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Remarks of

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before the

Federal Reserve Board

at a public hearing to consider

Building Sustainable Homeownership:

Responsible Lending and Informed Consumer Choice

June 9, 2006

You've titled today's hearing, "Building Sustainable Homeownership: Responsible Lending and Informed Consumer Choice." So I'd like to talk about sustainable homeownership, responsible lending, and informed consumer choice.

First, sustainability. A study released last month shows that sustaining homeownership is becoming increasingly difficult for American families. Nationally, the foreclosure rate has risen 72% since last year. In Pennsylvania, at the end of the first quarter of 2006, one in every 428 households was in foreclosure - that's higher than the national average and puts us behind 32 other states.

We've all heard the pundits talk about what will happen as the housing market slows and interest rates rise. Families that have adjustable rate, interest-only, and other types of non-traditional mortgages will be squeezed. And, in this room, what we all worry about is that too many families will be squeezed beyond their ability to pay.

2005 year-end data seems to bear this out. In Pennsylvania, about 3.25% of prime loans are past due but a disturbing 14.75% of subprime loans are 30, 60, or 90 days late.

The factors that lead homeowners to foreclosures are complicated. Some are sad but unavoidable: illness, job loss, divorce. Some are criminal: forging documents, inflating appraisals, deceiving advertisements. But some - which leads me to my next point - are subtle. Otherwise acceptable mortgages are being sold to families who simply can't afford them.

This is <u>irresponsible</u> lending.

Irresponsible lending is this: making a mortgage with no real effort to discern if the borrower can repay the loan. And I'm not talking about whatever the first year's monthly payment is; I'm talking about making a reasonable effort based on all of the terms over the life of the loan.

It seems like a simple concept, but one that's increasingly absent in the structure of today's marketplace. Too often today, the salesperson has little or no stake in the long-term success of the loan.

When local bankers made loans 30 years ago, there were natural consequences to their underwriting. Even if they didn't expect borrowers to be long-term customers of their institutions, the basic soundness of their portfolios was on the line.

Today, someone can make a sale, get a commission, and never interact with the borrower or loan again. Chances are that even the original lender won't hold the mortgage for long. It will be included in a pool and sold on the secondary market. Whoever ends up holding the defaulted paper is so far down the line that the professionals at the beginning of the transaction are all too frequently removed from the consequences.

And, despite the fact that the vast majority of brokers are honorable people running reputable businesses, there is a very real possibility that a less-than-honest salesperson could put more money in his or her own pocket by brokering a less-than-best loan for the borrower - without ever disclosing the alternatives.

According to Wholesale Access, the number of mortgage brokerages grew at an average annual rate of 14% between 1991 and 1998. And, according to the Realty Times, a new study to be released later this month shows that the mortgage brokerage business is now five times larger than it was 15 years ago - with half of that growth occurring within the last three years.

Preliminary results also show that brokers produced 65% of all home loans last year - an industry-wide total of $1.6 <u>trillion</u>. Despite the huge volume, the typical firm produced only $38 million in mortgages, about the same as in the year 2000. The industry's tremendous growth, then, clearly stems from the recent and dramatic increase in the overall number of brokers.

The Pennsylvania Department of Banking currently licenses just over 4,000 brokers - regulating them pursuant to our authority under the commonwealth's Mortgage

Bankers and Brokers and Consumer Equity Protection Act and Secondary Mortgage Loan Act.

As you may know, across the nation all but two states regulate the mortgage industry. It has been leadership provided by the states, after all, that has resulted in the landmark Ameriquest and Household settlements. More routinely, however, states set minimum financial/credit standards, conduct background checks, require testing, order refunds and mandate continuing education.

In Pennsylvania, over the past three years (the very same years of explosive growth in the brokerage industry) the Banking Department has restructured itself within the powers it already has, has reached out to the legislature to expand oversight authority, and has worked with other state regulators as part of a national effort to protect consumers.

Internal restructuring activities under existing powers include, but are certainly not limited to:

- doubling the number of trained professionals who manage questions and complaints on our 1-800 PA BANKS consumer help line;
- doubling the number of field examiners who specialize in non-depository licensees (like mortgage brokers) and shifting the scheduling of our examinations to a more risk-focused basis;
- creating an investigations unit that couples experienced law enforcement professionals, intelligence analysts, and computer forensics specialists with financial and regulatory experts;
- enhancing the scrutiny applied to each applicant before granting a license - with access to more background databases, a full-time investigations professional, the requirement of 'business plans,' and more;
- working with consumer advocates, industry leaders, and others to develop regulations concerning proper conduct and statements of policy to define dishonest, fraudulent, unfair, unethical, and illegal practices - these will be published and opened for public comment soon.

