or deletion. We sought to determine whether password administration was being properly controlled and monitored.

With regard to inventory control over IT equipment, we evaluated whether an annual physical inventory and reconciliation was conducted and whether IT equipment was accurately reflected, accounted for, and properly maintained in the system of record. Regarding systems availability, we sought to determine whether adequate business continuity plans were in effect to help ensure that mission-critical and essential systems could be regained within an acceptable period of time should a disaster render processing inoperable or inaccessible. Moreover, we sought to determine whether adequate controls were in place to provide reasonable assurance that appropriate backup copies of application systems and data files would be available on-site and off-site to support disaster recovery and business continuity planning objectives.

We sought to determine the extent to which technology is used to support the licensing and the conducting of examinations for mortgage lenders and brokers. Further, we sought to assess the DOB's capacity to perform examinations to protect consumers and to evaluate the financial viability of the mortgage lender and broker entities throughout the Commonwealth.

Audit Methodology

To determine our audit scope and objectives, we initially obtained an understanding of the DOB's mission and business objectives. Through pre-audit interviews with managers and staff and reviews of documents, such as descriptions of the DOB's organization and operations, we gained an understanding of the primary business functions supported by the automated systems. We documented the significant functions and activities supported by the automated systems and reviewed automated functions designated as mission-critical by the DOB.

Regarding our review of IT organization and management, we interviewed senior management from DOB and OCABR and analyzed and reviewed the organizational structure and reporting lines of the DOB's IT staff. We obtained, reviewed, and analyzed selected IT-related policies and procedures to determine their adequacy. To determine whether the DOB's IT-related job descriptions and job specifications were up-to-date and reflected current responsibilities, we obtained a current list of the personnel employed as DOB IT staff, including their duties and job descriptions, and compared the list to the IT staff's organizational chart.

To evaluate physical security, we interviewed management and conducted a walk-through of areas housing IT equipment, such as the file server room and administrative offices. Through observation and tests, we determined the adequacy of physical security controls over areas housing IT equipment. In this regard, we examined the existence of controls such as office door locks and intrusion alarms. We determined whether individuals identified as being authorized to access areas housing computer equipment were current employees of DOB or OCABR and that these areas were restricted to only authorized personnel. Further, we reviewed procedures to document and address security violations and/or incidents and requested a list of key holders to areas housing computer equipment.

To determine whether adequate environmental protection controls were in place to properly safeguard automated systems from loss or damage, we checked for the presence of smoke and fire detectors, fire alarms, fire suppression systems (e.g., sprinklers and inert-gas fire suppression systems), an uninterruptible power supply (UPS) and surge protectors for automated systems, and emergency power

generators and lighting. We reviewed general housekeeping procedures to determine whether only appropriate office supplies and equipment were placed in the file server room or in the vicinity of computer-related equipment. To determine whether proper temperature and humidity controls were in place, we reviewed for the presence of appropriate dedicated air conditioning units in business offices and the data center that houses the file servers. Further, we reviewed control procedures to prevent water damage to automated systems, agency records, and magnetic backup media stored on site.

With regard to inventory control over IT equipment, we evaluated whether an annual physical inventory was conducted, whether IT equipment was accurately reflected in the fixed-asset inventory, and whether the IT inventory system of record was properly maintained. We also evaluated whether the IT resources were properly accounted for in the system of record. To determine whether adequate controls were in place and in effect to properly account for DOB's computer equipment, we reviewed inventory control policies and procedures and requested and obtained DOB's inventory system of record for computer equipment. We reviewed the current system of record to determine whether it contained appropriate data fields to identify, describe, and indicate the value, location, and condition of the computer equipment. We generated a sample of inventory records using ACL and tested them from both floor-to-list and list-to-floor at the main office and at the regional office in Springfield. To determine whether the system of record for computer equipment for fiscal year 2007 was current, accurate, and valid, we used a statistical sample of 72 items (21.5%) out of a total population of 334 items. Our tests included tracing the inventory tags and serial numbers of the hardware items listed on the inventory record to the actual equipment on hand. We also judgmentally selected an additional 20 items to identify and compare information from the selected items back to information contained on the inventory system of record.

To determine whether DOB complied with Commonwealth of Massachusetts regulations for accounting for assets, we reviewed evidence supporting DOB's performance of an annual physical inventory of IT assets. Finally, to determine whether DOB was in compliance with Chapter 647 of the Acts of 1989 regarding reporting requirements for missing or stolen assets, we reviewed incident reports for missing or stolen IT-related equipment for the audit period and verified whether these incidents were reported to the Office of the State Auditor.

To obtain an understanding of access security controls, we reviewed the DOB's access security policies and procedures that would provide reasonable assurance that only authorized users had access to the systems and to prevent unauthorized access to DOB's applications systems and data files. Our test of system access security controls included a review of user accounts for all DOB employees who were authorized to access DOB and OCABR application systems. We also reviewed job descriptions for

individuals possessing supervisory levels of access. To determine whether system access security was being properly maintained through the management of user IDs and passwords, we compared the system user list consisting of 156 user accounts provided by the DOB to a current employee list. We also reviewed password administration controls, such as user account activation and deactivation, password length and composition, and the frequency of password changes.

To assess the adequacy of system availability, we determined whether formal planning had been performed to develop and maintain a business continuity plan to resume computer operations should the network application systems be inoperable or inaccessible. We also determined whether the criticality of application systems had been assessed, and whether risks and exposures to computer operations had been evaluated. To evaluate the adequacy of controls to protect data files through the backup of on-site and off-site magnetic media, we interviewed both DOB and OCABR staff regarding the generation of backup copies of computer-related media. We also reviewed physical security and environmental protection at the off-site storage location in Springfield.

To assess the adequacy of the use of technology in monitoring and oversight of mortgage brokers and lenders, we reviewed DOB's tracking database used in the licensing and examination process. We obtained and reviewed the statutory requirements regarding the licensing and examination of mortgage brokers and lenders within the Commonwealth. We obtained, reviewed, and compared the number of licensees and examinations performed over a five-year period from 2003 through September 2007. We reviewed the license renewal process to gain and record an understanding of the DOB's criteria used to issue or grant a license or a renewal to a mortgage lender or broker. We obtained and reviewed a sample of 4 examinations for mortgage lenders and brokers to identify the areas evaluated by DOB for compliance with their established requirements. We observed and conducted interviews relative to the mortgage foreclosure hotline established in 2007 and researched relevant information regarding the current mortgage crisis. We also attended public hearings conducted by DOB regarding proposed amendments to strengthen public confidence in the regulations governing licensed mortgage lenders and brokers.

Our audit was performed in accordance with Generally Accepted Government Auditing Standards (GAGAS) issued by the Comptroller General of the United States and generally accepted industry practices. Criteria for the IT portion of our audit included management control practices outlined in Control Objectives for Information and Related Technology (CobiT), issued by the Information Systems Audit and Control Association, July 2000.

