A REGULATOR'S PERSPECTIVE OF THE NEW REGULATORY REGIME IMPLEMENTED BY THE DODD-FRANK ACT AND ITS IMPACT UPON THE MORTGAGE INDUSTRY

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Thank you for that very kind introduction, and good morning. I am honored to speak with you today on the new regulatory regime implemented by both the Dodd-Frank Act and other various related regulatory initiatives and their impact upon the mortgage industry.

We are obviously operating in a tremendously challenging time. The rupture of the housing bubble, followed by the collapse of the capital markets, the ensuing recession, and the legislative and regulatory reaction to the crisis have all resulted in a vastly different regulatory regime and industry than we knew just a few short years ago. Policymakers and regulators have been spurred to action in an attempt to fortify the housing market and prevent a future crisis.

Today I will offer my perspective on the still-emerging regulatory landscape and the impact it has upon you as mortgage providers.

ABOUT DFI

However, since this is my first time addressing this organization, before delving into the "macro" impact of such regulatory evolution, I'd like to take a moment to provide information about the Indiana Department of Financial Institutions (DFI) and our role in mortgage supervision here in Indiana.

DFI was created by the Indiana Financial Institutions Act of 1933 with the mission to regulate and supervise financial services providers in a manner that:

- Assures the residents of Indiana adequate and proper financial services;
- Protects the interest of depositors, borrowers, shareholders and consumers;
- Promotes safety and soundness in Indiana financial institutions; and
- Advocates and enforces compliance with applicable state and federal laws.

Originally, the Department was commissioned with the responsibility for the supervision of commercial banks, trust companies, private banks, savings banks, building and loan associations, credit unions, and finance companies. The scope of DFI's jurisdiction has since been broadened to include pawnbrokers, payday lenders, industrial loan and investment companies, money transmitters, check cashers, budget service companies, and rental-purchase agreement companies. In 2008, the Indiana Legislature gave DFI the authority to license and regulate first lien mortgage lenders beginning January 1, 2009.

In addition to the 149 depository institutions we regulate, DFI currently supervises 253 first lien mortgage lenders, 81 second lien mortgage lenders, over 3,000 mortgage loan originators, over 2,100 non-lending providers who sell goods and services on credit, and almost 270 other non-depository financial services providers.

Indiana has implemented the Secure and Fair Enforcement for Mortgage Licensing Act of 2008 (SAFE Act), requiring mortgage loan originators to satisfy certain criteria and be licensed through the Nationwide Mortgage Licensing System and Registry.

The focus of regulatory supervision for mortgage lenders in Indiana includes transaction compliance testing, a review of internal controls, and an in-depth examination of guidelines and practices regarding:

- The ability of the consumer to make required payments;
- The loan terms as related to marketing and advertising of specific loan programs;
- Verification that Loan To Value & Combined Loan To Value meet investor criteria;
- Monitoring of default accounts and foreclosures;
- Foreclosure prevention procedures;
- Compliance with Mortgage Examination Guidelines (MEGs) for Non-traditional and/or Sub-prime loans; and
- MLO licensing and compensation.

Our intent is to facilitate such examination functions "off-site" to the extent possible to minimize disruption or imposition upon our mortgage lenders.

EVOLUTION OF THE MORTGAGE INDUSTRY AND REGULATORY RESPONSE

The changes in the residential mortgage industry over the past two decades have been dramatic and far-reaching. Over the past 20 years, the market has ushered in new players, new products, a new originate-to-distribute securitization model, and has had a tremendous impact on the economy as a whole.

This evolution, which may be more aptly described as a revolution, brought with it a number of good things, such as a vast flow of liquidity into the mortgage market, increased availability of mortgage credit, and higher rates of homeownership. But it has also brought moral hazard, as the allocation of risk of a default became dispersed through complex arrangements that begin with the local mortgage broker and ultimately end up with a Wall Street investor. Controls that had previously been in place to govern the industry were simply overwhelmed by the revolution and supervision could not keep pace with industry advancements.

NMLS AND THE SAFE ACT

State regulators, because of our proximity to the entities we supervise, recognized this evolution in the mortgage market fairly early. In the early 2000's, state regulators identified troubling practices and trends in the residential mortgage industry and took action to address those concerns. In 2004, state regulators, through the Conference of State Bank Supervisors (CSBS) and the American Association of Residential Mortgage Regulators (AARMR), began the innovative development of the Nationwide Mortgage Licensing System and Registry, which is better known as NMLS.

