

TESTIMONY OF

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On behalf of the

CONFERENCE OF STATE BANK SUPERVISORS

On

SAFE AND FAIR SUPERVISION OF MONEY SERVICES BUSINESSES

Before the

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INTRODUCTION

Good morning, Chairman Capito, Ranking Member Maloney, and distinguished Members of the Subcommittee. My name is Deborah Bortner, and I serve as the Director of Consumer Services at the Washington State Department of Financial Institutions. The Washington State Department of Financial Institutions (DFI) regulates a variety of bank and non-bank financial institutions licensed or chartered in Washington State. As Director of Consumer Services, I lead the Division within DFI responsible for the regulation of money transmitters, check cashers and sellers (including payday lenders), mortgage brokers, mortgage bankers, loan servicers, consumer loan companies, and independent escrow companies. In addition to serving the State of Washington, I serve on the Board of Directors for the Money Transmitter Regulators Association (MTRA), the State Regulatory Registry (SRR) Board of Managers, and recently completed a term as Ombudsman of the Nationwide Mortgage Licensing System and Registry (NMLS or System).

It is my pleasure to testify before you today on behalf of the Conference of State Bank Supervisors (CSBS). CSBS is the nationwide organization of banking regulators from all 50 states, the District of Columbia, Guam, Puerto Rico, and the U.S. Virgin Islands. State banking regulators supervise over 5,400 state-chartered banks. Further, most state banking departments also regulate a variety of non-bank financial services providers, including mortgage lenders and money services businesses (MSBs). For more than a century, CSBS has given state supervisors a national forum to coordinate supervision of their regulated entities and to develop regulatory policy. CSBS also provides training to state banking and financial regulators and represents its members before Congress and the federal financial regulatory agencies.

I thank you, Chairman Capito, and the Members of the Subcommittee, for holding this hearing on money services businesses. The states are no strangers to policy structures that balance federal standards and state flexibility to achieve broad yet responsive regulation and supervision. This paradigm has existed in various areas of financial regulation, including banking and mortgage, for many years. I appreciate the opportunity to discuss the applicability of these models to regulation of money services businesses and to provide an overview of state MSB regulation.

STATE REGULATION AND SUPERVISION OF MONEY SERVICES BUSINESSES

States have long recognized the importance of ensuring the transfer of money occurs in a safe and transparent manner. Money transfers involve an intricate system of business-to-consumer and business-to-business relationships, both of which are overseen by state regulators to ensure there is accountability at each stage of a money transfer. The distribution of money is a highly personal transaction for consumers, and the contractual relationships between businesses must not interfere with basic consumer protections, while still ensuring appropriate recourse between parties. These relationships are perfect examples of the nexus of the states' interest: consumers must be protected, businesses must operate in a safe and sound manner, and those who commit crimes must be brought to justice.

State MSB Regulation

The federal term "MSB" encompasses several financial services and products including money orders, travelers checks, check cashing, currency exchange, currency dealing, prepaid access cards and most notably, money transmission. States have regulated MSBs for decades and virtually all states require licensing of MSBs. The licensing of an MSB typically requires

the submission of personal background information on directors and officers, financial statements, surety bonds, company policies, Bank Secrecy Act (BSA) policies, as well as proof of registration as an MSB with the Financial Crimes Enforcement Network (FinCEN), if appropriate.

The majority of states who license MSBs also conduct periodic on-site examinations of MSBs. These exams are generally on an 18- to 24-month cycle and are based on risk assessments performed by regulators. These exams cover several areas, including BSA and Anti-Money Laundering (AML) compliance, adherence to reporting and recordkeeping requirements, compliance with FinCEN registration requirements, principal oversight of agents, and compliance with capital, surety bond and permissible investment requirements.

In addition to regulation and supervision of business practices, requirements on the front-end of MSB transactions are used to increase transparency for consumers. Through disclosure requirements like refund notices and mandated receipts, consumers are made aware of the money transmission process and their recourse in the event of a failed transmission before and after the money transfer occurs.

