



Commonwealth of Massachusetts  
Office of the State Auditor  
Suzanne M. Bump

*Making government work better*

Official Audit Report – Issued January 25, 2012

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## Division of Banks

For the period July 1, 2008 through April 30, 2011



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The Division of Banks and Loan Agencies (DOB) was established by Chapter 26, Section 1, of the Massachusetts General Laws. The mission of the DOB 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 that provides supervision of the day-to-day operations of the DOB, oversees all regulatory matters, and conducts strategic planning for the DOB.

The DOB is responsible for the oversight of nearly 225 state-chartered banks and credit unions holding approximately \$271 billion in combined assets as of March 31, 2011. The DOB coordinates with the Federal Deposit Insurance Corporation (FDIC) and the Federal Reserve Bank of Boston to conduct approximately 81 bank examinations of state-chartered banks annually, and with the National Credit Union Association (NCUA) to conduct approximately 60 examinations of state-chartered credit unions annually. The DOB is also charged with licensing and examining over 8,000 non-bank entities, including mortgage lenders, mortgage loan originators, brokers, check cashers and sellers, automobile sales finance companies, debt collectors, third party loan servicers, foreign transmittal agencies, insurance premium finance agencies, retail installment sales, and small loan agencies.

The purpose of our audit was to determine whether corrective action had been taken to address the Audit Results contained in our prior audit report, No. 2007-0100-4T. That audit found that additional resources were needed to adequately address the DOB's oversight of mortgage brokers and lenders and that DOB should implement enhanced controls over business continuity and disaster recovery planning for its mission-critical applications.

Based on our review we have determined that, except as reported in the Audit Results section of this report, for the period July 1, 2008 through April 30, 2011, the DOB maintained adequate internal controls and complied with applicable laws, rules, and regulations related to its operations for the areas tested.

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Our prior audit revealed that DOB's capacity to perform examinations had not kept pace with the increase in the number of mortgage lenders and brokers under its authority. We also found that DOB had been forced to reallocate 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. Our follow-up audit revealed that as a result of significant regulatory reform and an increased emphasis on performing examinations of non-bank entities, the DOB is providing adequate oversight of mortgage brokers and lenders under its authority. In addition, we found that from 2007 to 2010, the number of mortgage brokers and lenders licensed in Massachusetts has declined by 67%.

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Our prior audit revealed that DOB did not have a formal disaster recovery and business continuity plan to provide reasonable assurance that information technology (IT) functions could be regained effectively and in a timely manner should a disaster render automated systems inoperable. The audit revealed that system user departments had not developed user area contingency plans to address a potential loss of automated processing.

Our follow-up audit determined that as a result of Executive Order 510 regarding the consolidation of IT services within executive branch agencies, the Executive Office of Housing and Economic Development now has responsibility for the support of all equipment and applications installed at DOB. Although certain objectives for contingency planning existed, our audit found that DOB did not have a sufficiently comprehensive disaster recovery plan in place to provide for the timely restoration of business and IT capabilities should application systems be rendered inoperable or inaccessible.

In response to the audit report, the DOB stated that it continues to place a priority on disaster recovery and business continuity planning.

## **INTRODUCTION**

### ***Background***

The Division of Banks and Loan Agencies (DOB) was established by Chapter 26, Section 1, of the Massachusetts General Laws. The DOB's main office is located at 1000 Washington St., Boston, with regional field offices located in Burlington, Lakeville, and Springfield. The mission of the DOB 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 that provides supervision of day-to-day operations, oversees all regulatory matters, and conducts strategic planning for the DOB.

The DOB is responsible for the oversight of nearly 225 state-chartered banks and credit unions holding approximately \$271 billion in combined assets as of March 31, 2011. The DOB coordinates with the Federal Deposit Insurance Corporation (FDIC) and the Federal Reserve Bank of Boston to conduct approximately 81 bank examinations of state-chartered banks annually, and with the National Credit Union Association (NCUA) to conduct approximately 60 examinations of state-chartered credit unions, on an annual basis. The DOB is also charged with licensing and examining over 8,000 non-bank entities, including mortgage lenders, mortgage loan originators, brokers, check cashers and sellers, automobile sales finance companies, debt collectors, third party loan servicers, foreign transmittal agencies, insurance premium finance agencies, retail installment sales, and small loan agencies.