NMLS was created to:

- Improve the efficiency and effectiveness of state supervision of the mortgage industry;
- Enhance consumer protection;
- Fight mortgage fraud and predatory lending;
- Increase accountability among mortgage professionals; and
- Unify and streamline state license processes for lenders and brokers.

Launched in January 2008 with seven states, by October 2010, just 33 months later, 58 agencies in all 50 states, the District of Columbia, Puerto Rico and the Virgin Islands were using NMLS to license their regulated mortgage providers. The Indiana DFI began participating in NMLS in January of 2009.

Congress, recognizing the efforts of state regulators to enhance mortgage supervision, built upon the regulatory framework created with the development of NMLS by enacting the SAFE Act. The SAFE Act seeks to protect consumers and prevent mortgage fraud by implementing an array of requirements for licensed or registered mortgage providers.

As you are aware, the SAFE Act requires state-licensed mortgage originators to pass a written test, to complete pre-licensure education courses and to take continuing education courses. In addition, licensed and registered originators must submit fingerprints to NMLS for submission to the FBI for a criminal background check, and state-licensed providers must provide authorization to NMLS to obtain an independent credit report. To further enhance efficiency, a single criminal background check or credit report may be submitted to multiple regulators, thereby lowering costs and eliminating repetitive filings.

Furthermore, the SAFE Act requires all mortgage loan originators to have a unique ID number provided by NMLS. The final registration rules promulgated by the federal agencies further requires that banks employing mortgage lenders must also have a record on NMLS and be provided a unique ID number. This means that NMLS is a complete system of all companies and individuals who are originating residential mortgages.

BENEFITS OF NMLS AND THE SAFE ACT

Together, NMLS and the SAFE Act represent a dramatic overhaul of the supervisory framework of the mortgage industry. My fellow state regulators and I are fully cognizant of the tremendous resources you have committed to be licensed and to become compliant with the enhanced mandates of the SAFE Act. You each should be commended for your dedication to your vocation and the professionalism you have obviously demonstrated to be licensed, SAFE Act-compliant mortgage providers.

Consistency and Efficiency

Concerns raised by mortgage loan originators regarding the challenging standards imposed by NMLS and the SAFE Act do not fall upon deaf ears. If you recall, one of the primary objectives of launching NMLS in the first place was to "unify and streamline state license processes for lenders and brokers." By establishing identical NMLS forms for all state-supervised mortgage entities to utilize consistently across all states, we vastly enhanced the uniformity of mortgage licensure in the United States and made the application and renewal process much more efficient for mortgage providers. State licensing laws are more uniform now than ever before.

Improved Data

Another requirement of the SAFE Act which represents a significant change is the NMLS Mortgage Call Report for non-depository entities on behalf of their MLOs. Prior to passage of the SAFE Act, most states required companies to submit financial statements, and 38 states required an annual report of mortgage activity. These requirements were not uniform, which made compliance more difficult and made any comparison of data across state lines less valid.

State regulators formed a working group to develop a draft mortgage call report, not only to meet the mandate of the SAFE Act, but to create a uniform call report that would be beneficial to both regulators and members of the industry, while not placing undue regulatory burden upon mortgage providers. After extensive changes due to comments received during the public comment period and numerous discussions among state mortgage regulators and industry participants, the NMLS Mortgage Call Report was significantly modified from the original draft to reflect the many suggestions received from commenters. The final NMLS Mortgage Call Report was finalized in late 2010 and marks the first ever standardized information collection for the residential mortgage industry.

Beginning last month, all state-licensed mortgage companies and those companies employing state-licensed mortgage loan originators were required to submit the NMLS Mortgage Call Report on a quarterly basis. Data will be gathered concerning the financial condition and mortgage loan volumes by type and state. The call report will provide timely, comprehensive and uniform information of the non-depository mortgage industry, thereby allowing state regulators to effectively monitor both licensees and mortgage activities. To date, nearly 11,000 call reports have been filed through NMLS. This tremendous response has been higher than many had originally anticipated.

It is important to note that the NMLS Mortgage Call Report will benefit policymakers and members of the industry alike. For instance, gathering the required data will enable companies to have a better grasp on their own production and financial condition. Further, aggregate statistical information will be gathered over time from the NMLS Mortgage Call Report, which will be particularly useful for policymakers to assess how companies compare on a state, regional and national level.

