

MORTGAGE LENDER AND BROKER LICENSURE
October 11, 2007

JURISDICTIONAL ANALYSIS

Prepared by

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The information contained in this chart is based upon materials supplied by the Conference of State Bank Supervisors and others. An effort has been made to update this information as of the date set forth above; however, it is an area of intense interest and is undergoing substantial changes in many jurisdictions. This data is for informational purposes only and may not be relied upon as legal or other advice.

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Testimony of Judith G. Ripley, Director
Before the interim study committee
On mortgage lending practices and home loan foreclosures
October 11, 2007 10:00 a.m.

We have prepared a list of possible statutory changes that we believe would go a long way towards the goal of making certain this mortgage foreclosure crisis doesn't happen again. The market is on its way to limiting the current damage to a variety of lenders, investors and – regrettably – a substantial number of borrowers. Some borrowers cannot be helped due to the type of loans they have and their dire financial conditions. Unfortunately, we do not believe you can undo the situation as it currently exists. In fact, this subprime and non-traditional mortgage crisis will continue for some time as an estimated 32% of subprime adjustable rate mortgages are scheduled to reset through 2008. What the DFI is encouraging is consideration of a legislative approach to stop certain abusive practices now so that, hopefully, the problems with subprime and non-traditional mortgages will not happen again. Given the extensive and continuing media coverage of these issues, and the effects on your constituents, I know I do not have to convince you of the importance of this issue.

First, I will list for you several possible legislative remedies for your consideration. I will then expand upon them to provide a more global perspective.

- 1) Consideration of the licensing and regulation of first mortgage lenders under the uniform consumer credit code (also known as the "UCCC").
- 2) Consideration should be given to eliminating the numerous exemptions under the loan broker statute for HUD, FHA, VA and other federally related programs.

- 3) Consideration of increasing the current bonding levels of \$50,000 for all mortgage brokers – possibly based on their volume of mortgage loan activity.
- 4) Consider requiring all appraisers and brokers to undergo FBI criminal background checks.
- 5) Consider including language to ensure that all licensed and certified appraisers should meet the highest standards for the industry in regards to entry into the profession and continuing education requirements.
- 6) Consider including in the UCCC mortgage loan underwriting standards that are consistent with the Non-Traditional Mortgage Guidance and the Subprime Lending Statement issued by the DFI.
- 7) Consider including in the UCCC provisions to hold lenders accountable for the activities of the brokers and appraisers used in their loan transactions.
- 8) Consider including language to provide for civil monetary penalties and other civil and/or criminal actions that would be available to regulators, borrowers, and the courts to punish “bad actors” in the mortgage industry.
- 9) Consider a requirement that the mortgage documents include one document that contains the sales price, homestead credit information, buyer’s signature, and the names and license numbers of all parties involved in the mortgage transaction.
- 10) Consider the addition of a mandatory financial literacy program to our K-12 school curricula.
- 11) Consider the requirement of a simplified one or two page disclosure document that would provide prospective borrowers essential, timely information in summary form at least five days prior to closing.

First, as I testified at the last meeting, first mortgage lenders are not licensed in Indiana. As you know, 20 years ago most mortgage loans were obtained from a depository institution or from a mortgage banker who was a “portfolio lender.” Since the bank or mortgage company retained the mortgages, they performed thorough due diligence reviews in the underwriting of their loans. In the last several years, the majority of first mortgage lending has moved from banks, credit unions, savings banks or other depository institutions --all of which are regulated and examined-- to the non-depository brokers and lenders whose lending activities are largely unregulated. The incentive to do true

underwriting was removed by the financial motivation to complete and sell the loan as quickly as possible.

Buying a home is a financial undertaking that is not surpassed by many other purchases I can name. And for most of us, it is the largest single investment we make in our lives. It is common sense to make certain that all mortgage brokers and lenders are required to maintain the same high standards that we expect from our depository institutions. John Ryan just told you that if the states do not answer the call to act on stricter mortgage regulation and underwriting standards, the federal government is going to mandate it. We believe that our state legislators are better equipped to address problems unique to our state. We also believe that consumers will receive faster, more effective responses to complaints. And you, as policy makers, will be able to set specific standards for compliance and determine appropriate penalties for violations.

Second, the loan broker act exempts from licensing persons who are approved to sell or service loans insured by HUD and various other government sponsored entities, such as Fannie Mae, Freddie Mac and the VA. Consideration should be given to whether or not this exemption is appropriate in today's mortgage lending environment. These exempted brokers are seldom subject to any examination or substantive review by these federal programs. The number claiming the exemption is large: the Securities Commissioner estimated that there are 1,400 brokers claiming exempt status compared with 1,100 brokers who obtain licenses. The DFI has contacted the mortgage broker regulators in numerous states, and the vast majority of these states do not allow these types of exemptions due to the lack of regulatory oversight provided by these federal entities. By the same token, if first mortgage lenders are to be licensed in this state, consideration should be given to ensuring that no exemptions are available to lenders under these federal programs. From our point of view as a regulator, it is important to place both brokers and lenders in the same regulatory posture so that one group does not have a regulatory advantage over the other. A level playing field for all brokers and lenders is important. The use of the upcoming Nationwide Mortgage Licensing System being developed by the Conference of State Bank Supervisors and the American Association of Residential Mortgage Regulators will provide a nationwide licensing system for all brokers and lenders.