The Massachusetts Office of Consumer Affairs and Business Regulation (OCABR) provides strategic and tactical planning for, as well as administrative oversight of, DOB operations. Connectivity to computer operations is supported through the use of a local area network (LAN) and through the Commonwealth's wide area network (WAN). The DOB utilizes the General Examination System (GENESYS) application provided by the 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.

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

In accordance with Chapter 11, Section 12, of the Massachusetts General Laws, we performed a follow-up audit of selected internal controls at DOB for the period July 1, 2008 through April 30, 2011. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

The scope of our audit consisted of an evaluation of the status of Audit Results in our prior audit report, No. 2007-0100-4T, regarding the oversight of mortgage brokers and lenders and business continuity and disaster recovery planning for mission-critical applications utilized by DOB.

Our objective regarding the oversight of mortgage brokers and lenders was 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. In order to achieve our objectives, we performed the following audit tests and analyses:

- Interviewed appropriate management personnel responsible for the licensing and examination of mortgage brokers and lenders.
- Obtained and reviewed all changes to the statutory requirements regarding the licensing and examination of mortgage brokers and lenders within the Commonwealth.
- Obtained, reviewed, and compared the number of licensees and examinations performed over the period July 1, 2008 through April 30, 2011.
- Reviewed the changes in DOB's criteria used to issue or grant a license or a renewal to a mortgage lender or broker.

To assess the adequacy of disaster recovery and business continuity planning, we reviewed the level of planning and the procedures to be followed to resume computer operations in the event that computing system capabilities became inoperable or inaccessible. In order to achieve our audit objectives, we performed the following audit tests and analyses:

- Interviewed both DOB and OCABR management to determine whether the criticality of application systems had been assessed.

- Conducted an information technology (IT) risk analysis for computer operations to determine mission-critical systems and whether DOB, in conjunction with OCABR, had developed tactical and strategic plans for unintended disruptions to data processing capabilities.
- Reviewed the extent to which a Continuity of Operations Plan (COOP), disaster recovery plan (DRP), and business continuity plan (BCP) were in place and in effect and whether there was adequate evidence that the plans had been tested and test results were incorporated back into the plans.

Based on our review we have determined that, except as reported in the Audit Results section of this report, for the period July 1, 2008 through April 30, 2011, DOB maintained adequate internal controls and complied with applicable laws, rules, and regulations related to its operations for the areas tested.

## AUDIT RESULTS

### 1. PRIOR AUDIT RESULT RESOLVED – IMPROVED OVERSIGHT OF MORTGAGE BROKERS AND LENDERS

Our prior audit report, No. 2007-0100-4T, revealed that the Division of Banks and Loan Agencies' (DOB) capacity to perform examinations had not kept pace with the increase in the number of mortgage lenders and brokers under its authority. We also found that DOB had been forced to reallocate 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. We found that without increased resources and/or regulatory changes, DOB's mission to ensure public confidence relative to the safety and soundness of the mortgage credit industry in the Commonwealth could be impacted.

Our follow-up audit disclosed that as a result of significant regulatory reform and an increased emphasis on performing examinations of non-bank entities, the DOB is providing adequate oversight of mortgage brokers and lenders under its authority. In addition, we found that from 2007 to 2010, the number of mortgage brokers and lenders licensed in Massachusetts has declined by 67%. According to DOB management, the rate of examinations was able to return to the historic norm of 30% by 2010, due to more comprehensive and stronger regulatory requirements and improvements to the financial conditions for the lending institutions.

The chart below represents the examination activity by the DOB on Massachusetts-licensed mortgage brokers and lenders between 2007 through 2010.