AUDIT CONCLUSION

Based on our audit, we determined that additional resources are needed to enable the Division of Banks (DOB) to more adequately address its responsibilities to license and examine mortgage brokers and lenders. Our audit also revealed that controls pertaining to disaster recovery and business continuity planning needed to be strengthened. Our audit found that internal controls in place provided reasonable assurance that IT-related control objectives pertaining to organization and management, physical security, environmental protection, system access security, inventory control over computer equipment, and on-site and off-site storage of backup copies of magnetic media would be met.

Based on our review of DOB's processes for licensing, monitoring, and providing oversight of mortgage lenders and brokers, we found that the Division used technology to support licensing operations, track consumer complaints against mortgage brokers and lenders, and support examination procedures. Although we believe that the DOB exercises due diligence regarding the licensing of mortgage lenders and brokers, additional resources are needed to perform an increased number of examinations, especially in light of the current crisis in the mortgage credit industry. The DOB has taken appropriate steps to reallocate resources within the Division to better address the increased volume of examinations over mortgage lenders and brokers, and to support a newly established hotline for consumers to register credit complaints. Since resources are being drawn from other examination areas, the DOB needs to closely monitor the impact of shifting resources to ensure that examination objectives in other areas are not being jeopardized.

The problems currently facing the mortgage industry nationally stem from a wide range of factors. It is evident that a weakening in the quality of loan reviews, the absence of sufficient regulatory requirements, the lack of licensing of loan originators, inadequate controls, and insufficient risk-based models have all contributed to make this a national crisis. We believe that additional factors have also contributed to the problem, such as financial incentives for brokers and lenders that were at cross purposes with sound mortgage lending practices, greed, mortgage fraud, and transferring responsibilities for bundled high-risk revenue streams in the form of Collateralized Debt Obligations (CDOs). During the period of time since problems in the industry began to surface last year, the Division of Banks has taken a proactive role in providing valued input to banking, regulatory and legislative communities to help develop corrective strategies.

With respect to IT general controls, our review of IT-related organizational and management controls indicated that the DOB had a defined IT organizational structure, an established chain of command, clearly delineated reporting responsibilities, and documented job descriptions for the three members of the IT staff. Our review of IT internal controls found that the DOB, in conjunction with the Office of Consumer Affairs and Business Regulation (OCABR), had developed and documented policies and procedures for IT-related functions.

We found that physical security controls provided reasonable assurance that IT resources located in the Division's offices, off-site storage area, and file server room were adequately protected against unauthorized physical access. We found that the combination of preventive and detective controls, including management control practices, provided reasonable assurance that IT equipment would be protected against unauthorized access, damage or theft.

We found that environmental protection controls over the file server room and office areas provided reasonable assurance that IT resources were operating in a controlled environment. We confirmed that the DOB, in conjunction with OCABR, had policies, procedures, and appropriate control mechanisms in place to address environmental protection objectives. Specifically, we found that control objectives related to air conditioning; fire prevention, detection, and suppression; emergency power and lighting; and power shut-off would be met. We note that although general housekeeping controls in the file server room needed to be improved, upon our recommendation, the condition was corrected during the course of the audit. We recommend that OCABR monitor the general housekeeping condition of the file server room. In addition, we suggest that OCABR reinforce the importance of properly maintaining the file server room to all three entities currently sharing the room.

Regarding system access security, we found that controls for the DOB's application systems provided reasonable assurance that only authorized users had access to the DOB's application programs and data files residing on file servers and workstations. We found that users were properly authorized, and that administrative controls over user IDs and passwords provided reasonable assurance that access privileges would be deactivated, or appropriately modified, should personnel terminate employment or incur a change in job requirements. Although our audit tests confirmed that all current users were DOB employees, two user accounts needed to be deactivated. We determined that neither of the limited access accounts had been used since the individuals had left the employment of the Division. DOB management subsequently identified the user accounts in question as being assigned to former summer interns who had limited access privileges, and immediately deleted the accounts when we brought this issue to their attention. Regarding password security, all users are required to change their password

within a pre-defined time period, and passwords must meet a defined length of alpha/numeric characters as recommended by the Commonwealth's Information Technology Department. During the course of our audit, nothing further came to our attention to indicate that there were weaknesses in the DOB's access security controls.

With respect to inventory control over computer equipment, we found that a complete and accurate list of computer equipment was being maintained. The inventory list, which assists DOB management in identifying IT resources under its control, is also provided to OCABR to help ensure that the official system of record for property and equipment is accurate and complete for IT resources allocated to the DOB. We confirmed that the DOB performed annual physical inventories and reconciliations to address accounting requirements promulgated by the Office of the State Comptroller. Our tests indicated that hardware items were locatable, properly accounted for, and tagged. However, we believe that including lease expense terms for all computer equipment deployed would enhance the computer equipment inventory record.

Although the DOB had a detailed Continuity of Operations Plan (COOP) that provided business continuity plans for Division operations, a detailed IT business continuity plan outlining specific procedures for IT recovery strategies was unavailable. Although we acknowledge that the DOB has taken steps to address disaster recovery and business continuity planning for IT systems by designating an alternate processing site and implementing on-site and off-site storage of backup copies, the Division needs to further document the details of its recovery strategies and conduct sufficient tests to provide adequate assurance of the plan's viability.

AUDIT RESULTS

1. Oversight of Mortgage Brokers and Lenders

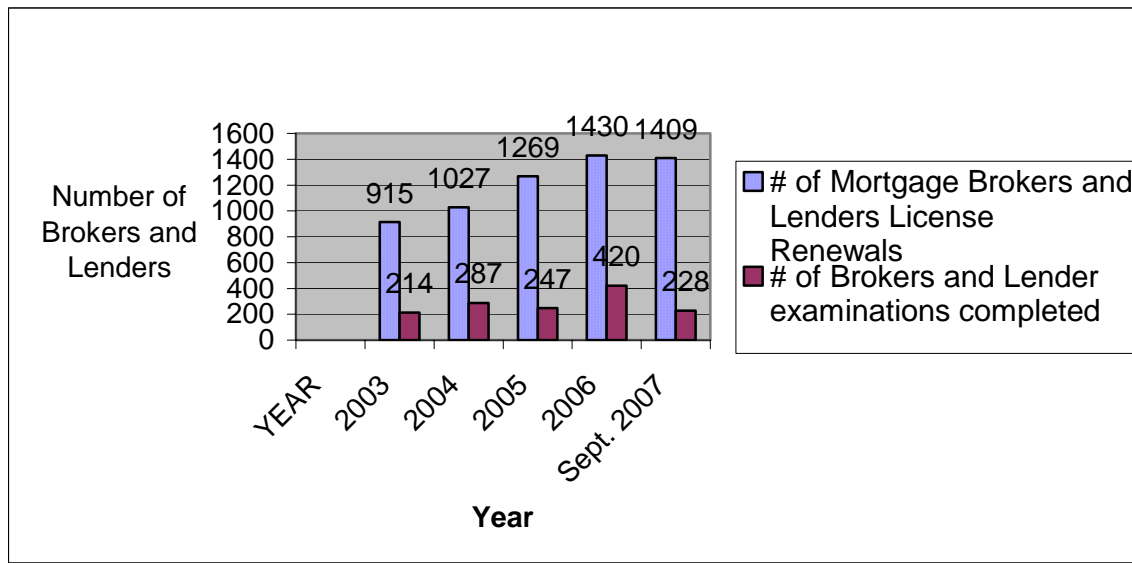
Although our audit indicated that DOB has made a concerted effort to provide sufficient oversight of mortgage lenders and brokers, DOB's capacity to perform examinations has not kept pace with the increase in the number of mortgage lenders and brokers under its authority. Based on our review of DOB's processes for licensing, monitoring, and providing oversight of mortgage lenders and brokers, we found that the Division used technology to support licensing operations, track consumer complaints against mortgage brokers and lenders, and to support examination procedures. Our audit revealed that DOB has reallocated personnel from its banking and credit union divisions on a temporary basis to assist in the monitoring and resolution of consumer complaints regarding mortgage brokers and lenders. DOB stated that there has not been a negative impact on its ability to supervise state-chartered banks and credit unions for the short term. However, from a strategic standpoint, without additional resources, DOB's mission to ensure public confidence relative to the safety and soundness of the mortgage credit industry in the Commonwealth could be impacted. According to DOB management, the number of staff needed to perform examinations of non-bank entities should be increased by a factor of approximately 100 percent to adequately monitor and evaluate these entities, including mortgage brokers and lenders.