Increased Professionalism
The SAFE Act has also imposed higher barriers of entry to the mortgage industry. In the early years of the collapse of the housing market, policymakers, federal regulators and the media placed blame for the housing bubble upon mortgage brokers. Mortgage lenders were accused of poor underwriting practices, selling inappropriately complex products to unsophisticated borrowers, maximizing their personal return on each loan regardless of its suitability for the borrower, and even engaging in fraudulent practices. The actions of a few bad actors effectively tainted the reputation of the entire industry.

The development of NMLS and the enhanced credentialing standards introduced by the SAFE Act have worked to eradicate this problem. The ability of state regulators to track bad actors using the NMLS Unique Identifier prevents predatory lenders from escaping punishment merely by moving to another state. Now, if an originator's license is revoked in one state, it is revoked in every state across the nation.

By requiring all licensees to submit fingerprints to the FBI for a criminal background check, those individuals who have been convicted of certain types of felonies are prohibited from the industry. Also, credit history checks are being conducted on each licensee. The SAFE Act does not dictate explicit credit standards that licensees must achieve, and Indiana, like most states, has been very flexible in its implementation of this particular mandate.

Further, the testing and education requirements of the SAFE Act are working to ensure that mortgage lenders demonstrate a basic level of industry and regulatory knowledge. To receive a license, originators must pass a national test component and a state test component for each state in which he or she operates. As of April 30, over 147,000 individuals had taken the national test component with a pass rate of 84%, and nearly 215,000 state test components had been taken with a pass rate of 93%. The tests are designed to be challenging and to effectively verify an originator's knowledge and expertise, and were created and designed by pragmatic developers to ensure they are accurate and performing appropriately.

Similarly, the pre-licensure and continuing education requirements ensure that mortgage providers remain knowledgeable about constantly-evolving laws, regulations, ethics, and lending and origination standards.

These enhanced professional standards should put an end to enabling those few "bad actors" to malign the reputation of your entire industry and help restore consumer confidence in all mortgages lenders. Thanks to NMLS and the SAFE Act, those "bad actors" have nowhere to hide in today's mortgage industry. True, the poor market conditions have also contributed to force some providers out of the industry. But what is left is, quite simply, the cream of the crop. You and your colleagues are well-trained, educated, and professional mortgage providers.

But, beyond the removal of bad actors, NMLS supports the return of a diverse secondary market and securitization by credentialing of originators by adding tools that allow investors to track mortgage performance to institutions and individuals, and by providing a framework for greater transparency. This already has begun by Fannie Mae, Freddie Mac, and the FHA requiring the NMLS unique ID number for all loans they purchase or insure.

THE DODD-FRANK ACT

Despite the enhanced supervision and the improved professionalism of the mortgage industry implemented by NMLS and the SAFE Act, the tenets of the Dodd-Frank Act took full aim at the mortgage industry and its regulatory regime. Dodd-Frank represents a dramatic overhaul of the financial regulatory framework, but its provisions are particularly prescriptive with regards to mortgage lending.

For example, here is a glance at some of rulemakings required under Dodd-Frank which target the mortgage industry:

- Retention of credit for residential mortgages;
- Defining “qualified residential mortgage”;
- Registration of non-depository covered persons;
- Disclosures for consumer financial products and services;
- Prohibiting steering to certain mortgage loans;
- Prohibiting providing predatory loans;
- Prohibiting engaging in abusive or unfair lending practices;
- Mischaracterizing a consumer’s credit history or the appraised value of property;
- Establishing minimum net worth or surety bond requirements for originators;
- Combined TILA and RESPA disclosures;
- Income verification for consumers of residential mortgage loans;
- Verify consumers’ ability to repay loans;
- Establishing debt to income ratio for “qualified mortgages”;
- Limits on mortgage prepayment penalties;
- Directions on how to describe negative amortization;
- Statutory notices for non-hybrid adjustable rate mortgage loans;
- Inclusion of certain information in periodic statements for residential mortgage loans;
- Definition of “high-cost” mortgages; and
- Property appraisal requirements.

State Perspective on Select Regulations

Obviously, we don’t have time today to discuss each of these initiatives. Suffice it to say, the provisions of Dodd-Frank and the extensive requirements for the mortgage industry clearly illustrate policymakers’ focus on the mortgage industry and its supervision. However, I would like to touch on a few regulations which have or could have a significant impact upon the mortgage industry.

