

## **Viewpoint: Guidance to Streamline Mortgage Supervision**

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By Neil Milner

It's not surprising that confusion is the order of the day when it comes to how the U.S. residential mortgage industry is supervised. The supervisory framework can befuddle even the most astute among us, not to mention the consumer who just wants a mortgage he or she can afford.

Recently, mortgage regulation has moved up on the priority lists of federal bank supervisors and members of Congress who are mulling whether to initiate legislation or rulemaking. But the fact is that outside the arena of federally regulated banks and savings associations, most mortgage lending is regulated and supervised at the state level.

It's no secret that the residential mortgage industry has rapidly evolved in the past two decades. What is often misunderstood is the states' role in supervising this industry and significant efforts to improve supervision.

The last 20 years have witnessed a shift from a market where savings and loans originated most residential mortgages, federal government-sponsored enterprises or agencies held a significant percentage of the market share, and the majority of mortgages were fixed-rate 15- or 30-year mortgages. Now S&Ls make up a minority of the market, loans sold to Fannie Mae and Freddie Mac or insured by the Federal Housing Administration account for less than half the market, and the product choices for consumers have exploded.

Recognizing the evolving nature of the industry and its supervisory challenges, most state legislatures have passed laws to regulate mortgage brokers, lenders, and/or loan officers.

Under our current regulatory system, the state agencies have shouldered the primary responsibility for overseeing the residential mortgage industry. The increasing role that brokers play in the residential mortgage process, concerns about predatory lending, the explosion of product choices offered by the private sector, and the realignment of the federal role in housing finance have required the states to develop new tools to protect consumers and to ensure that mortgage markets operate in a fair and level manner.

Across the nation, there has been significant growth in products and underwriting practices, including interest-only loans, various types of adjustable-rate mortgages, and stated-income underwriting. In many cases, however, it appears the borrower does not fully understand how these products work.

Therefore, the Conference of State Bank Supervisors, and the American Association of Residential Mortgage Regulators strongly endorse and applaud the federal financial agencies for recently proposing a statement on subprime lending and for issuing guidance on nontraditional mortgage product risks last year. Neither the proposed statement nor the interagency guidance, however, applies to those mortgage brokers and mortgage companies not affiliated with a bank holding company or an insured financial institution. Such companies currently originate a vast majority of loans.

In an effort to provide consistent underwriting standards and consumer protection provisions to all residential mortgage consumers, the CSBS and the AARMR developed parallel guidance on nontraditional product risks for state regulators to apply to their licensed residential mortgage brokers and lenders and released the parallel guidance almost immediately after the interagency guidance was released.

The guidance is nearly identical to the interagency guidance; only provisions that do not apply to mortgage brokers and companies (such as stress testing, capital requirements, and portfolio management) were removed. In addition, the CSBS and the AARMR anticipate developing a statement on subprime lending that would be applicable to state-licensed entities and would parallel the proposed interagency guidance.

So far 26 states and the District of Columbia have officially adopted the parallel guidance. The majority of these states have adopted the guidance as regulatory guidelines or best practices, but some have decided to implement the guidance as a rule. The CSBS is confident that many states will soon follow suit and adopt the guidance. In California, for example, state Sen. Michael Machado has introduced legislation to implement the guidance as a law.

The CSBS believes all states have the authority to adopt the guidance, and we expect full adoption.

While the guidance is a step in the right direction, there is much more to be done to improve supervision of the residential mortgage industry. To that end, the CSBS and the AARMR are developing a residential mortgage licensing initiative to create uniform, national mortgage broker and lender licensing applications and a centralized database to house this information.

The uniform application and database will streamline the processing of licensees at the state level. The national database will contain licensing information, enforcement actions, and background data for every state-licensed mortgage broker, mortgage lender, control person, branch location, and loan originator.

Another hurdle to overcome is the faulty disclosure process. The current disclosure documents are too complex and fail to provide consumers with the information they need to protect their interests. The CSBS believes an entirely new disclosure process is necessary to help consumers keep pace with the ever-expanding array of mortgage products.

While mortgage regulation is evolving, it is not unregulated. In fact, states are working together on an unprecedented scale to improve standards and accountability. States also continue to ramp up their supervision of their regulated entities. Through the CSBS and the AARMR, the states are working toward stronger, more consistent, and more uniform regulation and supervisory standards.

Ultimately, the state agencies must fully utilize the tools in their arsenal to supervise the residential mortgage industry more effectively. The states have been proactive in developing these tools and coordinating with the federal financial regulators.

Improved communication among all regulators — state and federal — and increased coordination is essential to provide consistent consumer protection and supervisory standards across the entire mortgage industry.

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