**Mortgage Broker and Lender Examinations**

Year	Licensed Brokers and Lenders	Brokers Examined	Lenders Examined	Total	Percent Examined
2007	1665	232	90	322	19.34%
2008	1073	235	111	346	32.25%
2009	692	290	83	373	53.90%
2010	544	86	75	161	29.60%

The financial regulatory environment has dramatically changed since our prior audit of DOB, issued November 27, 2007. Numerous changes have effectively raised the barriers for entities to enter into the mortgage broker and lender industry. The more comprehensive and stronger

regulations will ensure that consumers seeking mortgages are protected from unscrupulous lenders and brokers and ensure public confidence relative to the safety and soundness of the mortgage credit industry in the Commonwealth. The following represents significant regulatory reform of the industry since our prior report:

- Chapter 206 of the Acts of 2007, enacted in July 2008, requires all mortgage loan originators be licensed.
- Chapter 44 of the Acts of 2009 requires that all mortgage originators complete pre-licensing and continuing education courses, and pass both federal and state written examinations as a requirement for licensure.
- 209 Code of Massachusetts Regulations (CMR) 42.03 and 42.06, effective on December 31, 2008, increased the requirements for net worth as a condition of licensure. For lenders, the requirement was established at \$200,000; for brokers, \$25,000. In addition, bonding requirements for lenders are now based on annual loan volume and DOB has the authority to adjust those requirements as volumes increase or decrease. For brokers, the bond requirement was set at \$75,000.
- DOB has, through enforcement action, been able to recover approximately \$75,000 in funds for consumers through the new bonding requirements since 2009.
- The Nationwide Mortgage Licensing System (NMLS) utilized for individual loan originators and lender/broker licensing provides information to state regulators throughout the United States pertaining to an applicant's license status and history, including information on enforcement actions and outstanding and pending regulatory issues and violations in every state. This information is critical when determining an applicant's worthiness in obtaining a mortgage broker, mortgage lender, or mortgage loan originator license. The NMLS system became effective in 2008.

As previously noted, the number of licensed mortgage brokers and lenders in Massachusetts has decreased by approximately 67% since our prior report. This decrease is due to several economic factors as well as stronger regulatory controls enacted at both the state and federal level. These new regulations have served to increase the barriers to entry into this industry by instituting stronger financial requirements and safeguards for all mortgage brokers and lenders and mortgage loan originators.

We found that the screening of applicants at the beginning of the licensing process, combined with improvements in information sharing between state regulators across the country have enhanced controls over the oversight of mortgage brokers and lenders licensed in Massachusetts.

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**2. PRIOR AUDIT RESULT UNRESOLVED – DISASTER RECOVERY AND BUSINESS CONTINUITY PLANNING**

Our prior audit revealed that DOB did not have a formal disaster recovery plan (DRP) and business continuity plan (BCP) to provide reasonable assurance that information technology (IT) functions could be regained effectively and in a timely manner should a disaster render automated systems inoperable. The audit revealed that system user departments had not developed user area contingency plans to address a potential loss of automated processing. The audit also found that management had not assessed the relative criticality of DOB's automated systems or conducted a risk analysis to determine the extent of potential risks and exposures to IT operations.

Our follow-up audit determined that as a result of Executive Order 510 regarding the consolidation of IT services within executive branch agencies, the Executive Office of Housing and Economic Development (EOHED) now has responsibility for the support of all equipment and applications installed at DOB. Although certain objectives for contingency planning existed, our audit found that DOB did not have a sufficiently comprehensive DRP in place to provide for the timely restoration of business and IT capabilities should application systems be rendered inoperable or inaccessible. We found that DOB had a draft Continuity of Operations Plan (COOP), dated February 2011, that provided detailed procedures to be performed to sustain key business functions during and after a disruption of computer operations. However, we determined that DOB did not have a formal DRP and user area plans that work in conjunction with the draft COOP to address a catastrophic event.

A business continuity plan should document DOB's recovery strategies with respect to various disaster scenarios. Without adequate disaster recovery and contingency planning, including required user-area plans, DOB is at risk of not being able to gain access to automated systems. Furthermore, the absence of a comprehensive and tested DRP could result in unnecessary costs and significant processing delays. The lack of a detailed, tested plan to address the resumption of processing by the local area network (LAN) and microcomputer systems might also render data files and software vulnerable should a disaster occur.