The mortgage industry has undergone significant changes over the past fifteen years. The introduction of new financial products and the development of the sub-prime mortgage market necessitated further regulation and oversight of the industry. The Massachusetts Legislature, beginning in 1991, mandated that the Division of Banks be responsible for the licensing of mortgage brokers and lenders.

Our audit revealed the number of mortgage brokers and lenders licensed by the Division of Banks has dramatically escalated since 2003. According to statistics provided by the DOB, there were a total of 915 licensed mortgage brokers and lenders in 2003, of which a total of 214 examinations were completed. As of September 2007, the number of mortgage brokers and lenders had increased by 54 percent, to 1,409 and the number of examinations completed as of September 19, 2007 was only 228. As result of the increase in the amount of licensed brokers and lenders, combined with the current financial crisis in the mortgage industry, DOB should increase

examination staffing to support a higher frequency of examinations and to ensure that consumers seeking mortgages are protected from unscrupulous lenders and brokers.

Number of Examinations Completed for Licensed Mortgage Brokers and Lenders



DOB uses an in-house licensing system for mortgage lenders and brokers. While DOB is able to track individuals and companies operating in Massachusetts, there is no means to determine whether an out-of-state company that is applying for a license in Massachusetts has violated consumer protection or other laws and regulations in other states. Four years ago, DOB began working with other states on a Nationwide Mortgage Licensing System that would provide information that could help identify questionable lending practices to help prevent mortgage fraud. This system is targeted to begin operations on January 2, 2008, with DOB scheduled to be one of the first agencies to use the system.

Although the DOB has established its own process for monitoring mortgage lenders and brokers, our audit revealed that there are currently no specific statutes regulating or governing the frequency and nature of examination for mortgage lenders and brokers. Senior management schedules the examinations on a risk-based approach of mortgage brokers and lenders, similar to the method used for the examination of banks and credit unions. The DOB makes use of a numerical rating system based on the Federal Financial Institutions Examination Council's (FFIEC) "Uniform Financial Institutions Rating System", where licensees are rated from 1 to 5,

with 1 being the strongest. Individual ratings are assigned to 6 key performance factors identified by the acronym “CAMELS”: Capital Adequacy, Asset Quality, Management, Earnings, Liquidity, and Sensitivity. From these individual ratings an overall rating is determined. In addition, complaints telephoned to the consumer hotline provide another cause for examination. As a result of the increase in mortgage foreclosures on both the state and national level, the DOB hotline has been enhanced whereby the DOB will seek a delay in the foreclosure process for any Massachusetts homeowner that complains to the Mortgage Hotline.

The current crisis in the mortgage industry is a serious national problem that requires comprehensive analysis and examination to bring about corrective action and stability to the industry. According to real estate industry analysts, the national foreclosure rate for the period January 1, 2007 to June 30, 2007 increased over 55 % over the same time frame as the previous year. According to the data pertaining to foreclosure filings, the Commonwealth of Massachusetts reported a total of 23,116 foreclosure filings during the period April 2006 to April 2007. Factors such as the slowing of home sales, the upward re-pricing of adjustable rate mortgages, the decline of equity positions, and the reduction in the ability to consolidate consumer debt and existing home mortgages into lower monthly payments have all contributed to the foreclosure crisis. The maturation of a growing number of subprime loans, non-traditional mortgage loans, and increasing evidence of mortgage fraud are also contributing to the present problem. This indicator clearly demonstrates the need for more comprehensive monitoring and oversight of the mortgage industry. More stringent use of risk-based models to cover credit risk and securitization exposure, validation of risk parameters and risk ratings, and rigorous attention to internal control are needed.

Recommendation:

As a result of the increase in the number of licensed brokers and lenders, combined with the current credit market problems with insufficiently-collateralized loans and the mortgage foreclosure crisis, we recommend that the DOB increase the number of examiners to fulfill its mission of ensuring public confidence in the mortgage industry in the Commonwealth. We recommend that DOB use this increased staffing to increase the frequency and number of examinations of mortgage brokers and lenders under its regulatory authority. The increased need for financial examiners correlates with the increased number of mortgage brokers and lender licensees over the past five years, as well as with the anticipated continuation of the mortgage industry crisis. Nationally, the complexity of new financial products, combined with failures of

internal control, inadequate oversight of mortgage originators, and the substantial increase in the amount of mortgage brokers and lenders, has created a mandate for stricter regulation of the industry. We acknowledge that the DOB has proposed legislative relief. We recommend that the DOB continue to pursue legislation (House Bill No. 4047 –“An Act Relative to The Supervision of the Mortgage Industry”) to allow DOB to establish a separate fund to expand personnel and to increase the monitoring and oversight of mortgage brokers and lenders under its jurisdiction. DOB has proposed, among other things, to use the increased funding to establish a mortgage fraud investigation and enforcement unit. We also recommend that DOB pursue other technology solutions to enhance its supervision of mortgage lenders and brokers.

Auditee’s Response:

Staffing and Examinations

The IT Audit recommends that the Division increase the number of examiners in order to increase the number of examinations performed of licensed mortgage lenders and brokers. The IT Audit recognizes the dramatic increase (over tenfold) in the number of licensed mortgage lenders and mortgage brokers since the Division first started licensing these entities in 1992. The Division currently supervises over 2,000 licensed mortgage lenders and brokers with less full-time equivalent (FTE) staff than in 1992.

