TESTIMONY OF

STEVEN L. ANTONAKES

MASSACHUSETTS COMMISSIONER OF BANKS

On behalf of the

CONFERENCE OF STATE BANK SUPERVISORS

On

LEGISLATIVE PROPOSALS ON REFORMING MORTGAGE PRACTICES

Before the

COMMITTEE ON FINANCIAL SERVICES

UNITED STATES HOUSE OF REPRESENTATIVES

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Good morning, Chairman Frank, Ranking Member Bachus, and distinguished members of the Committee. My name is Steven L. Antonakes, and I serve as the Commissioner of Banks for the Commonwealth of Massachusetts. I am also the Chairman of the State Liaison Committee (SLC), making me the newest voting member of the Federal Financial Institutions Examination Council (FFIEC).[1] I am also a founding board member of the Nationwide Mortgage Licensing System. It is my pleasure to testify today on behalf of the Conference of State Bank Supervisors (CSBS). Thank you for inviting us here to comment on legislative proposals to reform mortgage lending and brokerage activities.

CSBS is the professional association of state officials responsible for chartering, supervising, and regulating the nation's 6,182 state-chartered commercial and savings banks, and 400 state-licensed foreign banking offices nationwide. For more than a century, CSBS has given state bank supervisors a national forum to coordinate, communicate, advocate and educate on behalf of state bank regulation. In addition to banks, most CSBS members also have licensing and supervisory responsibilities for mortgage companies.

States have been active in mortgage regulation since the 1980s, when the first states passed mortgage broker licensing laws. All 50 states, plus the District of

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[1] The Federal Financial Institutions Examination Council (FFIEC) is a formal interagency body empowered to prescribe uniform principles, standards, and report forms for the federal examination of financial institutions by the Board of Governors of the Federal Reserve System (FRB), the Federal Deposit Insurance Corporation (FDIC), the National Credit Union Administration (NCUA), the Office of the Comptroller of the Currency (OCC), the Office of Thrift Supervision (OTS), and the State Liaison Committee (SLC) and to make recommendations to promote uniformity in the supervision of financial institutions. The FFIEC website is http://www.ffiec.gov.

Columbia, have now adopted some form of regulatory oversight of the residential mortgage industry. By the most recent count states have jurisdiction over more than 90,000 mortgage companies nationwide, with 75,000 branch locations and around 370,000 loan officers and other professionals.

Chairman Frank, Representatives Watt and Miller, we commend your dedication to protecting consumers, and to promoting the principles of responsible lending. CSBS supports the direction of H.R. 3915, the Mortgage Reform and Anti-Predatory Lending Act of 2007 to improve consumer protections and regulatory standards. Additionally, we applaud the work that Representatives Bachus, Gillmor, and Pryce have done on H.R. 3012 to address lending abuses, and that would facilitate the creation of a nationwide supervisory database for the mortgage lending industry.

CSBS looks forward to working with Congress and our fellow financial regulators to develop a more coordinated state/federal system to address today's developing foreclosure crisis and the ongoing regulatory challenges of the evolving mortgage finance industry. Many factors have contributed to the current state of the mortgage market. Restoring consumer confidence and stability will take cooperation from state and federal regulatory authorities, Congress and state legislatures, members of the industry, and consumers.

For the last four years, we at the state level have been working on solutions to the challenges raised by the revolution in mortgage finance, and the fragmented system in place to supervise its players. CSBS began with a vision for a national licensing system, and has moved on to coordinated regulatory policy with the federal banking agencies, enhanced examiner training, and pilot programs for coordinated examinations of mortgage lenders. Our goal, like yours, is a streamlined, consistent system of oversight that protects consumers and enforces best practices while maintaining a stable flow of credit through our markets.

We appreciate that the Miller-Watt-Frank bill acknowledges and builds from work that is already being done in the states to protect consumers and restore the public trust in our mortgage finance and lending industries. CSBS sees the need for improvement in our current supervisory framework, and we are taking those steps. It is vital that any new federal legislation support and enhance existing state and federal efforts to improve supervision and enhance consumer protection.

