TESTIMONY OF

STEVEN L. ANTONAKES

MASSACHUSETTS COMMISSIONER OF BANKS

On behalf of the

CONFERENCE OF STATE BANK SUPERVISORS

On

"MORTGAGE LENDING REFORM:

A COMPREHENSIVE REVIEW OF THE AMERICAN MORTGAGE SYSTEM"

Before the

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Introduction

Good afternoon, Chairman Gutierrez, Ranking Member Hensarling, and distinguished members of the Subcommittee. My name is Steven L. Antonakes, and I serve as the Commissioner of Banks for the Commonwealth of Massachusetts. It is my pleasure to testify today on behalf of the Conference of State Bank Supervisors (CSBS).

CSBS is the professional association of state officials responsible for chartering, supervising, and regulating the nation's over 6,000 state-chartered commercial and savings banks. For more than a century, CSBS has given state supervisors a national forum to coordinate supervision of their regulated entities, develop regulatory policy, provide training to state officials, and represent state officials before Congress and the federal financial regulatory agencies.

In addition to regulating banks, most state banking departments also supervise the residential mortgage industry. As the mortgage industry has evolved over the past two decades, CSBS has expanded its mission beyond traditional commercial bank supervision and has been working closely with the American Association of Residential Mortgage Regulators (AARMR)[1] to enhance supervision of the mortgage industry. States currently have regulatory oversight of over 77,000 mortgage company licenses, 50,000 branch licenses, and 410,000 loan officer licenses.

The states, the federal financial regulatory agencies, the Obama Administration, and Congress have all been very active in trying to restore confidence in the mortgage market. I commend you, Chairman Gutierrez and members of the Subcommittee, for your

[1] AARMR is the organization of state officials responsible for the administration and regulation of residential mortgage lending, servicing, and brokering. http://www.aarmr.org/.

dedication to protecting consumers and for promoting the principles of responsible lending.

The residential mortgage market is undergoing significant reforms to prevent a similar collapse in the future. Presently, we are working toward a more coordinated state/federal system of supervision to address the ongoing challenges presented by the evolving mortgage market and to ensure that no market participants fall through gaps in financial supervision. High minimum standards for mortgage professionals and consumer protection must be the hallmark of a reformed system. In other words, there should be nowhere to hide from high lending standards or enforcement of those standards. Let me be clear: federalization of regulation and applicable law is not the best option available to us. A coordinated network of state and federal regulation and state and federal law will be much more nimble, responsive and comprehensive in providing high standards and meaningful regulation.

Mr. Chairman, in my testimony I will discuss the Mortgage Reform and Anti-Predatory Lending Act that passed the House last Congress and which CSBS supported. I will also address the evolution of the mortgage market and the actions taken by state officials to enhance supervision of the mortgage industry. Finally, I will offer the Subcommittee suggestions for regulatory changes that should be considered as Congress debates reform of financial regulation, including offering our support for the Congressional Oversight Panel's recommendation to eliminate federal preemption of state consumer protection laws. Ultimately, the solution to our economic crisis must be to support the actions taken by state and federal regulators as we work to develop a new era of cooperative federalism and break down barriers to cooperation that currently exist. Specifically, I'd like to highlight the pilot initiative led by the Federal Reserve on coordinated state-federal supervision of non-banks. This is a model for how cooperative federalism can work.

Mortgage Reform and Anti-Predatory Lending Act/NMLS as Model of Federalism

Another model for cooperative federalism is the CSBS-AARMR Nationwide Mortgage Licensing System (NMLS) and the S.A.F.E. Act enacted last year. The states first recognized the need for a tool to license mortgage originators several years ago. Since then, states have dedicated tremendous monetary and staff resources to develop and enact NMLS.

The hard work and dedication of the states was ultimately recognized by Congress as they enacted the Housing and Economic Recovery Act of 2008 (HERA). I commend Chairman Frank, Ranking Member Bachus and Representatives Watt and Miller for introducing and passing through the House the Mortgage Reform and Anti-Predatory Lending Act in the 110th Congress. The bill acknowledged and built upon the work that had been done in the states to protect consumers and restore the public trust in our mortgage finance and lending industries. CSBS continues to support the creation of a federal minimum predatory lending standard that allows the states to address these predatory practices as they evolve. The federal standard must be a floor for all lenders that does not stifle a state's authority to protect its citizens through state legislation that builds on the federal standard. States should also be clearly allowed to enforce—in cooperation with federal regulators—both state and federal predatory lending laws over institutions that act within their state.

A significant portion of the Mortgage Reform and Anti-Predatory Lending Act was eventually incorporated in HERA as the Secure and Fair Enforcement for Mortgage Licensing Act of 2008 (the S.A.F.E. Act). Special recognition must go to Representative

Bachus, who developed the S.A.F.E. and its state-federal model for regulation and supervision. The purposes of the S.A.F.E. Act are to increase uniformity, reduce regulatory burden, enhance consumer protection, and reduce fraud by requiring all mortgage loan originators to be licensed or registered through NMLS.

First proposed among state regulators in late 2003, NMLS launched on time and on budget on January 2, 2008. The Nationwide Mortgage Licensing System is more than a database. It serves as the foundation of modern mortgage supervision by providing dramatically improved transparency for regulators, the industry, investors, and consumers. Seven inaugural participating states, including Massachusetts, began using the system on January 2, 2008. Only 15 months later, 23 states are using NMLS and by January 2010—just two years after its launch—CSBS expects 40 states to be using NMLS. Passage of the S.A.F.E. Act requires all states to comply with minimum testing, education, professional integrity and other standards by July 31, 2010. I have attached, as Exhibit A, a map indicating when states will begin using NMLS.