In recognition of the need to increase staff to supervise the mortgage industry, the Division, in cooperation with the administration of Governor Deval Patrick, has worked closely with the Joint Committee on Financial Services. House Chairman Ronald Mariano has filed legislation (H4047) to enable the Division to raise licensing fees, retain the increase in the form of a trust, and expend monies from the trust for increased staffing in the area of mortgage supervision. The Division has proposed using revenue from increased fees to establish a mortgage fraud investigation and enforcement unit. The Division will continue to seek passage of H4047 as soon as possible to enable the Division to enhance its current ability to supervise all licensed mortgage brokers and lenders.

During 2006 and 2007, notwithstanding the need for additional resources, the Division has addressed emerging issues as they have developed to ensure adequate supervision of the mortgage industries. In 2006 and through September 30, 2007, the Division has issued a total of over 250 enforcement actions against mortgage brokers and lenders. In the fall of 2006, in response to instances of mortgage fraud found in Division examinations in several low- and moderate-income communities in the Commonwealth, the Division conducted nearly 100 surprise visitations of mortgage brokers resulting in 17 enforcement actions. In early 2007, in response to tightening liquidity in the mortgage markets resulted in the Division conducting approximately 100 visitations this time of licensed mortgage lenders.

Since January of this year, the Division has taken a lead role among regulators nationally by hosting and moderating weekly conference calls of all State mortgage regulators to discuss problem areas and ways to ensure consumers

are protected. I appreciate the acknowledgment in the IT Audit of the Division's proactive role not only in this but in other areas noted below.

Regulation of the Industry

The IT Audit states that the increase in licensed mortgage brokers and lenders highlighted above, together with increasingly complex mortgage products and a breakdown of lending operations requires increased regulation of the mortgage industry.

The Division recognized those developments and enhanced its supervision of mortgage lenders and brokers and has worked closely with the Patrick Administration, the Legislature, the Office of the Attorney General, and Congressman Frank to increase funding, amend statutes, and on several additional initiatives. In fact, the Division has been a leader in enhancing its regulation and supervision of mortgage lenders and mortgage brokers.

(See Appendix for full text)

Technology Solutions

The IT Audit also recommends that the Division "pursue other technology solutions to enhance its supervision of mortgage lenders and brokers". The IT Audit recognizes the Division has been working for four years on a Nationwide Mortgage Licensing System (NMLS) which is scheduled to go live in just 7 weeks on January 2, 2008. The NMLS will provide a single platform for licensing non-bank mortgage lenders, brokers, and originators as well as a central repository of information about licensing and enforcement actions. The system will also facilitate the use of fingerprinting and FBI criminal background histories.

Most importantly, the NMLS will be the foundation for coordinated supervision of multi-state mortgage entities on a going forward basis. Opportunities for forum shopping or moving an entity across state lines to avoid regulation will be eliminated. I believe the NMLS is the single most important initiative ever undertaken relative to the supervision of the non-bank mortgage industry. Longer-term, the NMLS provides an opportunity for additional technology solutions, including possible complaint case management and multi-state examination scheduling and coordination.

Auditor's Reply:

Many of the actions being taken by DOB are certainly complementary, and indicate an effort to tighten controls, increase examinations of mortgage lenders and brokers, and enhance monitoring capabilities through the use of technology and shared data. However, many of the procedures and mechanisms being implemented and control practices being sought are to a certain extent reactionary, and had not been given the same level of attention prior to the credit crisis. The Division should ensure that more comprehensive risk management approaches and vulnerability assessments are exercised by brokers and lenders to identify control weaknesses in industries that

are either poorly regulated or unregulated to potentially negate future crisis. The DOB should ensure that mortgage brokers and lenders have adopted risk-based mortgage practices that incorporate capital requirements more sensitive to credit risk, more aggressive loan review and validation. We agree with the Division's efforts to educate borrowers regarding the risks involved in managing credit and in addressing the need to license loan originators.

As your response indicates, "the Division conducted nearly 100 surprise visitations of mortgage brokers resulting in 17 enforcement actions". The 17% rate of enforcement actions demonstrate an acute need for additional monitoring and oversight of mortgage lenders and brokers through visitations.

2. Disaster Recovery and Business Continuity Planning

Our audit revealed that the DOB, in conjunction with the Massachusetts Office of Consumer Affairs and Business Regulation (OCABR), developed a disaster recovery and business continuity plan for restoring processing functions in the event that automated systems were rendered inoperable or inaccessible. However, while we acknowledge the existence of a documented business continuity plan, we found no evidence that DOB had conducted any recovery tests of the plan. According to management, DOB's active participation supporting the Massachusetts Emergency Management Agency's (MEMA) project to comply with Massachusetts Executive Order No. 144, directing all state executive agencies to prepare for emergencies and disasters, took priority over further development, including testing of the business continuity plan.

The lack of a formally tested plan to address the resumption of processing capabilities may significantly impact DOB's recovery efforts to properly restore mission-critical, essential, and confidential data. Without a formal, tested recovery strategy, DOB might experience delays in re-establishing mission-critical functions such as processing of bank examinations, credit union reviews, and licensing renewals of non-banking entities. Recovery tests are a key component of a formal business continuity plan.

The objective of business continuity planning is to help ensure timely recovery of mission-critical functions, should a disaster cause significant disruption to business or computer operations. Business continuity planning for information services is part of business continuity planning for the entire organization. Generally accepted business practices and industry standards for computer operations support the need for the DOB and OCABR to have an ongoing business

continuity planning process that assesses the relative criticality of information systems, maintains appropriate contingency and recovery plans, and conducts recovery tests to provide assurance of the viability of the business continuity plans. To that end, DOB, in conjunction with OCABR, should assess the extent to which it is dependent upon the continued availability of information systems for all required processing or operational needs, and conduct tests for its recovery plans based on the critical aspects of its information systems.

Regarding our examination of backup computer media, we found that controls were in place to provide reasonable assurance that control objectives relating to the physical security over the storage of computer media would be met. However, our audit revealed weaknesses in the timeliness of storing the backup copies of magnetic media off-site.

We found that each DOB location conducted system backups on a daily basis, and the backup tapes were kept at secure on-site locations. Our examination also revealed that weekly backups were being performed at the end of each weekend and stored off-site at a designated regional office. However, we found that the central office located in Boston retains the most current copy of its backup for the following week, to accommodate various requests for file and data restorations, while transporting the previous weekly backup to a regional office. Therefore, the backup copies of information being stored off-site is never less than one week old, and can extend to two weeks, which could result in significant delays to recovery efforts should DOB experience a loss or disruption to their automated systems. Because the backup copies used to recover the system do not contain the timeliest data available, we believe that deferred off-site storage of data could impede efforts to recover electronically processed information in a timely manner.

Recommendation:

We recommend that the DOB, in conjunction with OCABR, assess their automated processing environment from a risk management and business continuity perspective and develop and test appropriate business continuity and contingency plans. We recommend that an assessment of criticality and business impact be performed at least annually, or upon major changes to DOB's operations or the overall IT environment.