Addressing the Issue at the State Level

The housing market, so fundamental to the U.S. economy, is facing enormous challenges. The changes in the residential mortgage market over the past two decades have been dramatic and far-reaching. This evolution has had a number of benefits, including a vast flow of liquidity into the mortgage market, increased availability of credit, and higher rates of homeownership.

The evolution of the securitized mortgage market has also, however, created moral hazard by redistributing the risk of loan defaults through contractual agreements that begin with the local broker, and end with a Wall Street investor. This dispersal of risk has created opportunities and incentives for some actors to engage in weak underwriting or fraud.

While CSBS believes that this new model's long-term strengths outweigh its current failings, securitization changed the incentives within the industry, and the industry's internal controls did not keep pace with these changes. The failure to identify and implement these internal controls now threatens both our housing market and our economy.

States have been seeing and responding to problems created by weak industry controls for some time. States have acted to pass licensing laws and laws against predatory lending, and these laws now serve as models for the legislative proposals we are discussing today. This role of states as models for federal action is a long-standing benefit of our dual banking system, and one CSBS has discussed on many occasions in previous testimony.

Recognizing that the traditional model of state-by-state autonomy was not appropriate for an industry that combines the most local of financial products – a home mortgage – with a global system of finance, CSBS began four years ago to develop a more coordinated system. The core of this coordinated system is the Nationwide Mortgage Licensing System (NMLS). The NMLS helps accommodate the changes in state law that have extended supervision beyond the company to the individual, creating standards for professional qualifications and practices that will protect consumers and help give them more information on who they are doing business with. The scope of this project is enormous, as I will discuss, and it covers a universe of mortgage providers too large to be supervised by any one agency.

States have also pursued unprecedented cooperative efforts with our federal counterparts in areas such as guidance for nontraditional and subprime lending, and pilot programs for coordinated and cooperative supervision of subprime lenders.

To address our immediate challenges, state attorneys general and bank regulators have been meeting with industry representatives to explore ways to minimize the impact of rising foreclosure rates. In September, a working group of attorneys general and bank regulators, led by Iowa Attorney General Tom Miller, spent two days meeting with the ten largest subprime servicers, in a cooperative effort to find ways to avoid foreclosure and modify loans that may still be viable. Over the next two weeks, the working group will meet with the next ten largest subprime servicers, as the top 20 comprise more than 90% of the industry.

Earlier this year in Massachusetts, in response to the growing foreclosure crisis, Governor Deval Patrick directed my office to work with lenders and servicers in order to secure a delay in the foreclosure process. The purpose is to allow consumers a little time to consider their alternatives, including a loan workout, and to encourage consumers to seek foreclosure counseling. Since April 30th, the Massachusetts Division of Banks has secured 30- to 60-day delays in the foreclosure process for nearly 500 Massachusetts homeowners who have called my office. Many other states have similar initiatives underway.

Industry representatives have agreed to share information with state officials in order to help us track the problems that are having such an impact on our communities. We were pleased to see the Treasury Department's HOPE NOW announcement, which sets goals similar to our own. CSBS has asked the federal agencies to work with state officials on this effort, as coordination is essential to success. As we are most directly experiencing the impact of foreclosures within our states, a state role is essential to any effort to work with servicers.

Congress has the opportunity to build upon this new system of state and federal cooperation. At the state level, we have already begun to identify and address the weaknesses in applicable state law and oversight of the mortgage lending and finance system. Because mortgage lending is a local activity, and foreclosures so devastating to local economies, states must be at the core of any solution to this problem, and should be able to respond to future problems as they develop. State regulators, with the offices of the state attorneys general, have the resources and experience necessary to address these issues at the homeowners' level.

At the same time, we look to this Committee to complement this regulatory system by setting minimum federal lending standards based on the states' collective experience, and provide the same transparency for the capital markets that states seek to provide for consumers. We also urge Congress to make sure that the states are included in any new federal rule-making processes for mortgage providers. The FFIEC, already in place with a voting state representative, provides the most appropriate forum for developing these new rules.