NMLS currently maintains a single record for every state-licensed mortgage company, branch, and individual that is shared by all participating states. This single record allows companies and individuals to be definitively tracked across state lines and over time as entities migrate among companies, industries, and federal and state jurisdictions. Additionally, this year consumers and industry will be able to check on the license status and history of the companies and individuals with which they wish to do business.

NMLS provides profound benefits to consumers, state supervisory agencies, and the mortgage industry. Each state regulatory agency retains its authority to license and supervise, but NMLS shares information across state lines in real-time, eliminates any duplication and inconsistencies, and provides more robust information to state regulatory agencies. Consumers will have access to a central repository of licensing and publicly adjudicated enforcement actions. Honest mortgage lenders and brokers will benefit from the removal of fraudulent and incompetent operators, and from having one central point of contact for submitting and updating license applications.

In addition to loan originator licensing and mandatory use of NMLS, the S.A.F.E. Act requires the states to do the following:

1. Eliminate exemptions from mortgage loan originator licensing that currently exist in state law;
2. Screen and deny mortgage loan originator licenses for felonies of any kind within seven years and certain financially-related felonies permanently;
3. Screen and deny licenses to individuals who have ever had a loan originator license revoked;
4. Require loan originators to submit personal history information and authorize background checks to determine the applicant's financial responsibility, character, and general fitness;
5. Require mortgage loan originators to take 20 hours of pre-licensure education in order to enter the state system of licensure;
6. Require mortgage loan originators to pass a national mortgage loan originator test developed by NMLS;
7. Establish either a bonding or net worth requirement for companies employing mortgage loan originators or a recovery fund paid into by mortgage loan originators or their employing company in order to protect consumers;

8. Require companies licensed or registered through NMLS to submit a Mortgage Call Report on at least an annual basis;
9. Adopt specific confidentiality and information sharing provisions; and
10. Establish effective authority to investigate, examine, and conduct enforcement of licensees.

Taken together, these background checks, testing, and education requirements will promote a higher level of professionalism and encourage best practices and responsible behavior among all mortgage loan originators. Under the legislative guidance provided by Congress, the states drafted the Model State Law for uniform implementation of the S.A.F.E. Act. The Model State Law not only achieves the minimum licensing requirements under the federal law, but also accomplishes Congress' ten objectives addressing uniformity and consumer protection.

The Model State Law, as implementing legislation at the state level, assures Congress that a framework of localized regulatory controls are in place at least as stringent as those pre-dating the S.A.F.E. Act, while setting new uniform standards aimed at responsible behavior, compliance verification and protecting consumers. The Model State Law enhances the S.A.F.E. Act by providing significant examination and enforcement authorities and establishing prohibitions on specific types of harmful behavior and practices.

The Model State Law has been formally approved by the Secretary of Housing and Urban Development and endorsed by the National Conference of State Legislatures and the National Conference of Insurance Legislators. The Model State Law is well on its way to approval in almost all state legislatures, despite some unfortunate efforts by industry associations to frustrate, weaken or delay the passage of this important Congressional mandate.

The S.A.F.E. Act acknowledges the work of the states and its extensive requirements appropriately create a minimum standard nationwide while demanding immediate and broad action by the states.

My fellow state regulators and I have expressed our ability and willingness to face the challenges posed by the mortgage market by enhancing supervision of the industry. Our efforts, however, must be supported by the efforts of the federal regulatory agencies. State and federal regulators are in the early stages of developing a more coordinated system of supervision to provide comprehensive regulation of the entire financial system. This should be strongly encouraged by Congress.

Evolution of the Mortgage Industry in the United States

The residential mortgage industry has changed dramatically over the past two decades. Twenty years ago, federal- and state-regulated savings and loans originated the majority of residential mortgages. Federal government-sponsored enterprises such as Fannie Mae, Freddie Mac, and Ginnie Mae held a significant percentage of the secondary market share and effectively set standards for the industry. At the time, the “standard” mortgage was a fixed-rate 15- or 30-year mortgage.

By 2000, the mortgage markets had dramatically changed. Savings and loans, traditional depository institutions, Fannie Mae, Freddie Mac, and Ginnie Mae no longer dominated the market. Product choices for consumers exploded. Mortgage loans were available in practically any combination of fixed, adjustable, or hybrid adjustable rate and amortizing, non-amortizing, or negatively amortizing mortgages, with terms ranging anywhere from two years to 50 years. Loan documentation requirements and underwriting standards also became less stringent. In addition to these changes, risk-based pricing allowed more consumers than ever to qualify for home financing by trading a lower credit score or down payment for a higher rate. The industry changed dramatically in a relatively short period of time. Lending is still local, but financing is now global, and loan servicing has been consolidated into a few dominant companies associated with banks.

The volume of loan originations also increased dramatically over this time period from $500 billion in the early 1990s to a peak $3.8 trillion in 2003.[2] This increase in loan volume was facilitated in part by advances in technology such as automated underwriting systems, the increase of mortgage products available to the consumer, the development of the subprime market, and an expansion of the secondary market for mortgage securities to include international investors, hedge funds, and private equity funds.