The business continuity plan should document DOB's recovery and contingency strategies with respect to various disaster scenarios and outline any necessary contingencies. The recovery plan should contain all pertinent information, including clear delineation of key personnel and their roles and responsibilities, needed to effectively and efficiently recover network or IT operations

within the prescribed time frames. We recommend that business continuity be tested and periodically reviewed and updated as needed, based on test results, to ensure the viability of the plan. DOB's completed plan should be distributed to all appropriate staff, who in turn should be trained in the execution of the plan under emergency conditions. In addition, a complete copy of the plan should be stored in a secure off-site location.

We acknowledge DOB's efforts to actively support MEMA's Continuity Of Operations project to comply with Massachusetts Executive Order No. 144. However, we recommend that DOB enhance its efforts to develop and maintain a formal business continuity plan for the timely restoration of mission critical and essential business functions.

We recommend that DOB formally test its disaster recovery plans to assess the viability of the plans and thereby reduce restoration time, to minimize the risk of errors or omissions of necessary processes and procedures, and to mitigate any negative impact to the recovery of its business functions.

Auditee's Response:

The IT Audit notes that, while the Division has a Continuity of Operations Plan (COOP) to address disaster recovery and business continuity in the event of a disaster or other event which renders the Division's IT systems inoperable, it has not conducted a test of the plan. The IT Audit recommends that the Division not only assess its IT environment from a risk management and business continuity perspective, but also that the Division test the plan and refine the plan as a result of the test.

The Division places a priority on disaster recovery and business continuity. Several years ago, the Division invested in the necessary IT resources to allow the Division to resume operations from its Springfield Field Office in the event of an emergency. Division senior staff has been provided with Government Emergency Telecommunication Service (GETS) cards through the Department of the Treasury. These calling cards allow authorized staff to secure a prioritized phone line during an actual emergency. The Division has also developed a thorough COOP Plan under the direction of the Massachusetts Emergency Management Agency (MEMA) and the Office of Consumer Affairs (OCA). The Division is also an active participant in the U.S Treasury Department's financial inter-agency coordinating body. The purpose of this interagency group is to ensure the integrity of the financial system against homeland security threats. In addition, the Division has developed a Flu Pandemic Plan to ensure continued operations in the event of a flu pandemic. The Division also recently participated in the Financial Banking Information Infrastructure Committee (FBIIC) and the Financial Services Sector Coordinating Council (FSSCC) Pandemic Flu Exercise. This exercise involving over 2,700 industry and government organizations was intended to test existing

flu pandemic plans and to determine the risks to the financial services sector as a result of a flu pandemic.

The Division agrees with the IT Audit's recommendation on the need to test its disaster recovery and business continuity plans. While prior versions of this plan were activated during Y2K and shortly after 9/11 and thereafter modified, in response to the IT Audit recommendations, Division IT Management will perform a risk assessment of our automated processing environment, develop and test business continuity and contingency plans, and will perform an annual disaster recovery test no later than March 31, 2008. All sections within the Division will be required to submit a business continuity plan, which will be validated by IT and included in the overall COOP Plan. This plan will be reviewed and updated twice yearly or more often if necessary, distributed to all relevant staff members, and stored at a secure off-site location.

Auditor's Reply:

We acknowledge DOB's efforts to enhance and test the COOP plan as a necessary first step in developing a comprehensive and formalized business continuity plan; however, the COOP plan does not provide sufficiently detailed recovery strategies to restore the IT processing environment and automated systems to support DOB's business objectives. We encourage DOB management to evaluate, continue to test, and approve and finalize a comprehensive business continuity strategy. Once developed, the business continuity plan should be reviewed and updated annually, or whenever there are significant changes to processing requirements, risks, or the DOB's IT infrastructure.

APPENDIX –Auditee’s Response

DEVAL L. PATRICK
GOVERNOR

TIMOTHY P. MURRAY
LIEUTENANT GOVERNOR

DANIEL O'CONNELL
SECRETARY OF HOUSING AND
ECONOMIC DEVELOPMENT

The Commonwealth of Massachusetts
Office of the Commissioner of Banks
One South Station
Boston, Massachusetts 02110

DANIEL C. CRANE
DIRECTOR, OFFICE OF
CONSUMER AFFAIRS AND
BUSINESS REGULATION

STEVEN L. ANTONAKES
COMMISSIONER OF BANKS

November 16, 2007

Mr. John W. Beveridge
Deputy Auditor
Office of the State Auditor
One Ashburton Place, Room 1819
Boston, MA 02108

Re: 2007-0100-4T

Dear Mr. Beveridge:

This letter serves as the response of the Division of Banks (Division) to the Office of the State Auditor’s Report on the Examination of Information Technology-Related Controls at the Massachusetts Division of Banks (IT Audit). The IT Audit of the Division covered the period between July 1, 2005 and October 5, 2007. The IT Audit included a review of certain IT controls within the Division’s IT environment as well as controls related to the Division’s supervision of licensed mortgage lenders and mortgage brokers.

The Audit Results section of IT Audit made recommendations in two areas: oversight of mortgage brokers and lenders, and disaster recovery and business continuity planning. Below is the Division’s response to each of these areas as well as what actions the Division has taken or will take as a result of the IT Audit’s recommendations.

I. Oversight of Mortgage Brokers and Lenders

Staffing and Examinations

The IT Audit recommends that the Division increase the number of examiners in order to increase the number of examinations performed of licensed mortgage lenders and brokers. The IT Audit recognizes the dramatic increase (over tenfold) in the number of

licensed mortgage lenders and mortgage brokers since the Division first started licensing these entities in 1992. The Division currently supervises over 2,000 licensed mortgage lenders and brokers with less full-time equivalent (FTE) staff than in 1992.

In recognition of the need to increase staff to supervise the mortgage industry, the Division, in cooperation with the administration of Governor Deval Patrick, has worked closely with the Joint Committee on Financial Services. House Chairman Ronald Mariano has filed legislation (H4047) to enable the Division to raise licensing fees, retain the increase in the form of a trust, and expend monies from the trust for increased staffing in the area of mortgage supervision. The Division has proposed using revenue from increased fees to establish a mortgage fraud investigation and enforcement unit. The Division will continue to seek passage of H4047 as soon as possible to enable the Division to enhance its current ability to supervise all licensed mortgage brokers and lenders.

During 2006 and 2007, notwithstanding the need for additional resources, the Division has addressed emerging issues as they have developed to ensure adequate supervision of the mortgage industries. In 2006 and through September 30, 2007, the Division has issued a total of over 250 enforcement actions against mortgage brokers and lenders. In the fall of 2006, in response to instances of mortgage fraud found in Division examinations in several low- and moderate-income communities in the Commonwealth, the Division conducted nearly 100 surprise visitations of mortgage brokers resulting in 17 enforcement actions. In early 2007, in response to tightening liquidity in the mortgage markets resulted in the Division conducting approximately 100 visitations this time of licensed mortgage lenders.