Multi-State Supervision

As in other regulated financial industries, state regulators actively work together to reduce regulatory burden and increase regulatory efficiency through coordinated MSB examinations.

Multi-state exams have a “lead state,” which serves as a central point of contact. The lead state coordinates document and information requests and acts as a repository for documentation to help minimize duplicative document requests. As in the case of an exam conducted by a single state, multi-state exams include analysis of the money transmitter’s

financial condition, adherence to state regulatory requirements, and compliance with the Bank Secrecy Act. MSB examination standards and objectives share certain similarities with depository institutions examinations, including a review of financial strength, operational effectiveness, asset quality, as well as transmission volume.

Both CSBS and MTRA play an active role in facilitating this multi-state process. A sister organization of CSBS, MTRA is a membership organization consisting of state regulatory authorities in charge of regulating money transmitters and sellers of travelers checks, money orders, and prepaid access cards. MTRA formed the foundation for multi-state MSB efforts by executing the Money Transmitter Regulators Cooperative Agreement in 2002¹ and the MTRA Examination Protocol in 2010, which 46 states have signed. These documents set up the framework the states use to coordinate MSB examinations and share information, minimizing regulatory burden on supervised entities and conserving regulatory resources. The MTRA Agreement developed the beginning steps in coordinated regulatory oversight by promoting concurrent and joint examinations between states. The Protocol provides a process for examinations, including examination schedules, work programs and reports designed to increase effectiveness and reduce regulatory burden.

To continue to improve multi-state supervision, the states are enhancing the scope and expanding the scale of the 2002 MTRA Cooperative Agreement and the 2010 MTRA Examination Protocol through the CSBS-MTRA Nationwide Cooperative Agreement for MSB Supervision and the Protocol for Performing Multi-State Examinations (Agreement and Protocol).² The enhanced Agreement and Protocol are designed to promote a framework of

¹ The MTRA Cooperative Agreement can be found at http://www.mtraweb.org/coop_agr.shtm.

² The Agreement can be found at <http://www.csbs.org/regulatory/Cooperative-Agreements/Documents/MSB/MSB-CooperativeAgreement010512clean.pdf>; the Protocol can be found at <http://www.csbs.org/regulatory/Cooperative-Agreements/Documents/MSB/MSB-Protocoll010512.pdf>.

coordination and consistency while ensuring regulatory requirements are met and burden is reduced for industry. To do so, the Agreement and Protocol outline how states will work together to examine for consumer protection and safety and soundness requirements in an efficient manner for both the states and supervised entities. The Agreement also establishes the Multi-State MSB Examination Taskforce (MMET) to enhance supervision of multi-state MSBs. The Protocol also provides guidelines on joint examination schedules and reports, as well as the development of a supervisory program that is tailored to the MSB's risk profile. As discussed below, the Agreement and Protocol, including the creation of the MMET, have been informed by the state mortgage regulators' efforts to improve supervision of multi-state mortgage companies. Although CSBS only began seeking state signatures for the enhanced Agreement and Protocol in March, 34 states have already signed, providing a significant start to this important effort in supervisory coordination.

State-Federal Coordination

The states, FinCEN, and the Internal Revenue Service (IRS) work together to ensure that the requirements of the Bank Secrecy Act are met. This includes concurrent examination responsibilities and efforts by the IRS and MTRA to coordinate examination schedules to reduce duplication and redundancy. Additionally, state-federal coordination on MSB regulation has included efforts such as:

- The issuance of the 2008 Bank Secrecy Act/Anti-Money Laundering Examination Manual for MSBs that was a collaborative effort of FinCEN, IRS, state agencies, CSBS and MTRA;
- Nationwide training jointly provided by state and IRS examiners on the BSA/AML Examination Manual for MSBs;

- Jointly developed exam procedures and processes that are utilized by state and IRS examiners during concurrent examinations; and
- Quarterly calls between the IRS and state regulators to discuss current initiatives, supervisory issues, and training needs.