More than ever before, homebuyers considered their home as a financial asset that would rarely, if ever, decline in value. In addition to providing protection from the elements, homes were seen as a source of financial security for the future. Homeownership was widely promoted by financial institutions, consumer advocates, politicians, the secondary mortgage market, and the media. Mortgage lenders and the Wall Street developed a number of products that offered homebuyers a wide variety of choices to manage this financial asset. Many of these products were quite complex, providing both opportunities and perils for consumers. Greater consumer confusion and commission-based compensation schemes also created greater opportunities and incentive for fraudulent or deceptive sales and lending practices. The sophisticated nature of these mortgage products requires an elevation of professionalism in mortgage originators and more robust oversight of the companies and individuals offering such products.

[2] Source: Mortgage Bankers Association. http://www.mba.org.

The mortgage revolution brought with it a number of benefits: a vast flow of liquidity into the mortgage market, increased availability of mortgage credit, and higher rates of homeownership. But it also brought moral hazard, as the allocation of risk of a mortgage loan default became dispersed through complex contractual arrangements that frequently began with the local mortgage broker, and ultimately ended with Wall Street investors. This dispersal of risk created opportunities and incentives for some actors to engage in lax underwriting and fraudulent practices.

Controls and market discipline that were in place to govern the market were overwhelmed by a Wall Street driven and funded securitization machine built for quantity, not quality. Years of stellar performance and low market interest rates created a demand for high yielding subprime mortgage securities, and the mortgage origination system responded to supply that demand.

As the mortgage industry has evolved, the states are increasingly playing a more active role in supervising the companies and professionals that originate and fund loans. All 50 states and the District of Columbia currently regulate mortgage companies and/or professionals. This is a dramatic change since 1993, when only 18 state agencies regulated the mortgage industry.[3]

States are leading the fight to reign in abusive lending through predatory lending laws, licensing and supervision of mortgage lenders and brokers, and through enforcement of consumer protection laws. State regulators are working collaboratively and effectively on many fronts with each other and our federal counterparts. My fellow state supervisors and I welcome coordination with our federal counterparts to promote responsible lending across the residential mortgage industry. In many instances, federal regulators are working

[3] Source: Mortgage Asset Research Institute (MARI), A LexisNexis Service. http://www.marisolutions.com/.

closely with state authorities through the Federal Financial Institutions Examination Council to develop processes and guidelines to protect consumers and prohibit certain acts or practices that are either systemically unsafe or harmful to consumers.

State Initiatives to Enhance Supervision of the Mortgage Industry

As the residential mortgage industry has rapidly evolved, the states are playing a more active role in its regulation and supervision. It is worth noting that the residential mortgage industry as we know it is relatively young. Therefore, state supervision of the industry is also relatively new. Conversely, state bank supervision in the United States has been in existence since the late 18th century. The first bank in my home state, the Bank of Massachusetts, was chartered in 1784. The charter was signed by Governor John Hancock and Senate President Sam Adams. Obviously, state bank supervision has had centuries to evolve and improve. State mortgage supervision grows and improves each day.

My fellow state regulators and I have long recognized the need for changes to the residential mortgage system. As a result, CSBS and AARMR are working diligently to improve cooperation and coordination among state regulators and between state and federal authorities. Much progress has been made towards enhancing supervision of the residential mortgage industry as federal and state regulators have engaged in an unprecedented number of cooperative initiatives and agreements to ensure comprehensive supervision of the industry. State and federal financial regulators have developed—and continue to develop—guidelines, best practices, and regulations to prevent abusive lending practices in the mortgage industry. Congress and state legislatures have passed or are debating legislative initiatives designed to change industry standards and protect consumers.

State Predatory Lending Laws

Currently, 35 states plus the District of Columbia have enacted subprime and predatory mortgage lending laws.[4] Attached as Exhibit B is a chart of state predatory mortgage lending statutory provisions. These state laws supplement the federal protections of the Home Ownership and Equity Protection Act of 1994. The innovative actions taken by state legislatures have prompted significant changes in industry practices, as the largest multi-state lenders have adjusted their practices to comply with the strongest state laws. All too often, however, states are frustrated in our efforts to protect consumers by the federal preemption of state consumer protection laws. Preemption should not be a tool for charter enhancement or used as a circumvention of more stringent consumer protection requirements.

State Enforcement of Consumer Protection Laws

State attorneys general and state regulators are also cooperatively pursuing unfair and deceptive practices in the mortgage market. Through several settlements, state regulators have returned nearly one billion dollars to consumers. For example, a settlement with Household Financial resulted in $484 million paid in restitution; a settlement with Ameriquest Mortgage Company resulted in $295 million paid in restitution; and a settlement with First Alliance Mortgage Company resulted in $60 million paid in restitution. These landmark settlements further contributed to changes in industry lending practices.

Success, however, is sometimes better measured by those actions that never receive media attention. States regularly exercise our authority to routinely examine mortgage companies for compliance not only with state law, but with federal law as well.

[4] Source: National Conference of State Legislatures. http://www.ncsl.org/.

Unheralded in their everyday routine, examinations or investigations identify weaknesses that, if undetected, might be devastating to the company and its customers. State examinations act as a check on financial problems and sales practices gone astray. Examinations also stop a supervised entity from engaging in misleading, predatory, or fraudulent practices. Also, examinations or investigations often result in the early detection of emerging harmful practices or trends. Attached as Exhibit C is a chart of enforcement actions taken by state regulatory agencies against mortgage providers. As an example, in 2007 alone, states took 5,896 enforcement actions against mortgage lenders and brokers.