Since January of this year, the Division has taken a lead role among regulators nationally by hosting and moderating weekly conference calls of all State mortgage regulators to discuss problem areas and ways to ensure consumers are protected. I appreciate the acknowledgment in the IT Audit of the Division's proactive role not only in this but in other areas noted below.

Regulation of the Industry

The IT Audit states that the increase in licensed mortgage brokers and lenders highlighted above, together with increasingly complex mortgage products and a breakdown of lending operations requires increased regulation of the mortgage industry.

The Division recognized those developments and enhanced its supervision of mortgage lenders and brokers and has worked closely with the Patrick Administration, the Legislature, the Office of the Attorney General, and Congressman Frank to increase funding, amend statutes, and on several additional initiatives. In fact, the Division has been a leader in enhancing its regulation and supervision of mortgage lenders and mortgage brokers. Below is a partial list of the regulatory initiatives undertaken by the Division over the last 14 months (for a more detailed listing of the projects undertaken to address increasing foreclosures, see the attachment, "Massachusetts Foreclosure Initiatives"):

- In September 2006, the Division issued a letter to the mortgage lenders and brokers regarding reduced documentation loan programs warning of the actions to be taken by the Division in cases of false or inflated borrower income.

- Also in September 2006, the Division issued emergency regulations governing mortgage lenders and brokers to expand the prohibited acts and practices to include inflating borrower income or requiring a borrower to sign blank or incomplete documents.
- On November 14, 2006, in response to rising foreclosures in Massachusetts, the Division hosted a Mortgage Summit comprised of nearly 50 participants from government, non-profit, and the mortgage lending industries to develop a foreclosure prevention strategy. The full day summit resulted in a consensus that further cooperation was necessary and a willingness by participants to continue to work together to forge a foreclosure prevention strategy.
- As a result of the Mortgage Summit two Working Groups were formed and began meeting in January 2007: one looking at rules and enforcement and the second focusing on consumer education and foreclosure assistance. The purpose of the Working Groups was to take the ideas of the Summit and develop concrete recommendations to both help consumers confronted with the loss of their homes as well as to address longer-term issues affecting communities across the Commonwealth of Massachusetts.
- On January 2, 2007, the Division released a Regulatory Bulletin on “Guidance on Nontraditional Mortgage Product Risks”. The Guidance, which mirrors the federal Guidance issued at the end of 2006, is intended to clarify how mortgage lenders and mortgage brokers can offer nontraditional mortgage products in a way that clearly discloses the risks that borrowers may assume.
- On April 30, 2007, Governor Deval Patrick directed the Division to seek delays from mortgage lenders or servicers, on a case-by-case basis, for any Massachusetts homeowner who filed a complaint with the Division of Banks. As part of this process, the Division would refer consumers to a credit or foreclosure counselor. Lenders are also urged to work with consumers facing difficulty on their mortgage payments and to consider reasonable loan workouts or modifications. To date, over 1100 consumers have contacted the Division and over 500 stays in the foreclosure process have been secured.
- On June 11, 2007, the Governor filed a bill covering the legislative recommendations from the Mortgage Summit Working Groups. See House 4085.
- On July 2, 2007, the Division issued a revised Regulatory Bulletin on the experience requirements for mortgage lenders and mortgage brokers. The prior experience requirement for a person to obtain a mortgage broker license raised from one year to three years and for a mortgage lender from one to five years.
- On September 7, 2007, the Division issued final amendments to its regulations governing licensing mortgage lenders and mortgage brokers. The amendments increase the minimum net worth requirement for licensed mortgage lenders and establish a minimum net worth requirement to implement the financial responsibility requirement for licensed mortgage brokers. A surety bond requirement for both licensed entities was also established.

- On September 10, 2007, the Division released a Regulatory Bulletin on subprime lending. The “Statement on Subprime Lending”, which mirrors the federal Statement issued in July, is intended to clarify how mortgage lenders and mortgage brokers can offer subprime mortgage products in a way that clearly discloses the risks that borrowers may assume.

In addition, the Division and the Patrick Administration have testified in favor of legislation that would create several new mandates for the mortgage industries, including licensing of mortgage loan originators; extending the Commonwealth’s Community Reinvestment Act (CRA) to certain mortgage lenders; establishing a foreclosure database at the Division; and prohibiting subprime adjustable rate mortgage loans unless a consumer 1). opts out of a fixed rate product, and 2). the consumer provides evidence that they had received counseling from an approved credit counselor. In light of the increased supervisory responsibilities this legislation would impose on the Division, the bill appropriates funding to ensure the Division has adequate resources to carry out these new responsibilities.

The Division takes its regulatory responsibilities very seriously and seeks to address emerging issues and risks on a proactive basis. The Division is currently working with its counterparts in other states and with federal banking agencies to enhance coordinated supervision of companies operating on a nationwide basis.

Technology Solutions

The IT Audit also recommends that the Division “pursue other technology solutions to enhance its supervision of mortgage lenders and brokers”. The IT Audit recognizes the Division has been working for four years on a Nationwide Mortgage Licensing System (NMLS) which is scheduled to go live in just 7 weeks on January 2, 2008. The NMLS will provide a single platform for licensing non-bank mortgage lenders, brokers, and originators as well as a central repository of information about licensing and enforcement actions. The system will also facilitate the use of fingerprinting and FBI criminal background histories.

Most importantly, the NMLS will be the foundation for coordinated supervision of multi-state mortgage entities on a going forward basis. Opportunities for forum shopping or moving an entity across state lines to avoid regulation will be eliminated. I believe the NMLS is the single most important initiative ever undertaken relative to the supervision of the non-bank mortgage industry. Longer-term, the NMLS provides an opportunity for additional technology solutions, including possible complaint case management and multi-state examination scheduling and coordination.

II. Disaster Recovery and Business Continuity Planning

The IT Audit notes that, while the Division has a Continuity of Operations Plan (COOP) to address disaster recovery and business continuity in the event of a disaster or other event which renders the Division’s IT systems inoperable, it has not conducted a test of the plan. The IT Audit recommends that the Division not only assess its IT environment from a risk management and business continuity perspective, but also that the Division test the plan and refine the plan as a result of the test.

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Lastly, I want to take this opportunity to thank you and all your staff, in particular Frank Cintolo, Director Information Technology Division; James Moriarty, Audit Supervisor; and Thomas Vereker, Senior Auditor. These individuals and the other auditors on the IT Audit conducted themselves professionally and were always accommodating of any scheduling issues with my staff. I appreciate their comments and recommendations and those in the IT Audit.

If you have any comments, please feel free to contact me or David J. Cotney, Chief Operating Officer at (617) 956-1510 or at david.cotney@state.ma.us.