We found that although both DOB and EOHED management were sufficiently aware of the need for a comprehensive DRP and BCP, an appropriate risk analysis methodology was not conducted to identify the relevant threats that could render IT systems inoperable or

inaccessible, the likelihood of the threat, and expected frequency of occurrence for each disaster scenario. As a result, if a disaster were to occur rendering IT capabilities inoperable or inaccessible, EOHED may not be able to provide the foundation and structural framework for managing computer capabilities associated with emergency response and continuity of responsibilities supporting DOB's mission within an acceptable time period.

Generally accepted business practices and industry standards for computer operations support the need for the DOB, in conjunction with EOHED, to have an ongoing business continuity planning process that assesses the relative criticality of information systems and develops appropriate contingency and recovery plans.

***Recommendation***

DOB, in conjunction with EOHED, should assess the extent to which it is dependent upon the continued availability of information systems for all required processing or operational needs and develop its recovery plans based on the critical aspects of its information systems.

We recommend that sufficiently detailed disaster recovery and business continuity plans be developed that are based on criticality and business impact assessments, risk management, and recovery plan testing. The BCP should address all key business processes, including procedures for sustaining the business functions during and after a disruption of services. The DRP should also address IT recovery under circumstances when access to DOB's facility is denied for an extended period of time.

The DOB's contingency plans should assign specific staff members with roles and responsibilities and present detailed steps for them to follow in recovering mission-critical and essential IT systems and operations. The BCP and DRP should also address the telecommunications and security issues that would arise if the agency had to conduct off-site computer operations. Further, the plans should be adequately tested to provide reasonable assurance of their viability, periodic training should be conducted for IT and operational staff, and hardcopy and electronic copies of the disaster recovery, business continuity, and agency-specific user area plans should be stored in a secure off-site location.

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**Auditee's Response**

*The Division continues to place a priority on disaster recovery and business continuity.*

*The Division has maintained a Continuity of Operations Plan (COOP) for many years which was more formalized in 2001. The COOP has been assessed, tested, and revised on a regular basis. The most recent example of a test was when the Division moved its entire main office headquarters from South Station to its current location at 1000 Washington Street in March of 2010. In each test scenario, the Division has been able to restore access to mission critical applications as well as establish and maintain communications with all its various business partners as well as the public.*

*The Division views the complete relocation of the agency over a weekend and to conduct business as usual on the next Monday as a major successful test of its systems and procedures. The Division does recognize that there is more to address as noted in the follow-up audit. However, for the forthcoming reasons the Division cannot act alone. Executive Order No. 510 entitled Enhancing the Efficiency and Effectiveness of the Executive Departments Information Technology Systems calls for the consolidation of Information Technology (IT) services within Executive Branch agencies. As a result, the Division no longer has any dedicated IT staff; rather the Division relies on a pool of IT professionals housed within the Executive Office of Housing and Economic Development (EOHED) IT Services Department housed onsite at 1000 Washington Street. The IT professionals in EOHED provide technical support for all of the Division's IT related activities and is divided in three major working groups: application development, infrastructure services, and end-user support. However, there are no written agreements currently in place between the Division and EOHED that delineate responsibilities and expectations. Therefore, the Division will endeavor to engage in an Interdepartmental Service Agreement (ISA) with the EOHED IT Services Department to ensure that the Division's IT needs, including disaster recovery and business continuity, are met and that there is accountability and equity throughout the process. Currently, IT professionals in EOHED are coordinating with outside vendors to assess current services and build an infrastructure capable of supporting the day to day needs of the Division and other agencies as well as offering a base for growth. This includes the implementation of an effective backup and disaster recovery plan for the current consolidated IT infrastructure model and an agency by agency business impact analysis. Once complete, Division staff will collaborate with IT professionals in EOHED to formalize a DRP and business continuity plan which will include user area plans that work in conjunction with the Division's COOP in order to allow the Division to successfully respond to a catastrophic event. The formalized plans and testing are expected to be completed by no later than the end of March 2012. The Division is confident that all of those actions under Executive Order 510 in conjunction with the Division's COOP will result in a successful DRP that addresses all of the matters raised in the follow-up audit.*