Beyond statutory solutions and enforcement actions, states are undertaking numerous initiatives to enhance mortgage supervision. The examples detailed below provide a good model of financial regulation in a federalist system of government.

Nationwide Cooperative Protocol and Agreement for Mortgage Supervision

In December 2007, CSBS and AARMR launched the Nationwide Cooperative Protocol and Agreement for Mortgage Supervision to assist state mortgage regulators by outlining a basic framework for the coordination and supervision of Multi-State Mortgage Entities (those institutions conducing business in two or more states). The goals of this initiative are to protect consumers; ensure the safety and soundness of institutions; identify and prevent mortgage fraud; supervise in a seamless, flexible, and risk-focused manner; minimize regulatory burden and expense; and foster consistency, coordination, and communication among state regulators. Currently, 48 states plus the District of Columbia and Puerto Rico have signed the Protocol and Agreement.

The states have established risk profiling procedures to determine which institutions are in the greatest need of a multi-state presence and we are scheduled to begin the first multi-state examinations next month. Perhaps the most exciting feature of this initiative is the planned use of robust software programs to screen the institutions portfolios for risk, compliance, and consumer protection issues. With this software, the examination team will be able to review 100% of the institution's loan portfolio, thereby replacing the "random sample" approach that left questions about just what may have been missed during traditional examinations.

CSBS-AARMR Reverse Mortgage Initiatives

In early 2007, the states identified reverse mortgage lending as one of the emerging threats facing consumers, financial institutions, and supervisory oversight. In response, the states, through CSBS and AARMR, formed the Reverse Mortgage Regulatory Council and began work on several initiatives:

- *Reverse Mortgage Examination Guidelines (RMEGs).* In December 2008, CSBS and AARMR released the RMEGs to establish uniform standards for regulators in the examination of institutions originating and funding reverse mortgage loans. The states also encourage industry participants to adopt these standards as part of an institution's ongoing internal review process.
- *Education materials.* The Reverse Mortgage Regulatory Council is also developing outreach and education materials to assist consumers in understanding these complex products before the loan is made.

CSBS-AARMR Guidance on Nontraditional Mortgage Product Risks

In October 2006, the federal financial agencies issued the *Interagency Guidance on Nontraditional Mortgage Product Risks* which applies to insured depository institutions. Recognizing that the interagency guidance does not apply to those mortgage providers not affiliated with a bank holding company or an insured financial institution, CSBS and AARMR developed parallel guidance in November 2006 to apply to state-supervised residential mortgage brokers and lenders, thereby ensuring all residential mortgage originators were subject to the guidance.

CSBS-AARMR-NACCA Statement on Subprime Mortgage Lending

The federal financial agencies also issued the *Interagency Statement on Subprime Mortgage Lending*. Like the *Interagency Guidance on Nontraditional Mortgage Product Risks*, the Subprime Statement applies only to mortgage providers associated with an insured depository institution. Therefore, CSBS, AARMR, and the National Association of Consumer Credit Administrators (NACCA)[5] again developed a parallel statement that is applicable to all mortgage providers. The Nontraditional Mortgage Guidance and the Subprime Statement strike a fair balance between encouraging growth and free market innovation and draconian restrictions that will protect consumers and foster fair transactions.

AARMR-CSBS Model Examination Guidelines

Further, to promote consistency, CSBS and AARMR developed state Model Examination Guidelines (MEGs) for field implementation of the *Guidance on Nontraditional Mortgage Product Risks* and the *Statement on Subprime Mortgage Lending*.

Released on July 31, 2007, the MEGs enhance consumer protection by providing state regulators with a uniform set of examination tools for conducting examinations of

[5] The National Association of Consumer Credit Administrators represents the officials of the states and territories of the United States of America and of the Dominion of Canada, or their associates, who, by law, are vested with authority and duty to administer laws which require regulation or supervision of consumer credit agencies in the United States of America and the Domain of Canada. http://www.naccaonline.org/.

subprime lenders and mortgage brokers. Also, the MEGs were designed to provide consistent and uniform guidelines for use by lender and broker compliance and audit departments to enable market participants to conduct their own review of their subprime lending practices. These enhanced regulatory guidelines represent a new and evolving approach to mortgage supervision.

Mortgage Examinations with Federal Regulatory Agencies

Late in 2007, CSBS, the Federal Reserve System (Fed), the Federal Trade Commission (FTC), and the Office of Thrift Supervision (OTS) engaged in a pilot program to examine the mortgage industry. Under this program, state examiners worked with examiners from the Fed and OTS to examine mortgage businesses over which both state and federal agencies had regulatory jurisdiction. The FTC also participated in its capacity as a law enforcement agency. In addition, the states separately examined a mortgage business over which only the states had jurisdiction. This pilot is truly the model for coordinated state-federal supervision.

State-Specific Initiatives

Like many states, Massachusetts has taken a proactive approach to dealing with the foreclosure crisis and the devastating effect foreclosures have on our local communities. Below are some of the initiatives undertaken in Massachusetts—including passage of a comprehensive foreclosure prevention law signed by Governor Deval Patrick in November 2007—to address these issues and to prevent their recurrence:

- *Extending Community Reinvestment Act-like obligations to non-bank mortgage lenders.* Under a new law in Massachusetts, licensed mortgage lenders making 50 or more loans in a year in the state will be subject to requirements that are substantially similar to both the state and federal

Community Reinvestment Act (CRA). After issuing proposed regulations and holding a public hearing last summer, the new regulations became final on September 5, 2008. These “Mortgage Lender Community Investment” regulations include a Lending Test and a Service Test. Unlike the federal CRA for banks, these mortgage lender regulations include a review of the availability of mortgage products that are suitable for low- and moderate-income individuals. They also consider loans and services to assist delinquent borrowers to remain in their homes, including loan modifications. The Massachusetts Division of Banks posted the first schedule of examinations to be conducted on mortgage lenders under the new regulations. These examinations will begin in the second quarter of 2009.

