AARMR's Clark: Time Is Now to Modernize Mortgage Supervision

Nov 13, 2019

Prepared Remarks for Charlie Clark
President, American Association of Residential Mortgage Regulators
Director, Washington State Department of Financial Institutions
AARMR-CSBS National Mortgage Policy Summit, Washington, DC, November 13, 2019

On behalf of AARMR and CSBS, I am proud to welcome all of you today. We've got a terrific agenda for you. I am pleased to see so many of my state regulator colleagues…special guests who will address this summit…and all those interested in the mortgage industry. Again, welcome.

Special thanks go to CSBS CEO John Ryan and his organization for working with AARMR to organize this summit. Ours is a great partnership of mortgage regulators and state bank supervisors. And this summit will only strengthen our bond going forward.

So, why are we here? Beyond the existential nature of that question, we are here for a few reasons:

- To bring state and federal regulators together with policymakers and interested parties

- To take stock of the mortgage industry and how it has changed since the financial crisis
- To leverage this common understanding and forge partnerships with each other so that, together, we can shape the future of mortgage supervision

From today, you will see how state and federal regulators can work together to update prudential standards and foster a culture of compliance within the industry, with more uniform application by regulators…less burden on companies…and greater protections for consumers.

Our agenda reflects these and other issues before us…where change is likely to come from…and opportunities to strengthen our supervisory system:

- We will open with FHFA Director Mark Calabria. John Ryan will ask Mark about Fannie Mae and Freddie Mac…their important role…and plans to end conservatorship.
- Public policy implications will be the focus of Rep. Bill Huizenga and, after lunch, Rep. Patrick McHendry. Both congressmen sit on the House Financial Services Committee.
- A panel of industry leaders will discuss key changes in the mortgage market…ones happening today and ones to anticipate for the future
- Another panel of experts will examine the impact of technology…how it is affecting the industry's structure, delivery systems, consumers…and even us regulators
- From there, two more panels will follow, focusing on prudential standards for mortgage servicing and then housing finance reform
- Bret Afdahl, CSBS chairman and South Dakota banking commissioner, will close out the day by describing what all of us need to focus on going forward

This is an impressive agenda, with pretty amazing speakers. I hope you will enjoy, participate in and get value from our discussions.

Market and Supervisory Overview

Today, the mortgage market – more than $10 trillion strong -- relies almost exclusively on backing from the federal government, with funding and guarantees from federally supported entities such as the GSEs and Ginnie Mae/FHA/VA…who are responsible for almost all new home loans.

With roughly two-thirds market share, nonbank financial services companies are now the primary source of mortgage originations…and they represent a growing source of mortgage servicing as well, to nearly half of that market. Nonbanks have made homeownership possible for millions of Americans who otherwise would have received less favorable terms on their loan…or no loan at all. At the same time, nonbanks present different kinds of risk to regulators, such as greater dependence on third parties for liquidity…lower operating capital…and lack of asset diversification.

It used to be that banks and nonbanks would operate in counter-cyclical ways. When the economy was flush, banks would be the main source of originations. When the economy was in recession, nonbanks would keep markets going. But since the financial crisis through today, in what is a healthy economy, nonbanks have remained dominant.

What does that mean? As a regulator, I have to assume that nonbanks are here to stay. And I have to ask whether our supervisory system needs to change as a result. I believe it does. This change will require state and federal regulators to strengthen our regulatory network.

State regulators license and supervise mortgage companies. Whether it be compliance, safety and soundness, consumer protection or cybersecurity, we are the prudential regulators of nonbank mortgage companies. At the same time, federal regulators such as FHFA and the CFPB perform vital roles in safety and soundness and consumer protection issues. Thus, the better we work together, the better the supervisory system going forward.

Now, we are building from strength. The financial crisis led to dramatic improvements in mortgage supervision. Congress created the CFPB…and through definitions for qualifying mortgage and ability to repay, new rules were set for what made for good loans and the lender’s responsibility in originating them.

Meanwhile, Congress and the states mandated that all mortgage originators be licensed through the Nationwide Multistate Licensing System, operated by CSBS. A system that now spans more than 24,000 companies, NMLS ensures that the industry operates with accountability, transparency and integrity.