The Nationwide Mortgage Licensing System

The increased coordination of the supervision and regulation of mortgage companies across state lines has highlighted the need for a central nationwide source of information. To that end, CSBS and its sister organization, AARMR, have created the Nationwide Mortgage Licensing System (NMLS) to serve as a foundation for residential mortgage supervision. State supervisors have been the first responders to the problems experienced in the residential mortgage market, and have garnered considerable amounts of information and expertise. All state-to-state coordinated supervision is linked to the NMLS; therefore, it is absolutely vital that any federal legislation support this system because of its essential role in our supervisory coordination. We appreciate that the Miller-Watt-Frank and the Bachus-Gillmor-Pryce bills both incorporate this initiative into the framework of a nationwide mortgage originator licensing and registration system.

The goal of the NMLS is to ensure that consumers are protected from fraudulent practices. The NMLS seeks to improve the efficiency and effectiveness of the U.S. mortgage market, to fight fraud and predatory lending, to increase accountability among mortgage professionals, and to unify and streamline state licensing safeguards. This system is scheduled to launch on January 2, 2008, and it will allow companies and individuals to be tracked across state lines and over any period of time.

The benefits of this nationwide system to consumers, the industry, and state supervisory agencies will be immediate and profound. Consumers will have access to key information about providers. Honest mortgage providers will benefit from the creation of a system that drives out fraudulent and incompetent operators, and from having one central point of contact for submitting and updating license applications. Investors will benefit from the knowledge that the loans they have purchased were originated by a provider with a clean record. All market participants will benefit from a system that makes it easier to identify and punish the small percentage of dishonest operators in the mortgage industry.

Again, we appreciate that both the Miller-Watt-Frank and Bachus-Gillmor-Pryce bills facilitate the creation and operation of this system. We encourage the Committee to consider elements of the Bachus-Gillmor-Pryce bill not included in the Miller-Watt-Frank bill that would allow state and federal mortgage regulators to share information about licensed professionals without the loss of privilege or the loss of state and federal confidentiality protections; protect the Nationwide Mortgage Licensing System against civil actions or proceedings for monetary damages in the case of good faith errors; and facilitate FBI background checks for the states.

The Uniform Predatory Lending Standard

CSBS supports a more uniform predatory lending standard, provided that the federal standard is a floor, rather than a ceiling, and that states have clear authority to take enforcement actions against violations. States have taken the lead in this area, with 36 states plus the District of Columbia enacting laws against predatory lending. North Carolina was the first to do so, in 1999. These state laws supplement the federal protections of the Home Ownership and Equity Protection Act of 1994 (HOEPA), and have led to significant changes in industry practices. All too often, however, we have been frustrated in our efforts to protect consumers by the preemption of state consumer protection laws by federal agencies.

A federal anti-predatory lending standard should state clearly and unambiguously that lenders must consider a borrower's ability to repay a loan. This affordability standard should include all of the costs of homeownership, not just the monthly payment. Our concern has been that borrowers too often do not understand the characteristics and risks of the products they are purchasing.

The states have taken action to close what they perceived as gaps in HOEPA; now, the proposals you are considering today look to those state laws as models. This is federalism at its best. Markets change, industries change and laws need to change. Any federal legislative proposal must preserve the states' ability to address new problems as they emerge.

It is time for an update to HOEPA to incorporate the time-tested consumer protections implemented by the various states over the last decade. CSBS is pleased that the Federal Reserve Board has committed to a public release of HOEPA amendments in the coming months.

Preserving the States' Role

Fourteen years have passed since the original enactment of HOEPA. In that time, we have seen a revolution in mortgage finance, and the states have developed regulation and legislation to supervise the industry. Not all of these efforts have been successful, but through the experience of trial and error the states have created a supervisory framework and identified a set of best practices. Now, through Federal Reserve rulemaking, or changes in federal law, those best practices developed by the states can be incorporated into national standards.

The role the states have played in mortgage supervision can not be overlooked. Of the four landmark predatory lending cases that have created the common law framework for the industry, three originated from state action. Household, the largest predatory lending case in history, began with a single state investigation in 1999 and grew to a nationwide settlement benefiting hundreds of thousands of consumers by 2002. Even as that case was drawing to a close, the states were initiating the second largest predatory lending case in history, against Ameriquest. These cases have set the legal precedents for all subsequent predatory lending cases.