- *Requiring mandatory counseling for first time homebuyers who choose to take out a subprime adjustable rate-mortgage.* Massachusetts law now prohibits a lender from making a subprime adjustable-rate loan to a first-time homebuyer unless they affirmatively opt-out of a fixed rate or prime loan product and receive counseling from an approved counselor.
- *Providing grant funds.* The Division of Banks has provided $3 million in grants to fund regional foreclosure education centers, statewide foreclosure prevention efforts, and first-time homebuyer programs. $2 million in grants was provided in fiscal year 2008 and $1 million has been provided thus far in 2009 to fund non-profit organizations providing assistance to areas

hardest hit by foreclosures. All funding for this program comes from fees paid by licensed mortgage originators.

- *Database of foreclosure notices.* Launching a web-based database of foreclosure notices will allow my office to study trends and better focus examination efforts. In addition, we have also built in functionality to track the entities responsible for maintaining vacant foreclosed properties. The Division has partnered with local health and public safety officials to ensure that vacant properties do not become a threat to the neighborhood.
- *Seeking voluntary foreclosure stays.* For homeowners facing imminent foreclosure, at the Governor's direction we have worked to secure voluntary 30 to 60 day stays in the foreclosure process from mortgage loan servicing companies. Our goal is to provide a short amount of time for homeowners to connect with reputable homeownership counseling firms and encourage mortgage lenders to work with homeowners who are unable to make their mortgage payments to see if a solution short of foreclosure is attainable. Since 2007, the Division has been able to obtain nearly 1,100 voluntary stays for homeowners who were facing foreclosure in Massachusetts.
- *Establish a 90 day Right to Cure.* Homeowners are now entitled to a 90 day "Right to Cure" before a mortgage holder can initiate foreclosure proceedings. As part of this requirement, the lender or servicer must allow the homeowner 90 days to cure the default and must provide an accounting of how much must be paid during that time to bring the mortgage current.

During that period, the mortgage holder can not charge legal or other fees other than principal and interest under the mortgage.

- *Stabilizing neighborhoods.* To combat foreclosure trends in some of the hardest hit communities in Massachusetts, the state Department of Housing and Community Development (DHCD) launched neighborhood stabilization pilot programs in Lawrence, Boston, Brockton, New Bedford, Springfield and Worcester neighborhoods. DHCD has partnered with lenders and non-profits to reclaim pre-foreclosure and foreclosed properties in these communities. The properties will be sold to qualified first-time homebuyers with the goal of returning them to fully-occupied status as quickly as possible.

Around the nation, states are engaging in an array of efforts and initiatives to prevent foreclosure and protect consumers. The National Governors Association has developed a report that provides a comprehensive overview of state efforts in this area. The report is available online at http://www.nga.org/Files/pdf/0902FORECLOSUREREPORT.PDF.

Suggested Congressional Action

CSBS and the states are working to enhance the regulatory regime for the residential mortgage industry to ensure legitimate lending practices, provide adequate consumer protection, and to once again instill both consumer and investor confidence in the housing market and the economy as a whole. Many mortgage brokers and lenders are honest, law-abiding loan providers. Many of the problems we are experiencing are both the result of "bad actors" and bad assumptions by the architects of our modern mortgage finance system. Enhanced supervision and improved industry practices can successfully weed out the bad actors and address the bad assumptions. If regulators and the industry do not address both causes of our current crisis, we will have only the veneer of reform and will eventually repeat our mistakes. Some lessons learned from this crisis must be to prevent the following: the over-leveraging that was allowed to occur in the nation's largest institutions; outsourcing of loan origination with no controls in place; and industry consolidation to allow institutions to become so large and complex that they become systemically vital and effectively too big to effectively supervise or fail.

While much is being done to enhance supervision of the mortgage market, more progress must be made towards the development of a coordinated and cooperative system of state-federal supervision.

<u>Preserve and Enhance Checks and Balances/Forge a New Era of Federalism</u>

The state system of chartering and regulating has always been a key check on the concentration of financial power, as well as a mechanism to ensure that our banking system remains responsive to local economies' needs and accountable to the public. The state system has fostered a diversity of institutions that has been a source of stability and strength for our country, particularly locally-owned and controlled community banks. To promote a strong and diverse system of banking—one that can survive the inevitable economic cycles and absorb failures—preservation of state-chartered banking should be a high priority for Congress. The United States boasts one of the most powerful and dynamic economies in the world because of those checks and balances, not despite them.

Consolidation of the industry and supervision and preemption of applicable state law does not address the cause of this crisis, and has in fact exacerbated the problem. The flurry of state predatory lending laws and new state regulatory structures for lenders and mortgage brokers were indicators that conditions and practices were deteriorating in our mortgage lending industry. It would be incongruous to eliminate the early warning signs that the states provide. Just as checks and balances are a vital part of our democratic government, they serve an equally important role in our financial regulatory structure.