Third, we believe consideration should be given to an increase in the bond required for brokers (and if first mortgage lenders are licensed, for them as well). Consideration should include an analysis of whether the current amount of \$50,000 is adequate to compensate borrowers who have been damaged by the activities of a broker or lender. If the circumstances support drawing on a bond, it is likely that numerous borrowers have been hurt by the broker or lender. A more significant bond will demonstrate the commitment of the broker or lender to operate a fair and honest business. Additionally, it is our understanding that once the amount of the bond reaches \$100,000, the company issuing the bond would do more rigorous underwriting which would provide heightened confidence in the broker or lender.

Next on our list is a consideration of a requirement that all appraisers and mortgage brokers undergo FBI criminal background checks. You heard testimony at the last committee meeting that the single most common denominator in mortgage fraud schemes is the appraiser. Mortgage brokers currently get a state criminal background check. It is our understanding that the Securities Commissioner intends to amend the loan broker statute in the 2008 session to provide for FBI criminal background checks. The DFI recently met with the FBI regarding procedures for background checks. During that meeting, we learned that in Indiana, taxi drivers and massage therapists are required to undergo FBI background checks. Certainly, consideration of this same standard for appraisers and mortgage brokers is appropriate.

Item number five on appraisals recognizes the fact that an appraisal is the single most important part of the real estate purchase from the perspective of the lender and the customer. Standards for initial licensing and continuing education for licensed or certified appraisers should be among the highest in the industry.

The next item relates to the Guidance for Non-Traditional Mortgages and Subprime Lending Statement that the DFI approved for the second mortgage lenders we examine. We provided you copies of those documents at the last hearing. It is our suggestion that consideration be given to including in the UCCC specific references to the underwriting standards and other provisions of these documents. In that case, compliance with these standards would be a part of any examination conducted by examiners. Basically, these are rules lenders would follow if they were retaining the loan and not selling it into the

secondary market. They are common sense rules to assure the borrowers will be able to repay the loan based on prudent underwriting standards and verifiable information.

In conjunction with the Guidance for Non-Traditional Mortgages and Subprime Lending Statement, the DFI also suggests consideration of language that would require mortgage lenders to more effectively monitor the activities of the appraisers and brokers they use on any of their mortgage transactions. Regulators cannot discern all of the inappropriate or illegal activities which occur in the lending industry. If lenders are held accountable for the activities of the brokers and appraisers who participate on their loans, they will work with professionals whom they can trust to employ prudent and responsible lending practices.

Next, we have found that the possibility of significant civil monetary penalties and other statutory penalties serves as a strong deterrent against violating the law. It is, however, sometimes necessary to levy those penalties. Therefore, the DFI encourages consideration of penalties that are high enough to cause a violator to pay for the violation and not simply consider it a cost of doing business. These are remedies which should be available to the customer, the regulators and the courts.

As we testified at the last meeting and as you heard from Donna Eide and Gary Avery, consideration should be given to a requirement that mortgage documents include the names and license numbers of all participants to the loan. This would include both purchase money loans and refinances. Additional consideration should be given to including the sales price of the property, homestead credit information, and the buyer's signature. A single source document would make it much easier to track the history of the transaction and, once again, serve as a disincentive to violate the law. This could be on the warranty deed, the mortgage, or perhaps a stand alone document that could be easily scanned and the information populated in a database allowing regulators, lenders, and borrowers to track "bad actors."

Further, the DFI believes that consideration should be given to the inclusion of a consistent and continuous financial literacy course of study in the K-12 curriculum. Only seven states include a personal finance course as a high school graduation requirement. Students leave high school with little or no understanding of basic financial transactions.

College students are laden with high cost credit card debt. It is little wonder that so many people have been entrapped in the subprime and non-traditional mortgage crisis.

Finally, the DFI suggests consideration of the requirement for a simplified, one or two page disclosure similar to the one developed by CSBS. This simplified disclosure clearly states the up-front costs associated with the loan, both the initial and fully-indexed rates and payments, and other information essential to an informed decision. As you are aware, the extensive disclosure requirements currently in place result in a stack of documents that is unreadable, and results in no real disclosure. This simplified form could provide real, meaningful, and timely disclosure.

Again, we appreciate the opportunity to discuss this matter with you today and look forward to our continued efforts in the upcoming months.