However Congress chooses to improve consumer protection for mortgage finance, it is important to support the states' ability, through legislative and enforcement authority, to protect consumers from emerging problems. It is crucially important not to undercut the work we have already done. Federal legislation should build on state expertise and efforts to protect consumers.

Coordinating Supervision and Enforcement

Building on the experience and best practices of state regulation means increasing coordination and cooperation not only among state regulatory agencies, but also with all federal agencies responsible for the oversight of the mortgage lending industry. Regulatory turf battles must become a thing of the past; our joint imperative is consumer protection and the restoration of confidence, stability, and sound principles of responsible lending to the marketplace.

The states, therefore, have launched ground-breaking initiatives with our federal counterparts, and look to Congress support of these efforts. Three major examination initiatives are well underway.

The first of these was the publication of interagency guidelines for mortgage providers. The states applauded the federal agencies' Guidance on Nontraditional Mortgage Product Risks and the Statement on Subprime Mortgage Lending, and developed parallel guidance for state-supervised entities. Beyond that, however, the states have taken the lead in establishing a new environment for lending policy, and have begun to implement that policy at the local level by giving state examiners a detailed set of model examination procedures to test and monitor each provider's adoption of these guidelines. Those procedures were formally released at the end of July, and three federal agencies have already adopted them as the examination tool to be employed in joint federal/state examinations.

CSBS and AARMR will soon release a detailed training course available to both government and public reviewers of subprime lending practices. This holistic approach to training is intended not only to help outsiders evaluate a business, but also to help the businesses themselves make systemic changes to their practices. Our goal should be not to just tell the industry what it's done wrong after the fact, but to show them how to operate in a manner that protects consumers in the future.

The second major initiative began with the early successes of state predatory lending enforcement cases, and continues to the present day with multi-state examination and enforcement alliances that work across state borders and regulatory jurisdictions. In addition to the nationwide actions, state regulators took more than 3,600 enforcement actions in 2006 alone.

CSBS and AARMR facilitated a meeting of state mortgage regulators in Boston to formalize a multi-state protocol and agreement on this combination of state examination and enforcement resources. My colleagues and I are encouraged by this multi-state effort, as state supervisors continue to move toward a more coordinated and consistent supervisory framework.

The third initiative is the joining of forces with our federal counterparts in two unique pilot examination programs. The first of these pilots brings state examiners together with examiners from the Federal Reserve Board, the Office of Thrift Supervision and the Federal Trade Commission to conduct simultaneous examinations of mortgage companies whose separate charters cross federal and state jurisdiction.

The second pilot project is a coordinated effort among the OCC and the states of New York and Massachusetts. This examination will place state examiners in loan origination companies at the same time as the OCC is examining the federally-chartered institutions that acquire loans from those originators. Both pilots will provide a window into the mortgage lending process, from origination to funding.

Conclusion

As I said in my opening remarks, proper supervision of the residential mortgage market will require a coordinated effort from both federal and state authorities. Congress has the opportunity to make more than stop-gap repairs to the supervisory framework. Congress has the opportunity to create a new system of state and federal coordination for protecting homeowners and enforcing best practices in the mortgage lending industry.

While housing finance may be global, borrowing and home ownership – and, sadly, defaults and foreclosures – are local. Creating a new federal regulator would be neither efficient nor realistic, given the nature of the mortgage market. As I noted, the sheer volume of providers makes it impossible to imagine a single federal agency that could oversee them all. When it comes to protecting consumers, even globally funded mortgages are originated locally.

The solution, instead, is a coordinated federal and state supervisory framework that will provide both transparency and protection to all participants in the mortgage market, and restore the public trust. CSBS is already taking steps to create such a framework. We appreciate the efforts your legislation makes to improve consumer protection and enhance industry standards. CSBS looks forward to working with you to further ensure the efforts of state officials.

Thank you for inviting me to testify on this important subject today. I am pleased to answer any questions the Committee may have.