This collaborative framework has worked well, though going forward, decisions made at the federal level could strain states' ability to implement crucial federal policies. In the past, the Administration has proposed de-funding state access to WebCBRS, a system that provides federal and state regulators with access to crucial BSA data. The states and CSBS expressed concern about this proposal and we were pleased when Congress rejected the idea during last year's appropriations process.

More recently, the Administration has proposed that FinCEN rely more on state MSB examinations with no corresponding proposal for federal enhancement to the state supervisory process. While the states are committed to a robust system of supervision and active coordination with our federal counterparts, Congress must thoroughly assess where expectations exceed the consensus of established programs and reassess the means by which agreed expectations are to be achieved.

STATE MORTGAGE REGULATION

Based on state regulators' experience in mortgage regulation and supervision, we have seen the benefits of coordination, common standards, and a nationwide regulatory infrastructure. While state mortgage and MSB supervision have each evolved over the past several years, the mortgage arena has seen a new federal presence that has helped bring greater focus to certain components of the mortgage regulatory structure.

Well over a decade ago, state mortgage regulators recognized the need to work together to enhance supervision of the non-depository residential mortgage industry. State regulators, individually and through CSBS and the American Association of Residential Mortgage Regulators (AARMR), have worked diligently and in an unprecedented manner to create a regulatory framework that can support a diverse system of mortgage origination, while still ensuring safety and soundness and consumer protection.

Development and Launch of NMLS

The NMLS is a web-based application that enables state-licensed mortgage lenders, mortgage brokers, and loan originators to apply for, amend, update or renew licenses online using a single set of uniform applications. State mortgage regulators began development of NMLS in 2005 with the goal of unifying state mortgage supervision in a single system that allows regulators to better coordinate regulation and provide the industry a more uniform licensing process. Further, subsequent to passage of the Secure and Fair Enforcement for Mortgage Licensing Act of 2008 (SAFE Act), NMLS is the system through which federally regulated depository institutions and subsidiaries register their mortgage loan originators (MLOs). NMLS benefits industry and regulatory users by providing efficiency, uniformity, transparency, and enhanced supervision across state lines and organizational charter types. As of April 2012, NMLS has been enhanced to accommodate the licensing of non-mortgage, state-regulated financial industries, including consumer lending, debt collection, and money services businesses.

The Secure and Fair Enforcement for Mortgage Licensing Act of 2008

At its launch, NMLS was a voluntary state initiative. Subsequently, Congress, through the leadership of Chairman Bachus, embraced and codified the system into federal law through

the Secure and Fair Enforcement for Mortgage Licensing Act of 2008, creating an integrated and comprehensive state-federal approach to licensing and registering mortgage lending professionals. By calling on all states to adopt robust and largely uniform licensing standards for state-licensed MLOs, the SAFE Act created a coordinated system of state-federal mortgage supervision that combines the strength of local regulation with nationally uniform minimum professional standards. The SAFE Act's additional requirement of registration of federally regulated MLOs further strengthens the overall mortgage regulatory structure.

After the SAFE Act's enactment, state regulators quickly went to work to implement the law, including development of a model state law to execute the mandates of the SAFE Act in a uniform manner. Within 18 months of the passage of the SAFE Act, 50 states, the District of Columbia, Puerto Rico, and the U.S. Virgin Islands had all passed legislation to bring their laws into compliance with the SAFE Act. By the end of 2011, all states had transitioned their licensed MLOs onto NMLS. This rapid and uniform implementation of a law by so many states was significant and demonstrates the commitment and dedication of state officials and state legislatures to enhance supervision of the mortgage industry.

One of the main objectives of the SAFE Act was to expand a then state-only initiative into a comprehensive regime covering all MLOs. To that end, federally regulated MLOs began registering with NMLS on January 31, 2011. This event was the culmination of well over a year's worth of close cooperation between CSBS and the federal banking agencies to modify NMLS in order to provide a system that allows both depositories and MLOs to efficiently meet the SAFE Act requirements for registration. All individuals who act as MLOs and are employed by depositories were required to be registered on NMLS by July 29, 2011 in order to conduct those activities.