Ability to Repay

At the behest of the Dodd-Frank Act, the Federal Reserve Board has issued a proposed rule that would require creditors to determine a consumer's ability to repay a mortgage before making the loan and would establish minimum mortgage underwriting standards. The Fed has indicated they will not finalize these rules, but will instead defer the final rule-writing to the still evolving Consumer Financial Protection Bureau (CFPB). State regulators, through CSBS, are reviewing the proposal to develop our policy response before the July 22 comment deadline.

TILA/RESPA Disclosure

The CFPB is required to harmonize existing disclosures that are currently required under the Truth in Lending Act (TILA) and the Real Estate Settlement Procedures Act (RESPA) into a single, concise disclosure. At the end of May, the CFPB released two possible model forms to the general public for the RESPA-TILA form merger in anticipation of the formal rulemaking process. Effectively, the CFPB is utilizing technology to allow any interested parties to weigh in on which form they prefer and to identify segments of the forms they dislike. In a few months, the CFPB will issue their formal proposed disclosure. At that time, CSBS will provide feedback on the proposed forms.

Risk Retention

As required by Dodd-Frank, the federal financial regulators have issued proposed rules requiring sponsors of asset-backed securities to retain at least 5% of the credit risk of the assets underlying the securities. The goal of the provision is to align incentives between securitizers and investors to promote prudent loan underwriting. The proposal also defines loans that are exempt from the credit risk retention, including asset-backed securities that are collateralized exclusively by residential mortgages that qualify as "qualified residential mortgages," or QRMs.

Credit risk retention should be required, to the extent that it encourages prudent underwriting and securitization. To achieve that goal, the federal regulators should implement a dynamic framework to monitor the performance of loans subject to credit risk retention. It is currently unknown if 5% is the appropriate amount of risk to be retained to align incentives; therefore, the retention amount should be adjusted periodically to reflect the status of underwriting performance.

With regards to the QRM, my fellow state regulators and I agree with the proposal's underwriting criteria, which include, but are not limited to: 80% LTV, 20% down payment plus closing costs; and 28% front-end ratio and 36% back-end ratio. The QRM should be the best category of mortgage available because those securities backed by QRMs do not require securitizers to retain credit risk. We believe the QRM standards proposed allow for other standard mortgage products to be developed and originated. If these standard mortgages are not allowed to exist because of the QRM, more flexibility will be needed to alter the underwriting standards for the QRM. Ultimately, the QRM should not be the only mortgage available on the market.

Ultimately, I believe the proposal represents an integral piece to a holistic regulatory effort in which we address the regulatory shortcomings that led to the recent economic meltdown. Risk retention is a policy that will address one of the fundamental problems that led to the housing bubble, and should not create insurmountable obstacles to homeownership.

Escrow

The Dodd-Frank Act amended TILA to provide a separate, higher threshold for determining coverage of the Federal Reserve Board's escrow requirement applicable to higher-priced mortgage loans. The provision also lengthens the time for which a mandatory escrow account established for a higher-priced mortgage loan must be maintained, and authorizes the Fed to create an exemption from the requirement for certain transactions.

We support the mandate to require escrow for higher-priced mortgage loans, but believe the exemption in the Fed's proposed rule should be broader. As proposed, the exemption for banks operating in rural or underserved areas falls short of the statutory exemption provided for in Dodd-Frank and applies too narrowly and inconsistently across the nation and indeed, Indiana. The statutory intent to exempt those institutions which may choose to "portfolio" the loan is clearly not reached when counties like Fayette, Wabash, Knox, Jackson and Wayne do not meet the Fed's criteria for "rural."

Appraisals

Dodd-Frank establishes new requirements for appraisal independence for consumer credit transactions secured by the consumer's principal dwelling. The objective of the statute is to ensure that real estate appraisals used to support creditors' underwriting decisions are based on the appraiser's independent judgment, free of any influence or pressure that may be exerted by parties that have an interest in the transaction.

Originator Compensation

One regulation which is not mandated by the Dodd-Frank Act, but which has a tremendous impact upon mortgage lenders, is the Federal Reserve's loan originator compensation proposal. Under the rule, which became effective on April 1, in an effort to prevent originators from increasing their own compensation by raising the consumer's loan costs, loan originators may not receive compensation that is based on the interest rate or other loan terms. The rule also prohibits loan originators from steering a consumer to accept a loan that is not in their best interest in order to increase the originator's compensation.

