Remarks of John M. Reich, Director
Office of Thrift Supervision
to the National Association of Mortgage Brokers
Legislative & Regulatory Conference
Washington, DC
February 6, 2008

Good morning. I'm pleased to be with you this morning. I want to thank Denise Leonard in particular for participating in our OTS-sponsored National Housing Forum on December 3rd, and for inviting me here today.

I don't need to tell you that the national and international financial markets, in reaction to certain mortgage practices of the past few years, have caused considerable consternation and disarray. Consequently, in 2008 we will see the start of an era of reform, driven by legislative and regulatory initiatives here in Washington, and also by actions by state legislatures and state bank supervisors.

OTS supports ongoing initiatives to create reasonable national standards for mortgage lending and to weed out those mortgage originators who have engaged in improper and predatory practices. I believe OTS can be instrumental in helping to monitor and supervise the broader mortgage industry.

First, I want to say I believe that mortgage brokers have made significant contributions to help fulfill the aspirations of people to own homes in America. The most recent studies show that, all combined, mortgage brokers accounted for 58 percent, or $1.7 trillion, of all home loans made in 2006.

The majority of these mortgages were made responsibly; they helped finance homes for minorities and first-time homebuyers, and those who wanted to refinance into a better interest rate when rates were falling. They also helped qualified borrowers with impaired credit buy homes and repair their credit ratings.

But, we all must acknowledge the serious abuses in lending practices that have thrown homeowners into foreclosure and neighborhoods into disarray. Predatory and irresponsible mortgage originators caused serious damage to consumers and financial markets throughout the world. I believe a minority of mortgage originators engaged in these practices and the actions of these bad actors harmed the reputation of entire mortgage industry.

The industry has received almost constant attention in the media, from the Administration and Congress, and from financial analysts and pundits. And while there is no doubt that some of this attention is warranted, there is a lot of disinformation out there too.

How many of you in this room have underwritten loans believing that the borrower wouldn't be able to make payments and would end up in foreclosure? How does it feel to be accused of this every day in newspapers, on TV, on the Internet, and by elected officials and candidates?

Certainly, inaccurate news reports and misinformation from some analysts can contribute significantly to the difficulties an institution experiences in weathering difficult financial conditions. For example, articles that report a bankruptcy is imminent, when it is not, or otherwise create a false perception of an organization can exacerbate the difficulties of coping with disruptions in the market.

The OTS has had to cope with some of the same types of issues. For instance, the OTS was recently reported as shrinking, when, in fact, our workforce has grown by almost 15% in the last two years. The same article misrepresented our budget and current financial condition.

In fact, the OTS is doing quite well and we oversee a dynamic industry. We are on a sound financial footing with strong contingency reserves. These are challenging times for the entire financial industry, but we are working our way through it with a continuing pledge to safety and soundness, and fairness to customers.

Now I'd like now to talk a little more about:

- The general state of the mortgage industry;
- H.R. 3915 and efforts to rein in lending practices, create uniform standards, and implement licensing and registration requirements;
- The need for improved regulatory supervision throughout the lending industry; and
- How OTS may be able to support some of these needs.

State of Industry Update

First, let me speak about the current condition of the industry. Recent data show that almost 20 percent of all subprime loans are delinquent, and more than 7.5 percent are in foreclosure. Perhaps even more worrisome, the foreclosure rate is continuing to rise. From November 2006 to November 2007, foreclosures for subprime loans more than doubled from 3.34 percent to 7.65 percent. Over the same period foreclosures for so-called Alt-A loans rose from 1.8 percent to 3.36 percent.

ARM resets will continue at high levels with an estimated 1.8 million owner-occupied subprime mortgage resets expected in 2008 and 2009. The likelihood of late payment rates over the next few quarters remains quite high. Record-high home price appreciation and the flawed assumption that house prices would continue to rise rapidly contributed to the current subprime delinquency crisis. But another large contributor was poor underwriting and, in some cases, fraud.

But there is plenty of blame to go around. There were homeowners who used this opportunity to buy the largest and most expensive homes they could get and realtors who encouraged them to do just that.

And let's not forget that Wall Street deserves a share of the blame. Investors' appetite for high-yielding subprime mortgage securities put a lot of pressure on the mortgage banking community to generate a high volume of loans without paying enough attention to quality. Before the 1990s, lenders held most loans on their balance sheets. But the increasing popularity of the securitization model allowed lenders to lower their underwriting standards because they could pass on the elevated risks to investors at prices that did not reflect those higher risk levels.

The complexity and lack of transparency of these products made the embedded risks difficult to discern. To identify the risks, investors relied on rating agencies that did not perform with distinction. As subprime mortgages began to default, expected cash flows did not materialize and rating agencies downgraded the securities. Investors abruptly stopped buying mortgage-backed instruments and demand for this paper virtually disappeared overnight.

Today, we are trying to cope with the fallout. Too many non-performing loans are on lenders' books or in securitizations and too many homes are in foreclosure. Regulators and lawmakers are struggling to determine how to prevent the abuses while preserving the flow of mortgages in the market.