NMLS Unique Identifier Number

A significant element introduced by NMLS is the NMLS Unique Identifier. As a single system of record shared by separate and sovereign state regulators, NMLS assigns each mortgage company, each branch, and each MLO a unique identification number that can be used to track that company, branch, and individual across states and over time. The NMLS Unique Identifier is also assigned to federally regulated depository institutions and mortgage loan originators, thus allowing each loan originator to have a single, seamless record, regardless of where he or she works or how he or she is regulated. The NMLS Unique Identifier assists in coordination of state oversight and provides the opportunity for investors and the secondary market to develop better metrics of loan originations and loan performance.

The Federal Housing Finance Agency requires Fannie Mae and Freddie Mac to collect the NMLS Unique Identifier for each loan they purchase. Similarly, the Federal Housing Administration requires the NMLS Unique Identifier for all mortgage loans submitted for insurance. This relatively quick adoption of the NMLS Unique ID by mortgage investors and insurers is a testament to the rapid and uniform adoption of NMLS by state agencies.

Mortgage Call Report

State regulators and Congress also recognized the value of uniform financial and activity data across state lines. As a result, the Mortgage Call Report now collects quarterly mortgage activity and financial data from all state-licensed companies. Launched in May 2011, the Mortgage Call Report provides a blueprint of the non-depository mortgage industry while simultaneously reducing burden on the industry. As a result of this initiative, some states have reduced regulatory burden by eliminating their unique annual state reports because the Mortgage Call Report collects sufficient information to satisfy their reporting needs. This information is

also a crucial tool for risk-scoping individual institutions and understanding broader industry trends.

NMLS Expansion

In developing the System, state regulators contemplated using NMLS to license and regulate mortgage providers as well as other non-depository financial services industries. Once the mortgage entities were in the final stages of transitioning onto NMLS, state regulators began the process of expanding System functionality to license other non-mortgage financial services industry entities through NMLS. In fact, due to the broad definition of some state license types, some non-mortgage financial service providers were already using NMLS to become licensed with a state.

The goal of expansion is to bring regulatory efficiencies and improved oversight to other financial service industries regulated by the states, including money transmitters, check cashers, payday lenders, debt collectors, debt management companies, small loan lenders, and auto finance lenders. During 2012, 12 state agencies are transitioning onto NMLS with 40 non-mortgage license types. An additional nine state agencies are planning to transition 17 license types onto NMLS in 2013.

In several states, these expanded license types include MSBs. As of today, 16 states have committed to using the NMLS to manage their MSB licenses by the end of 2013. Improvements to NMLS to accommodate the management of a broad range of licensees will continue to be made over the coming years as additional state agencies transition new types of licensees onto the System. For example, state regulators are currently working on functionality that will allow money transmitters to submit information regarding authorized delegates to the appropriate state regulators through NMLS.

State participation in NMLS for the expansion industries is voluntary. NMLS participation by most states will require law or regulation changes, but through the work of several state working groups and collaborative efforts with regulated industries, expansion industry participants will be able to satisfy their licensing requirements through NMLS. The transition process has included – and will continue to include – extensive industry outreach aimed at ensuring that the System and licensing structure meet policy goals while minimizing regulatory burden.

Facilitating Information Sharing

NMLS serves as a common system of record for state regulators and as a platform for regulatory coordination and collaboration. The SAFE Act helped facilitate this by providing that information entered into the System – and subsequently shared among mortgage regulators – retains any privilege and/or confidentiality otherwise conferred by state or federal law.³ With the expansion of the NMLS beyond the mortgage arena, CSBS believes it is important that regulated entities beyond the mortgage industry continue to have the confidence that information protected under state or federal laws as confidential and/or privileged retain those protections when shared with and among state and federal regulators.

This Committee’s work on H.R. 4014 is one step in that direction. Designed to amend the Federal Deposit Insurance Act with respect to information provided to the Consumer Financial Protection Bureau (CFPB), H.R. 4014 provides that any information given to the CFPB retains privilege in the same manner as information provided to banking regulators. However, more needs to be done. CSBS supports efforts to ensure that the protections in H.R. 4014 encompass information provided to any state regulator who may be sharing information about any regulated entity that falls within the purview of the CFPB. States will continue to expand the

³ See 12 U.S.C. § 5111.

use of the NMLS through state law and regulation, and appropriate assurances in federal law regarding the protection of privileged and/or confidential information would cement this policy decision.