Very truly yours,



Steven L. Antonakes
Commissioner of Banks

cc: Daniel Crane, Director, Office of Consumer Affairs

Massachusetts Foreclosure Initiatives
2006

Total enforcement actions against mortgage lenders and mortgage brokers – 132

September 1, 2006 to present

Weekly board meetings for the Nationwide Mortgage Licensing Database are initiated. Commissioner Antonakes was previously appointed as one of five state regulators to serve on a board of managers charged with overseeing the development and implementation of a nationwide database of mortgage professionals. The board had previously met monthly.

September 8, 2006

The Division announced recent enforcement actions against mortgage brokers for mortgage fraud, including inflating borrower income. At the same time, the Division launched multiple surprise examinations of nearly 100 licensed brokers to look at income issues.

The Division issued industry letter regarding reduced documentation loan programs and warning of actions to be taken in cases of false or inflated borrower income.

The Division announced emergency regulations to expand the prohibited acts and practices to include inflating borrower income or requiring a borrower to sign blank or incomplete documents.

The Division announced that it will host a mortgage summit in the fall of 2006 to develop a statewide foreclosure prevention strategy and to provide additional, meaningful measures to help consumers confronted with the loss of their homes. Invited participants will include representatives from government, non-profit organizations, and the industry. The proposed summit agenda included the discussion of the development and delivery of pre and post home purchase, financial education and counseling, additional statutory changes, and the creation of a source of funding for borrowers to refinance out of loans with high interest rates and unmanageable terms.

November 14, 2006

The Division hosted Mortgage Summit comprised of nearly 50 participants from government, non-profit, and the mortgage lending industries to develop a foreclosure prevention strategy. The full day summit resulted in a consensus that further cooperation was necessary and a willingness by participants to continue to work together to forge a foreclosure prevention strategy.

2007

Total enforcement actions (through 9/30) against mortgage lenders and mortgage brokers – 119

January to present

The Division hosts weekly conference calls of state mortgage regulators. Each week, upwards of 40 state regulators join the call to discuss problem institutions, including ways to coordinate regulatory actions to ensure consumer protection and proper funding of loans.

January through March 2007

Two Working Groups were formed in December 2006 as a result of the Mortgage Summit and began meeting in January 2007: one looking at rules and enforcement and the second focusing on consumer education and foreclosure assistance. The purpose of the Working Groups was to take the ideas of the Summit and develop concrete recommendations to both help consumers confronted with the loss of their

homes as well as to address longer-term issues affecting communities across the Commonwealth of Massachusetts.

January 2, 2007

The Division released Regulatory Bulletin on “Guidance on Nontraditional Mortgage Product Risks”. The Guidance, which mirrors the federal Guidance issued at the end of 2006, is intended to clarify how mortgage lenders and mortgage brokers can offer nontraditional mortgage products in a way that clearly discloses the risks that borrowers may assume.

February 28, 2007

The Division committed to participate in Nationwide Mortgage Licensing System beginning in 2008. Highlights of the system include:

- Improved efficiency and effectiveness of state supervision of the U.S. mortgage market;
- Improved ability to fight mortgage fraud and predatory lending that costs consumers and the mortgage industry hundreds of millions of dollars in losses each year;
- Increase accountability among mortgage industry professionals; and
- A unified and streamlined state license processes for mortgage lenders and mortgage brokers.

March 21, 2007

NeighborWorks[®] America honors Commissioner of Banks Steven L. Antonakes with its Government Service Award given annually to one individual representing state government. Commissioner Antonakes was recognized by NeighborWorks[®] America for his “leadership in combating foreclosures in the commonwealth of Massachusetts, and strengthening communities”.

March 26, 2007

The Division testified before the Legislature’s Joint Committee on Housing in support of Senate 747, “An Act to Preserve Homeownership”, and House 1290, “An Act to Preserve and Promote Homeownership”. Among the new initiatives, the bills would extend provisions similar to the Massachusetts Community Reinvestment Act to certain licensed mortgage lenders. In addition, the bills would require mortgage loan originators to be licensed by the Division of Banks.

March 27, 2007

Commissioner Antonakes, representing the nation’s state bank regulators, testified before the U.S. House Financial Services Subcommittee on Financial Institutions and Consumer Credit. Commissioner Antonakes said state regulators have actively pursued unfair and deceptive practices in the mortgage market. “In 2006 alone, states took 3,694 enforcement actions against mortgage lenders and brokers based on problems found during routine examinations of mortgage companies,” Antonakes said. He added that through three nationwide settlements alone, state regulators have returned over \$800 million to borrowers.

April 4, 2007

The Division testified before the Legislature’s Joint Committee on Financial Services in support of House 1028, “An Act to Facilitate Electronic Licensing of Mortgage Lenders and Mortgage Brokers and Information Sharing Among Regulatory Agencies”. The bill would authorize the Division to participate in the Nationwide Mortgage Licensing System. In addition, House 1028 would authorize the Division to increase licensing fees for mortgage lenders and brokers and establish a trust fund from which the Division could spend the increased fees for the supervision of the mortgage industry, including establishing a mortgage fraud investigation and enforcement unit.

April 11, 2007

The Mortgage Summit Working Groups released their report detailing a series of recommendations. These include changes to existing regulations, recommendations for legislative changes, and issues requiring further collaboration among government, non-profits, and members of the industry to promote consumer education and awareness as well as the development of products and programs to assist consumers facing foreclosure or default.

April 30, 2007

Governor Deval Patrick directed the Division to seek delays from mortgage lenders or servicers, on a case-by-case basis, for any Massachusetts homeowner who filed a complaint with the Division of Banks. As part of this process, the Division would refer consumers to a credit or foreclosure counselor. Lenders are also urged to work with consumers facing difficulty on their mortgage payments and to consider reasonable loan workouts or modifications.

June 11, 2007

Legislation drafted by the Division filed by Governor Patrick. The bill, entitled, "An Act Implementing the Division of Banks Mortgage Summit Recommendations," includes all of the recommendations of the Mortgage Summit Working Groups that had not already been filed. These include: the criminalization of mortgage fraud; providing a right to cure for delinquent homeowners; prohibiting abusive foreclosure rescue schemes; establishing a foreclosure database to be administered by the Division of Banks; and prohibiting subprime adjustable rate mortgage loans unless a consumer 1). opts out of a fixed rate product, and 2). the consumer provides evidence that they had received counseling from an approved credit counselor.

June 13, 2007

Commissioner Antonakes, representing the nation's state bank regulators, testified before the U.S. House Financial Services Committee on improving consumer protection in financial transactions.

The Comptroller of the Currency announces that it will partner with the Massachusetts Division of Banks and New York Banking Department to initiate a pilot program to coordinate examinations of national banks with examinations of the state licensed mortgage brokers they do business with. The idea was introduced by Commissioner Antonakes during his Congressional testimony on March 27, 2007.