Most importantly, it serves the consumer interest that the states continue to have a role in financial regulation. While CSBS recognizes the mortgage market is a nationwide industry that has international implications, local economies and individual homeowners are most drastically affected by mortgage market fluctuations. State regulators must remain active participants in mortgage supervision because of our knowledge of local economies and our ability to react quickly and decisively to protect consumers.

Therefore, CSBS urges Congress to implement a recommendation made by the Congressional Oversight Panel in their "Special Report on Regulatory Reform" to eliminate federal preemption of the application of state consumer protection laws to national banks. In its report, the Panel recommends Congress "amend the National Banking Act to provide clearly that state consumer protection laws can apply to national banks and to reverse the holding that the usury laws of a national bank's state of incorporation govern that bank's operation through the nation."[6] We believe the same policy should apply to the Office of Thrift Supervision. To preserve a responsive system, states must be able to continue to produce innovative solutions and regulations to provide consumer protection.

The federal government would better serve our economy and our consumers by advancing a new era of cooperative federalism. The S.A.F.E. Act enacted by Congress requiring licensure and registration of mortgage loan originators through NMLS provides a

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[6] The Congressional Oversight Panel's "Special Report on Regulatory Reform" can be viewed at http://cop.senate.gov/documents/cop-012909-report-regulatoryreform.pdf.

model for achieving systemic goals of high regulatory standards and a nationwide regulatory roadmap, while preserving state authority for innovation and enforcement.

Systemic Supervision/Capital Requirements

As Congress evaluates our regulatory structure, I urge you to examine the linkages between the capital markets, the traditional banking sector, and other financial services providers. Our top priority for reform must be a better understanding of systemic risks. The federal government must facilitate the transparency of financial markets to create a financial system in which stakeholders can understand and manage their risks. Congress should establish clear expectations about which regulatory authority or authorities are responsible for assessing risk and for using the necessary regulatory tools to address and mitigate risk.

Congress, the administration, and federal regulators must also consider how the federal government itself may inadvertently contribute to systemic risk—either by promoting greater industry consolidation or through policies that increase risk to the system. Perhaps we should contemplate that there are some institutions whose size and complexity make their risks too large to effectively manage or regulate. Congress should aggressively address the sources of systemic risk to our financial system.

My fellow state supervisors and I have long believed capital and leverage ratios are essential tools for managing risk. For example, during the debate surrounding the advanced approach under Basel II, CSBS supported FDIC Chairman Sheila Bair in her call to institute a leverage ratio for participating institutions. Federal regulation needs to prevent capital arbitrage among institutions that pose systemic risks, and should require systemic risk institutions to hold more capital to offset the grave risks their collapse would pose to our financial system.

Perhaps most importantly, Congress must strive to prevent unintended consequences from doing irreparable harm to the community banking system in the United States. Federal policy to preserve the collapse of those institutions considered too big to fail should ultimately strengthen our system, not exacerbate the weaknesses of the system. Throughout the current recession, community banks have largely remained healthy and continued to provide much needed capital in the communities where they operate. The largest banks have received amazing sums of capital to remain solvent, while the community banks have continued to lend in this difficult environment with the added challenge of having to compete with federally subsidized entities.

Congress should consider creating a bifurcated system of supervision that is tailored to the size, scope, and complexity of financial institutions. The largest, most systemic institutions should be subject to much more stringent oversight that is comprehensive enough to account for the complexity of the institution. Community banks, which operate in a much smaller market than the money center banks, should be subject to regulations that are tailored to the size and sophistication of the institutions. In financial supervision, one size should no longer fit all.

Facilitate Orderly Failures of Institutions that Pose Systemic Risks

The FDIC, in the case of insured depositories, and the Federal Reserve, for non-depository systemic risk institutions, must have the authority and resources to manage the failure of these institutions in an orderly manner. Since the creation of the FDIC in 1933, the states and the federal government have been able to address failures in a manner that both preserves market discipline and consumer confidence. This standard must be preserved and must apply equally to all institutions.

Roadmap for Unwinding Federal Liquidity Assistance and Systemic Responses

The Treasury Department and the Federal Reserve should be required to provide a plan for how to unwind the various programs established to provide liquidity and prevent systemic failure. Unfortunately, the attempts to avert crisis through liquidity programs have focused predominantly upon the needs of the nation's largest institutions, without consideration for the unintended consequences for our diverse financial industry as a whole, particularly community banks. Put simply, the government is now in the business of picking winners and losers. In the extreme, these decisions determine survival, but they also affect the overall competitive landscape and relative health and profitability of institutions. The federal government should develop a plan that promotes fair and equal competition, rather than sacrificing the diversity of our financial industry to save those deemed too big to fail.

Conclusion

A downward turn always reveals bad practices and structural flaws of both institutions and supervision. As regulators we must—with an unbiased eye—collectively and collaboratively acknowledge and address the weaknesses that a downturn in the economy identifies. Our highly diverse financial system has been the envy of the world, allowing our markets to be flexible and responsive, and has survived booms and busts. Thanks to our decentralized regulatory system, our financial institutions are competitive internationally and locally. However regulators and legislators address the current market failings, it should be in a way that preserves the diversity of financial institutions and supervision that has made our economy nimble, resilient, and dynamic.

There is a need for improved coordination and cooperation among functional regulators. CSBS has been actively engaged in efforts to enhance coordination as we work to develop a federalist system of supervision that ensures safety, soundness, and consumer protection, but still provides economic growth and innovation.