SUPERVISION OF MULTI-STATE MORTGAGE COMPANIES

State mortgage regulators have used NMLS and the SAFE Act as parts of a larger effort to create a framework for comprehensive and consistent mortgage supervision. However, this framework still relies on regulators to utilize this regulatory apparatus to supervise and regulate the industry effectively. States have long utilized our proximity to the entities we supervise to identify emerging trends and take actions when necessary.

As in the MSB arena, state mortgage regulators have recognized a need to create more coordinated supervision. While regulatory coordination on multi-state entities was not new to either MSB or mortgage regulators, the housing crisis accelerated aspects of this coordination in the mortgage world. To that end, in 2008 CSBS and AARMR established the Multi-State Mortgage Committee (MMC) to serve as the coordinating body for examination and supervision of multi-state mortgage entities by state mortgage regulators.

The MMC is tasked with developing examination processes that will assist in protecting consumers from mortgage fraud; ensuring the safety and soundness of multi-state mortgage entities; supervising and examining in an integrated, flexible and risk-focused manner; minimizing regulatory burden and expense; and fostering consistency, coordination and communication among state regulators. The MMC is made up of mortgage regulators from 10 states and represents all states' mortgage supervision interests under the CSBS-AARMR Nationwide Cooperative Agreement for Mortgage Supervision. In a similar manner, the CSBS-

MTRA Agreement and Protocol establishes the MMET as the oversight body for multi-state supervision of the MSBs.

The ability to pool resources and the resulting increase in consistency and coordination benefits both the state banking departments and the regulated entities. States have recognized this through the work of the MMC and multi-state efforts in the MSB arena, and we are confident this approach has the proper balance of efficiency and local regulation. These efficiencies also carry through to coordination with federal regulators. The newly created CFPB has a mandate to coordinate with state regulators in carrying out its responsibilities. Existing infrastructures such as the MMC and MMET help states engage and coordinate efficiently in supervisory efforts with the CFPB.

ENHANCING MSB REGULATION

As demonstrated by state participation in the earlier MTRA Cooperative Agreement and Protocol, the more recent CSBS-MTRA Nationwide Cooperative Agreement for MSB Supervision and Protocol for Performing Multi-State Examinations, and by ongoing collaborative efforts between state regulators and IRS and FinCEN, enhanced state coordination benefits regulators and regulated entities alike. MSBs are local in touch and national in scale, so state and federal regulators must work together to ensure effective and consistent supervision. The evolution of state mortgage regulation, when layered with the SAFE Act, has shown that uniform infrastructure and federal policy can support – not supplant – local governance and oversight. Combined state-federal regulatory regimes that include clear and appropriately calibrated incentives can promote consistent and comprehensive regulation without losing the benefits of states’ “on the ground” perspective.

Infrastructure has proven to be a crucial tool to support enhanced coordination efforts. Congress recognized it when it codified NMLS into federal law as a system of record for state licensing authorities and for federally registered mortgage loan originators. In addition to greater uniformity and more comprehensive regulation, having a single system that serves as a data repository, a licensing system, and that assigns each regulated entity a unique identification number that stays with that regulated entity has brought about an increase in regulatory and industry transparency and accountability. States that have decided to use NMLS as part of the MSB regulatory regime have already made the decision that NMLS can bring the same efficiency and enhanced uniformity to MSB supervision.

CONCLUSION

The challenge for policymakers – and for the regulators who implement their policies – is to create a regulatory framework that ensures industry professionalism, industry and regulatory accountability, and the proper alignment of incentives, all while avoiding unnecessary regulatory burden. For state regulators, policies and approaches that encourage regulatory collaboration and coordination and that support regulatory innovation have been vital to striking this balance.

Thank you for the opportunity to testify before you today. I look forward to answering any questions you may have.