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Testimony of Judith G. Ripley, Director before the Interim Study Committee on Mortgage Lending Practices and Home Loan Foreclosures September 13, 2007 10:00 A.M.

Good morning, Madame Chairperson and members of the committee. Thank you for inviting the DFI participation in this very important mortgage fraud and foreclosure study committee. I am Judy Ripley and I am the director of the Indiana Department of Financial Institutions. With me here today are John Schroeder, General Counsel and Deputy Director for Consumer Credit, and Mark Tarpey, Supervisor for Consumer Credit.

The DFI is a regulatory agency that supervises and examines financial institutions that are chartered or licensed by the state of Indiana. The DFI is a dedicated fund agency that derives all of its funding from the fees paid by the entities that we supervise. We receive no general fund money nor do we contribute to the general fund. The department is governed by a bi-partisan seven-member board appointed by the Governor. Members are appointed for staggered four-year terms and are comprised of persons from the Indiana financial community.

Members are instrumental in determining and approving the fees we charge. We have a staff of 75, 47 of whom are highly trained examiners. The DFI examiners are continuously furthering their examination skills and knowledge by attending training in all areas over which we have supervisory responsibilities. Examiners receive certifications in these various areas and specialties. For example, recently two of our consumer credit examiners completed a five week online interactive course in mortgage fraud. In November, two examiners will attend mortgage examiners school.

It is DFI's job to examine and supervise the various financial institutions that come under titles 28 and 24 of the Indiana Code. This includes banks, savings banks, thrifts, trust companies, credit unions, non-bank lenders, payday lenders, pawnbrokers, rent-to-owns, money transmitters, budget service companies and check cashers. DFI issues the charters, licenses or registrations for these entities and follows up with regular examinations or visits as deemed necessary. DFI regularly examines the state-chartered depository institutions for safety and soundness and compliance with consumer statutes. Additionally, when DFI examines depository institutions we examine their loan portfolios. Specific to the mortgage industry, we currently license and examine 285 non-depository second mortgage lenders for compliance with IC 24-4.5, the Indiana uniform consumer credit code (UCCC). Non-depository first mortgage lenders, whether the transaction is a purchase money loan or a refinance, are not licensed in Indiana. In Indiana, first mortgage lenders only have to maintain minimal compliance with certain provisions of the UCCC (IC 24-4.5-3-105) and the Home Loan Practices Act (IC 24-9) for high cost home loans.

A typical compliance examination of second mortgage lenders would occur approximately every 24 months. The examiner reviews all of the loan documents for compliance with the UCCC and related federal laws. The examiner also looks for any lending practices that are not consistent with the DFI guidelines for nontraditional mortgages and loans to sub prime borrowers. Most of the non-depository second mortgage lenders who are licensed with DFI also offer first mortgage products. At the present time, first mortgage non-depository lenders who are not licensed with DFI to make second mortgage loans have no state licensing or examination in Indiana. This is true of only a handful of other states. The DFI is a member of CSBS, the Conference of State Bank Supervisors. The DFI is also a member of AARMR, the American Association of Residential Mortgage Regulators. About three years ago, CSBS and AARMR began a project to develop a nationwide mortgage licensing system that would be a one-stop registry and licensing system for all mortgage lenders and brokers. CSBS contracted with the National Association of Securities Dealers (NASD) to design this system using the same principles that have been used for the past 20 years for licensing securities brokers. The system is in its final stages of testing and will be operational in January 2008. A few states are scheduled to go on line with the NMLS in 2008. Indiana is scheduled to go on line January 2009. Legislation passed by the General Assembly last session will allow Indiana to participate in the NMLS. To date 39 states have signed on to use this system. We understand that the Securities Division of the Secretary of State's office is also planning to participate in the NMLS for loan brokers.

All mortgage lenders and brokers will apply for licenses through this system. They will pay a transaction fee based on the number of states in which they wish to operate. Their information will then be entered into a database that will be available to participating states. The advantage will be a database that will allow a view of all licensed lenders and brokers across the country. You've already heard about the fraud and abuses rampant in the system now. A nationwide system will help regulators screen an applicant based on his or her actions in other states. This will simplify the licensing process for the licensees as well. Use of the system will be mandatory whether the lender or broker operates in one state or multiple states.

CSBS is also in the process of finalizing a 2-page revised mortgage disclosure for potential mortgage applicants. This would be given to the customer early in the application process, not after all of the paperwork is complete and the closing is scheduled. We have brought a copy of that disclosure for you to review. We believe it would be helpful for this document to be required rather than offered on a voluntary basis.

John Ryan, the executive vice president of CSBS, will be here on October 11th to testify before this Committee regarding the national landscape as to mortgage regulation and to give you an update as to what is expected in the way of federal regulation and legislation as well as updates on the issues of foreclosure and predatory lending.

It is important to note that the mortgage lending picture has changed significantly in the last few years. When the legislature looked at mortgage problems in 2002 and 2003, the emphasis was on mortgage fraud. Since that time, there has been a proliferation of products offered that changed the very nature of mortgage lending. There appears to be no limit to the innovative ways to loan money to subprime borrowers that have surfaced in the last few years. As fast as lenders were able to close those loans, Wall Street was ready to swoop in, bundle them in pools and offer them for sale as securitized debt instruments. As a result of this change, in November of 2006, the DFI and 38 other states adopted the Non-Traditional Mortgage Guidance that was originally drafted by the federal banking agencies. Additionally, in July of this year, the DFI adopted the Subprime Mortgage Statement that was also drafted by federal banking regulatory agencies. You were given a copy of the press release announcing the adoption of those guidelines at the last meeting. The DFI has notified the second mortgage licensees we examine that when we conduct our examinations we will be looking at their compliance with these guidelines not only for second mortgage loans but also first mortgage loans.

HEA 1717 requires the DFI to provide a report to the Legislative Council of the General Assembly in November regarding the feasibility of the DFI assuming the responsibilities for regulating mortgage brokers. This analysis is to be both on an examination basis and on a complaint basis. In the process of preparing this report, we have met with the Securities Commissioner and are contacting other states to determine what their mortgage lender and broker laws are, which agency or agencies regulate the mortgage transaction and what the most successful procedures have been in terms of deterring mortgage fraud and/or predatory lending. We anticipate we will have information compiled by October 11th that will give an overview of other state activities.

As a final remark, this foreclosure crisis is ongoing and I believe the high rate of foreclosures will continue into the foreseeable future. In addition to fraud and subprime lending, other factors including the lack of price appreciation for real estate and imprudent underwriting standards have contributed to this situation. We appreciate this opportunity to discuss this matter with you today and look forward to working with you in the upcoming months.