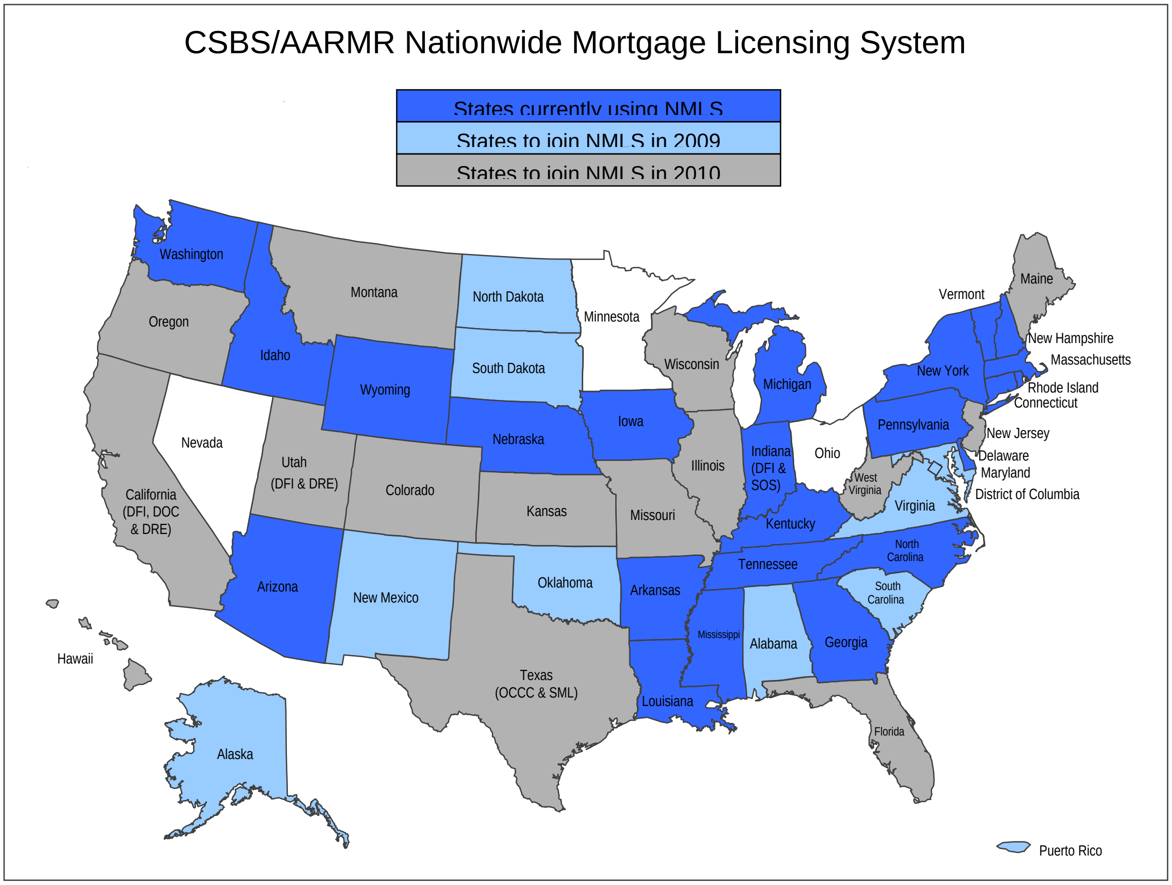
As Congress reviews proposals to restructure our financial regulatory system, there are several principles that must be adhered to. Ultimately, CSBS believes the structure of the regulatory system should:

1. Usher in a new era of cooperative federalism, recognizing the rights of states to protect consumers and reaffirming the state role in chartering and supervising financial institutions.
2. Foster supervision that is tailored to the size, scope and complexity of the institution and the risk they pose to the financial system.
3. Assure the promulgation and enforcement of consumer protection standards that are applicable to both state and nationally chartered financial institutions and are enforceable by locally responsive state officials against all such institutions.
4. Encourage a diverse universe of financial institutions as a method of reducing risk to the system, encouraging competition, furthering innovation, ensuring access to financial markets and promoting efficient allocation of credit.
5. Support community and regional banks, which provide relationship lending and fuel local economic development.
6. Require financial institutions that are recipients of governmental assistance or pose systemic risk to be subject to enhanced safety and soundness and consumer protection oversight.

CSBS looks forward to continuing to work with the federal regulators and Congress to address the needs and regulatory demands of an ever-evolving mortgage marketplace in an environment that fosters the strongest economy possible while protecting consumers and ensuring access to the broadest range of financial opportunity.

Appendix Items

Exhibit A: NMLS Implementation Map



State Regulatory Registry LLC, February 2009

Exhibit B: State Predatory Mortgage Lending Laws

NATIONAL CONFERENCE of STATE LEGISLATURES

The Forum for America's Ideas

Subprime and Predatory Mortgage Lending

This page addresses fraudulent or abusive lending practices in the mortgage market, commonly referred to as predatory lending. The most prevalent categories of abusive practices include:

Loan flipping-repeatedly refinancing loans, charging high fees each time.

Excessive fees and "packing"-adding fees far exceeding those justified on economic grounds, often through loan terms, such as the financing of points, fees and pre-payment penalties, single-premium insurance (to cover the balance of the loan should a borrower die, paid in one sum and added to the amount financed) and balloon payments (those due at the end of a loan that are significantly higher than monthly payments).
Asset-based lending-lending based on a borrower's overall assets, rather than income and ability to repay.
Outright fraud and abuse.