June 14, 2007

Commissioner Antonakes testified before the Federal Reserve Board on encouraging responsible mortgage lending. Commissioner Antonakes was invited to testify before the Federal Reserve Board as the agency considers defining unfair and deceptive acts and practices under its authority under the Home Ownership and Equity Protection Act of 1994 (HOEPA). Commissioner Antonakes made several recommendations to the Federal Reserve Board, including:

- Limiting prepayment penalties to expire at least 30 days prior to a rate reset on adjustable rate subprime loans.
- Prohibiting prepayment penalties that violate state as well as federal laws.
- Requiring escrows for taxes and insurance for all subprime loans.
- Prohibiting subprime adjustable rate or low documentation loans unless the borrower affirmatively opts out and receives counseling from a certified provider.
- Requiring all subprime and nontraditional mortgages to be underwritten at a fully-indexed rate on a fully amortizing schedule.

July 2, 2007

The Division issued a revised Regulatory Bulletin on the experience requirements for mortgage lenders and mortgage brokers. The prior experience requirement for a person to obtain a mortgage broker license raised from one year to three years and for a mortgage lender from one to five years.

July 11, 2007

The Department of Housing and Community Development (DHCD) announced a \$250 million loan program for Massachusetts Homeowners struggling with their mortgage payments. The program, through MassHousing, includes \$190 million from FannieMae and \$60 million in bond funding from MassHousing. The MassHousing “rescue” loan product guidelines include:

- Income less than 125% of median income (135% in metro Boston)
- Outstanding balance 105% or less of the value of the property
- 60 days late or less due to rate reset
- Credit score at least 560 (higher for multi-family)
- One to four family, owner-occupied property

July 17, 2007

The Division, in participation with the Conference of State Bank Supervisors, the Federal Reserve Board, the Office of Thrift Supervision, and the Federal Trade Commission, announced a pilot examination program of subprime mortgage lenders. The pilot will involve depository institutions that engage in subprime lending, including their subsidiaries or affiliates, as well as lenders and brokers with which they do business. The agencies will also share information about the reviews and investigations, take action as appropriate, collaborate on the lessons learned, and seek ways to better cooperate in ensuring effective and consistent reviews of these institutions.

July 31, 2007

Office of the Attorney General introduced emergency regulations, effective immediately, banning foreclosure rescue schemes.

Attorney General also announced the creation of a foreclosure hotline for low-income consumers to obtain pro bono legal services. The Division made presentations at the first two meetings of this group.

The Division, in participation with the Conference of State Bank Supervisors, issued Model Examination Guidelines (MEGs). The MEGs will enhance consumer protection by providing state regulators with a uniform set of examination tools for conducting examinations under both the Guidance on Nontraditional Mortgage Product Risks (see above) and the Subprime Statement (see below).

September 7, 2007

The Division issued final regulations amending 209 CMR 42.00 et seq., “The Licensing of Mortgage Lenders and Mortgage Brokers”. The amendments increase the minimum net worth requirement for licensed mortgage lenders and establish a minimum net worth requirement to implement the financial responsibility requirement for licensed mortgage brokers. The amendments exclude from the calculation of an applicant’s or a licensee’s net worth the value of a residence occupied in whole or in part by the applicant or licensee. The amendments require an applicant for a mortgage broker license to submit audited or reviewed financial statements. A surety bond requirement for both licensed entities was also established.

September 10, 2007

The Division released Regulatory Bulletin on “Statement on Subprime Lending”. The Statement, which mirrors the federal Statement issued in July, is intended to clarify how mortgage lenders and mortgage brokers can offer subprime mortgage products in a way that clearly discloses the risks that borrowers may assume.

October 10 – 11, 2007

The Division hosted a dozen mortgage regulators from around the country for a meeting on establishing formalized protocols for the supervision of multi-state mortgage lenders and brokers.

October 17, 2007

Office of the Attorney General finalized regulations setting out unfair and deceptive practices by mortgage lenders and mortgage brokers. The regulations make several changes, including:

- Prohibiting mortgage brokers or lenders from making a loan if they do not have a reasonable belief that the borrower is able to repay the loan.
- Restricting the abuse of no-documentation or “stated income” loans by requiring that the mortgage broker or lender disclose how the interest rates or other charges will increase under a “no-doc” loan, and obtain the borrower’s signed statement of income in order to process those types of loans.
- Prohibiting mortgage brokers from arranging or processing loans that are not in the borrower’s interest, and prohibit brokers from brokering loans if the broker’s financial interest conflicts with the borrower’s interest.
- Prohibiting mortgage lenders from steering borrowers to loan products that are more costly than those that the borrower qualifies for, and prohibits lenders from discriminating between similarly qualified borrowers.

The Division was asked to review the regulations and provide testimony.

October 18, 2007

Governor Patrick announced a comprehensive foreclosure prevention plan. Highlights of the plan include:

- **Neighborhood Stabilization Pilot Programs** – In six targeted neighborhoods across Massachusetts with the highest foreclosure rates, DHCD will partner with lenders and non-profits to reclaim foreclosed properties and return them as quickly as possible into owner-occupied properties.
- **Transition Resources** – The Administration proposes that lenders or servicers provide \$5,000 to a counseling organization for their expenses and for a consumer’s first and last month’s rent in certain situations.
- **Consumer Outreach and Education** – Building on the foreclosure intervention efforts by the Division, consumers would be directed to a single source, the “HOPE Hotline”, run by NeighborWorks. The Division would continue to serve as a resource for counselors to seek a delay in a foreclosure proceeding. In addition, counselors could direct clients to other resources at MassHousing or the Attorney General’s Office.
- **Lending Best Practices** – A series of best practices were introduced that all lenders and servicers are expected to conform to. These include: notification to borrowers at least three months in advance of a rate reset; consideration of a loan modification if a borrower will be unable to afford the new payments after a rate reset; moving borrowers from subprime to prime products if they have made timely payments on their mortgage; requiring tax and insurance escrows for all subprime borrowers; allowing a pre-foreclosure sale; and allowing a deed in lieu of foreclosure.

October 24, 2007

Commissioner Antonakes, representing the nation’s state bank regulators, testified before the U.S. House Financial Services Committee on the “Mortgage Reform and Anti-Predatory Lending Act of 2007” (H.R. 3915). Commissioner Antonakes said any new mortgage reform legislation should embrace state-federal efforts to better coordinate their supervisory efforts while building on state regulators’ expertise and

experience in consumer protection. “We appreciate that the bill acknowledges and builds from work that is already being done in the states to protect consumers,” Antonakes said. Antonakes commended sponsors of the bill for incorporating the states’ forthcoming mortgage licensing system and regulatory database which will launch on January 2, 2008. Antonakes also urged the Committee to make sure that the states are included in any new federal rule-making processes for mortgage providers and suggested the Federal Financial Institutions Examination Council (FFIEC), already in place with a voting state representative, would be the most appropriate forum for developing new rules.

November 2007

Congressman Frank’s office consulted with and sought the Division’s review of proposed amendments to the “Mortgage Reform and Anti-Predatory Lending Act of 2007”. The bill was passed by the House of Representatives on November 15, 2007.