While there are some applications of the final rule which may be complicated, the general purpose of the rule is to re-align originator incentives in an attempt to shift the mortgage industry away from a sales-driven culture, and more towards a culture of compliance. To that end, this rule complements the enhanced professional standards introduced by the SAFE Act. Final rules on MLO compensation will ultimately be issued by the CFPB.

Consumer Financial Protection Bureau
Perhaps the most undefined yet most significant creation of the Dodd-Frank Act, with respect to non-depository supervision at least, is the founding of the Consumer Financial Protection Bureau, or the CFPB. As I'm sure you are aware, the CFPB has been given primary federal rulemaking authority for numerous federal consumer protection statutes which will directly impact how mortgage lenders operate. The CFPB has also been granted supervisory and enforcement authority over mortgage-related businesses, regardless of their size.

There is still a great deal of uncertainty over what CFPB supervision of the mortgage industry will look like. Is it realistic to envision that the CFPB will try to examine every residential mortgage provider operating in the United States? In my opinion, it is not. After all, there are hundreds of thousands of individual mortgage licensees operating in the United States. Instead, I anticipate the CFPB will seek to harness existing resources and systems by coordinating with state mortgage regulators to supervise the mortgage industry.

To that end, CSBS and the CFPB signed an information sharing memorandum of understanding (MOU) to establish the foundation of state and federal coordination and cooperation for supervision of providers of consumer financial products and services, including mortgage providers. There exists a great amount of uncertainty as to what CFPB mortgage supervision will look like in the future. But it is my belief that the regulatory framework established by NMLS and the enhanced professionalism of your industry as a result of the SAFE Act requirements will result in coordination among the CFPB and state regulators. I believe this state-federal coordination is essential for a seamless, pragmatic, and thorough regulatory regime for the mortgage industry.

As likely followers of the financial press, you have seen the political drama over the appointment of a CFPB Director and its governance structure. Conventional wisdom holds that the CFPB lacks full use of its powers, including rule-writing, without a Senate confirmed director. While I have no interest in playing a role in this political theatre, I make this point only to highlight that we will not know the philosophy or approach of the Bureau until we see the rules they are crafting. All interested parties will want to engage in this process as I am certain that the IMBA will do so on your behalf.

GSE REFORM

Believe it or not, even though Congress has greatly reformed financial regulation through the Dodd-Frank Act, there is still much work to be done. The administration has submitted a report to Congress on the reform of America's housing finance market which laid out principles and options for the winding down of Fannie Mae and Freddie Mac in an effort to reduce the government's footprint in the market.

The impact of any legislation in this area will be significant. The housing finance market has proven to be, and continues to prove to be critically important to the health of the broader economy. One of my Deputy Directors recently pointedly stated "ROOFTOPS MATTER!" How homes are financed, new home construction, home improvements and family finances are all significant drivers of economic activity. Any action taken in this area must be done very carefully. Unintended consequences of legislation in this area could be catastrophic.

While the future of housing finance is still unknown and legislation has yet to be introduced, I believe there are certain principles which must be adhered to in order to preserve a healthy housing market and strengthen the U.S. economy as a whole.

To that end, I believe a diverse universe of financial service providers, both depository and non-depository, must be preserved as a method of reducing risk to the system, encouraging competition, furthering innovation, and ensuring access to financial markets and promoting efficient allocation of credit.

I also believe any housing finance framework implemented by future legislation must guarantee access to the mortgage securitization market for all financial institutions. The framework should allow for a diverse source of origination and not lead to fewer channels dominated by the largest institutions.

CONCLUSION

The residential mortgage industry and its supervision have been radically altered in the past few years. Uniform licensing standards, enhanced professionalism requirements, and the host of regulations to be implemented under the Dodd-Frank Act have created a wholly new industry. And while the regulatory and statutory changes imposed upon your industry have been challenging, those of you who remain in the industry have proven to be professional and responsible providers.

These enhanced requirements have given the residential mortgage industry new legitimacy, which should translate into enhanced consumer confidence, and will hopefully help lead our nation to a full economic recovery.

It will be up to the regulators and industry professionals to work together to embrace, interpret, and implement these emerging standards in a manner that promotes a vibrant and sustainable housing industry.

The Department of Financial Institutions hopes that it has been, and will continue to be, a collaborative partner in this effort.

Thank you again for this opportunity to speak with you today.