Legislation regarding foreclosures is covered on the Foreclosures page. Legislation regarding the specific crime of mortgage fraud is covered on the Mortgage Fraud page.

NCSL Information

Legislation Last Updated: June 12, 2008

Current State Laws

State:	Statutory Citation	Flipping Banned	Negative Amortization Banned	Prepayment Penalties Banned	Financing Credit Insurance Banned	Consumer Credit Counseling Provision	High Debt to Income Ratio Provision (Ability to repay loan)
Arkansas	Ark. Stat. Ann. §23-53-101 *et seq*.	X	X		X	3rd party required	Give due regard
California	Cal. Financial Code §4970 *et seq*. and §4973 *et seq.*	X	X			Disclosure	Presumption at 55%

Colorado	Colo. Rev. Stat. §5-3.5-101 *et seq*. and §38-40-105	X	X			Notification	Give due regard
Connecticut	Conn. Gen. Stat. §36a-746 *et seq*. and §36a-521		X			Notification	Presumption at 50%
D.C.	D.C. Code Ann. §26-1114. and §26-1151.01 *et seq*.		X	X			Give due regard
Florida	Fla. Stat. §494.0078 *et seq*.	X	X			Notification	Give due regard
Georgia	Ga. Code §7-6A-1 *et seq*.	X	X		X	3rd party required	Presumption at 50%
Illinois	Ill. Rev. Stat. ch. 815, 137/1 *et seq*. and ch. 765, 77/70	X	X		X	Notification	Presumption at 50%
Indiana	Ind. Code 4-6-12 and 24-9-1 *et seq*.		X		X	3rd party required	Give due regard
Kentucky	Ky. Rev. Stat. §294.010 *et seq*. and §360.100	X	X		X	Notification	Presumption at 50%
Louisiana	La. Rev. Stat. Ann. 6:1096(G) and 9:3572.6(C)						
Maine	Me. Rev. Stat. Ann. tit. 9-A, §2-509, tit. 9-B, §429; tit. 9-A, §8-103, §8-206-A, tit. 9-A, §10-102 and tit. 33, §506, 2007 Chapter 273, 2008 Chapter 471	X	X	X	X	3rd party required	Give due regard

Maryland	Md. Commercial Law Code §12-127, 12-311, 12-409.1 and 12-1029	X	X		X	3rd party required	Presumption at 45%
Massachusetts	Mass. Gen. Laws Ann. ch.183C, 1 *et seq.*		X	X		3rd party required	Presumption at 50%
Michigan	Mich. Comp. Laws §445.1631 *et seq.*		X		X	Notification	
Minnesota	2007 Chapter 18 Minn. Stat. §58.137	X				Notification	Requires vertification
Missouri	Mo. Rev. Stat. 375.937						
Montana	Mont. Code Ann. §32-5-306						
Nebraska	Neb. Rev. Stat. §45-702, 45-704 and 45-705				X		
Nevada	Nev. Rev. Stat. §598D.010 *et seq.*			X	X		Give due regard
New Jersey	N.J. Rev. Stat. 46:10B-22 *et seq.*		X		X	3rd party required	
New Mexico	N.M. Stat. Ann. §58-21A-1 *et seq.*	X	X	X	X	3rd party required	Give due regard
New York	N.Y. Banking Law 6-l	X	X		X	Notification	Give due regard
North Carolina	N.C. Gen. Stat. §24-1.1E, §24-1.1F, §24-10.2 and §53-243.01 *et seq.*	X	X			3rd party required	Presumption at 50%

Ohio	Ohio Rev. Code Ann. §1322.062, §1322.07, §1322.08, §1345.01 *et seq*. and §1349.25 *et seq*.	X	X		X		Give due regard/ Presumption at 50%
Oklahoma	Okla. Stat. tit. 14A, §3-204 and tit. 59, §2081 *et seq*.	X					Give due regard
Pennsylvania	Pa. Cons. Stat. 63, §456.101 *et seq*.					Notification	Presumption at 50%
Rhode Island	R.I. Gen. Laws §34-23-5 R.I. Gen. Laws §34-25.2-1 *et seq*.	X	X		X	3rd party required	Presumption at 50%
South Carolina	S.C. Code Ann. §37-23-10 *et seq*.	X	X		X	3rd party required	Presumption at 50%
Tennessee	Tenn. Code Ann. §45-20-101 *et seq*.	X	X				Presumption at 50%
Texas	Tex. Finance Code §343.001 *et seq*. and Tex. Gov. Code §2306.001 *et seq*.		X	X			Give due regard
Utah	Utah Code Ann. §61-2d-101 *et seq*.		X		X	Notification	
Virginia	Va. Code §6.1-422.1 and §6.1-422	X					
Washington	Wash. Rev. Code §31.04 *et*						

	seq.						
West Virginia	W. Va. Code §31-17-1 *et seq*.			X			
Wisconsin	Wis. Stat. Ann. §428.202 *et seq*.	X	X		X	Notification	Give due regard

Definitions of provisions:

Flipping: refinancing an existing mortgage loan with no benefit to the consumer; also referred to as churning.

Negative amortization: payment terms under which the outstanding principal balance will increase at any time over the course of the loan because the regular periodic payments do not cover the full amount of interest due or terms under which the aggregate amount of the regular periodic payments would not fully amortize the outstanding principal balance.