Because of the data collected through NMLS, we can produce Mortgage Call Reports, vital information that we share with federal agencies. State regulators adopted new standards to supervise companies based on their financial condition. We developed an operating agreement with the CFPB to coordinate supervision. Later, we turned the discussion to what would make for effective standards for prudential regulation, an effort still underway.

From all this work, we forged a stronger system of mortgage supervision.

Going Forward: Supervisory Practices & Prudential Standards

But the question going forward is: Is that enough? Do we need to make further changes? Again, the answer is yes. Not only has the industry structure changed, given the dominance of nonbanks, we regulators still have work to do on supervisory practices and fully implementing prudential standards.

So, here’s our game plan.

To me, it all begins with creating trust…trust among state and federal regulators, trust among regulators and the industry, and certainly trust with the public. It means avoiding a regulatory mentality of gotcha and, instead, embracing collaboration and coordination.

Together, we should forge a culture of compliance within the mortgage industry. One where new features can be embedded in loan origination systems that verify compliance with consumer protection laws…all before the loan even closes. Indeed, AARMR and CSBS recently announced our support for data standards to capture and transfer compliance-related information. And we are working with vendors today to assist with implementation.

Think about what all this makes possible:

- Mortgage companies can flag errors before they really cause damage
- Companies can conduct more thorough self-assessments they pass along to regulators
- Regulators can use this data to move towards real-time supervision, where we flag issues well before the next exam cycle
- With more accurate data, Mortgage Call Reports can become even more valuable
- And, to put a bow on this change, lengthy file reviews and adversarial positions between companies and regulators can fade into the rear-view mirror

That is our vison for a paradigm shift. Of course, bad actors will face different supervisory outcomes.

Now, we still need to perform formal exams. And can we do better here as well. To that end, CSBS recently deployed a new technology platform called the State Examination System. This platform offers the potential to process supervisory information much more quickly…leverage data analytics to triage cases based on risk…and further harmonize multistate examinations through information sharing and coordinated scheduling.

So, faster cycle times…a greater focus on riskier cases…and less burden on companies, all while ensuring consumer protections. The term “breakthrough” is no exaggeration.

Technology will get us only so far. We still need to shore up prudential standards on capital, liquidity and operations…and apply these standards more uniformly and consistently. With an industry increasingly comprised of nonbanks, evaluating financial condition becomes a paramount concern.

We need to make sure that a company has sufficient capital to absorb losses...assets strong enough to support their business...enough profit to ensure ongoing operations...liquidity to manage the ebbs and flows of cash demands...and a financial position not subject to wild swings of the business model or market.

At the state level, we are concerned about liquidity standards.

Given that nonbanks rely on third parties to fund loans, we need to set standards that are: 1) sufficient to mitigate the risk that a key provider terminates the relationship; 2) flexible to be tailored to the size and risk profile of the company; and 3) enduring to ensure the company causes no harm to consumers. We are currently discussing what such standards might involve. And we look forward to seeking public input on proposed standards and bringing them forward as a national model.

Regarding capital, we need standards to be uniform across the states and federal agencies. Washington State, for instance, uses the highest capital standards set by the GSEs. So, we look forward to partnering with our peers at the federal level… to help define appropriate standards and the best ways to implement them.

Dialogue, partnership and coordination are key ingredients to a modern supervisory system.

Let me sum up. We operate in an environment where post-crisis laws and standards have improved mortgage supervision and reduced the likelihood of repeat failures. But a change in industry structure…one towards nonbanks…has led us to believe we need to update our system and how we implement our practices. As the saying goes, it is better to fix the roof while the sun is shining than wait for the rain.

I believe we can modernize mortgage supervision by creating a culture of compliance with industry…implementing technology solutions to reimagine supervisory practices…and enhancing prudential standards to instill public confidence. All this will require collaboration and coordination among state and federal regulators, who share equally in our mandates and in the outcomes of supervision.

I am optimistic – extremely optimistic – that together we can forge an even more effective system of mortgage supervision in the United States.

202.296.2840
newsroom@csbs.org
1129 20th Street, N.W., 9th Floor, Washington, DC 20036