We've already started to see results from our efforts. Last year we levied about $110,000 in fines against mortgage brokers. With our increased capacity, we've already eclipsed that number in only the first five months of this year. Currently 71 brokers are under investigation. I'm using fines and investigations simply as proxies to illustrate our increased presence in the marketplace.

The Department has also worked extensively with the legislature to draft and introduce six bills that will help us better protect mortgage consumers. The issues range from changing the composition of the state's appraiser board to increasing the size of the loan covered by Pennsylvania's consumer protection laws.

Of particular concern for this hearing, however, are provisions focused on licensure. Currently the Department of Banking does license businesses that broker mortgages, but not their employees. So, let's say that a responsible business fires a staff person for using questionable, heavy-handed, or dishonest practices. That person can go out tomorrow and get another job at another firm. They have no individual accountability; they can just pick up where they left off.

We need to know who these people are. We need to do background checks on them. We need to be able to put education and testing requirements in place. We need to be able to revoke an individual's license for violating the laws and regulations of this state - and we need to be able to tell other states that their license has been revoked here so that they don't pick up and victimize people in other places.

To that end, the Pennsylvania Department of Banking is actively working with our regulatory colleagues across the nation in other states through the Conference of State Bank Supervisors and the American Association of Residential Mortgage Regulators to develop a national licensing and information exchange system for state mortgage regulators. You heard Janis mention this exciting initiative already this morning. We, too, believe that such a system will help increase accountability, reduce fraud, and protect consumers.

Again, it's important to emphasize that the vast majority of mortgage brokers provide an important service and conduct their business honestly. What the national system will do is reduce the ability for the small number of bad actors to move from state to state. In addition to a host of administrative benefits, the system will allow state regulators - like me - to instantly access all previous license information and any criminal or administrative sanctions against any broker no matter in what state they occurred.

We believe that it doesn't matter how small the subset of bad actors is, we must work together until they are stopped. Their effect is too great. Every single irresponsible loan has the possibility of ruining a family's future. To be sure, buying a home is the biggest financial transaction of most peoples' lives. But a home is about so much more than money. It's about safety. It's about memories. It's about birthday parties and holiday dinners. It's the stuff of life.

So, let's talk about informed consumer choice. In the end, it is nearly impossible to remove emotion from the home buying process. And, to be honest, when I think about how happy I am when I watch my children play in my own back yard - I don't think we'd want to.

So, given the complexity of the transaction and the importance of the purchase, how do we help consumers make the best informed choice for themselves and their families?

We must increase the availability of high-quality, trustworthy financial education in general and, specifically, we must fix the system that governs the disclosures associated with mortgage transactions.

In 2004, Governor Rendell created the Pennsylvania Office of Financial Education. We're proud to house it in the Banking Department and support it with the banking fund. One key accomplishment of this fledgling office has been the creation of "Your Money's Best Friend," a consumer-oriented website available at www.moneysbestfriend.com. The website was created by Pennsylvanians for Pennsylvanians and includes a wealth of information about mortgages and the home buying process. More importantly, however, the site allows users to enter their ZIP codes to find local financial education organizations - including housing counselors - near where they work or live.

In addition, the Pennsylvania Department of Banking has added a community outreach professional and has developed consumer information on topics such as shopping for a mortgage and avoiding foreclosure.

But - while these activities are important - they are not enough.

It is not appropriate that I disclose the specific content of the Department's soon-to-be-published draft regulations and policy statements, but I do think it's fair to say that we believe that the current disclosure system doesn't work for consumers. We have placed special emphasis on ensuring that each borrower is provided with a single document, written in understandable language, that outlines critical components of their transaction.

The Conference of State Bank Supervisors suggests that disclosures should be tailored to the exact characteristics of the loan in question; sufficiently detailed to permit consumers redress if there are variances in the final loan offering; standardized across institutions so that consumers can comparison shop; provided early in the borrowing process; and contain not more than three or four key summary items. State regulators are also considering how to adapt the proposed guidance on non-traditional mortgage products issued by the federal banking regulators last year to the mortgage businesses under their jurisdiction.

With that I will conclude my remarks. Thank you for inviting me here today to discuss our activities with you. As you can tell, the women and men of Pennsylvania state government, like the women and men at so many other state agencies, are deeply concerned with the safety of our homeowners. With issues like coordination and pre-emption, it is crucial that state and federal regulators work together and complement each other's strengths to protect consumers.

Thank you.