Legislative Efforts

I believe legislation and regulation are warranted and necessary to establish a national standard to protect consumers and to rein in abusive lenders and fraudulent borrowers. That said, I also believe a proper balance is critical between prudent lending and constraints on credit to qualified borrowers. We must remember that subprime and Alt-A lending created homeownership opportunities for those who could not otherwise have bought a home – particularly minorities, immigrants and first-time homebuyers. We must not let the pendulum swing so far that it prevents good borrowers from getting into homes of their own.

But, legislators and regulators, including OTS know that quick and decisive action is necessary to curb abusive lending practices that have hurt thousands of consumers and damaged our economy overall. In addition to efforts already taken to address mortgage origination problems, there are more legislative and regulatory initiatives on the way.

One such action at the federal level is H.R. 3915, which moved very quickly through the House and passed on a bipartisan vote in November. The Senate Banking Committee also introduced a bill, S. 2452 that would amend the Truth in Lending Act to establish new requirements for "high cost" loans and subprime and nontraditional mortgages. Like the House bill, the Senate bill includes provisions addressing loan servicing arrangements, fraudulent lending activities, assignee liability, appraisals and foreclosure prevention counseling.

But back to the House bill -- the intent of H.R. 3915 is to establish a national standard for originating residential home mortgages, create a registration and licensing system for loan originators, establish a minimum standard that requires borrowers to have a reasonable ability to repay a loan and establish limited liability for secondary market securitizers.

I believe strongly in these goals. Stricter lending standards, applied across the board to all loan originators, will establish a level playing field that allows brokers and other originators to compete successfully without sinking to the lowest level in order to capture market share.

Of particular importance to you must be the licensing and registration requirements in the bill. It calls for the establishment of a national registry of all loan originators, whether they work for a depository institution, mortgage company or mortgage broker. In addition, it establishes strict standards governing the state licensing of non-federally supervised loan originators, including such requirements as criminal background checks, fingerprinting, continuing education requirements and testing. I know that NAMB strongly endorsed the House bill as soon as it was passed. Your association supported the bill even knowing that it would place a burden on small mortgage brokers. You recognized that the national registry of all originators would be effective protection for consumers against bad actors in the industry. It would prevent those originators who break the law from moving from state to state or company to company without being detected.

And I applaud you for this position.

I also applaud the Conference of State Banking Supervisors for its role in establishing a registration system for mortgage industry professionals that it believes will weed out disreputable mortgage originators.

Under H.R. 3915, the states are given the authority to ensure that all non-federally supervised originators are registered with the Nationwide Mortgage Licensing System and Registry. The states would be required to have a system in place for registering and licensing loan originators and, if they do not, HUD would step in to establish and maintain a system.

How OTS Can Help

American consumers deserve basic protections when they make the largest investment of their lives, and we as public servants, have a responsibility to do our best to provide those protections. We believe that there may be two potential areas where OTS could play a role in achieving this goal – (1) licensing and registration of mortgage originators, and (2) joint state and federal oversight of state regulated mortgage banking companies.

Regarding the first point, as I said before, H.R. 3915 requires HUD to step in if a state is unable to put in place a system for registering and licensing mortgage brokers and other non-federally supervised originators. I wonder, however, if HUD is best positioned to take on this responsibility. OTS has many attributes that might make us a better choice.

At the OTS, we focus our regulatory approach on maintaining a thriving mortgage lending industry that complies with applicable laws and regulations to protect consumers. We strive to achieve that goal with a minimum burden on the industry. We have an expert staff that has a unique understanding of the financial services and mortgage industries. We believe that the private sector must be allowed to innovate, compete and prosper, but without harming consumers.

Now, regarding my second point, federal oversight of the entities that fund the mortgage process is crucial. It is critical to ensure that mortgage banks be forced to compete by the same set of standards as insured depository institutions. Establishing a partnership between the states and a federal overseer to set and enforce minimum mortgage funding standards would ensure accountability and consistency throughout the mortgage lending process. This could be similar to the partnership that exists between the FDIC and state banking commissioners in the oversight of state-chartered banks. Such a partnership need not involve establishing a federal mortgage banking charter, but rather a federal-state partnership to regulate these entities and ensure nationwide uniformity. The OTS has extensive expertise in the oversight and supervision of mortgage banking operations that I believe would benefit the currently unregulated mortgage banking market.

It is not my intention to needlessly expand our regulatory authority, but OTS is in a unique position to help level the playing field by acting as a backstop for state licensing and registration for originators, as well as participating in a prudential federal-state supervision of state mortgage bankers who fund mortgages. If Congress determined that the OTS could provide the best solution by taking on these responsibilities, we would certainly rise to the challenge.

Conclusion

Again, I want to stress that strict and uniform standards are critical for consumer protection and to avoid a future mortgage market meltdown. And I believe OTS is the best regulatory entity to work in conjunction with states to ensure proper protection for consumers and a healthy mortgage market.

Thank you again for the opportunity to meet with you today. I am happy to answer your questions as time permits.