

# THE FUTURE OF STATE MORTGAGE REGULATION

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It is great to be with you here today. As someone who was present at the creation of the NMLS, it is very gratifying to see that the investment of time, money and energy on this enterprise has been such a success. I would like to say it was my idea; but that would be false. Gavin Gee's intelligence, logic and good humor overcame the skepticism of a number of doubters – including your servant – and the NMLS is the result. For those of us not so sensible as Gavin, luck beats skill.

In order to discuss the future of state mortgage regulation, I think it is helpful first to review the reasons for the success of NMLS to date. From there, we can talk about how this success can help regulators and the industry deal with the challenges of the present and the future.

What is the basis of NMLS's success? I would argue that it is two deceptively easy concepts: cooperative federalism and collaboration with the mortgage industry.

Like many concepts involving power, federalism has positive and negative aspects. Negatively, it can involve jurisdictional conflicts between states or between states and the federal government. In this regard, the conflict over federal preemption of state consumer protection laws comes to mind. However, federalism can and should also have a positive aspect. As Justice Breyer has recently noted, federalism involves determining “the *level* of government at which Americans should solve their common problems.”<sup>1</sup> My friend and colleague, New York Superintendent of Banks Richard Neiman has taken this positive aspect one step further in his discussion of “cooperative federalism,” which involves the working together of state and federal governments to address common problems that neither could best address alone.<sup>2</sup>

We see glimmers of cooperative federalism in the Dodd-Frank Wall Street Reform and Consumer Protection Act and its recognition of the role of state regulation and state regulators. For example, state financial regulators are represented on the new Financial Stability Oversight Council. And we especially see this recognition in the area of consumer protection. In setting up the Consumer Financial Protection Bureau (the

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<sup>1</sup> Breyer, Stephen, *Making our Democracy Work: A Judge's View* (Knopf 2010).

<sup>2</sup> *Cooperative Federalism in Bank Supervision and Consumer Protection*, Remarks by Richard H. Neiman, Superintendent of Banks for the State of New York to the Exchequer Club (October 13, 2010) (text located at <http://www.banking.state.ny.us/sp101013.htm>).

“CFPB”), Congress recognized that this federal agency would not be able to do its job on its own, that states and state regulators are a valuable part of the regulatory fabric. Dodd-Frank expects — actually requires — the CFPB and state regulators to work together and to leverage their respective strengths and resources.

The NMLS is an example of cooperative federalism at its best. State licensing regimes were developed as part of state governments’ response to fraud and abuse in the mortgage market. In order to make their efforts more effective – and to head off federalization of licensing – the states worked together to establish a common platform and the beginning of a common approach to the licensing process. The SAFE Act incorporated NMLS into a federal scheme of regulation and thus incorporated the work of the states that formed the system and “encouraged” those that had not done so to adopt it. The result is a regulatory structure and system that was built quickly, well and cost effectively and has quickly become an integral part of the regulatory fabric. Your presence at this conference is a testament to the effectiveness of the system to date.

This interconnected state-federal approach has driven significant consistency across the states, producing a much more comprehensive and integrated regulatory structure. With the NMLS and the SAFE Act, you have one common system and state regulators operating under, by and large, one common set of rules. Further, as of last week, the NMLS began accepting registrations for mortgage loan originators working for depository institutions, and by the end of July this year, all such “federally regulated” MLOs will be registered on the system. The work that has gone into bringing these federal registrants onto the NMLS has, itself, been an exercise in coordination and collaboration between the states and the federal banking agencies. (I know that there is a panel of experts from the federal agencies coming up this afternoon, I will leave it to them to go into the details.)

This is monumental. After July, *anyone* out there making a mortgage loan will be in the system. In fact, each MLO will have a unique ID number that stays with them for their entire professional life. *No residential loan* will be originated without an individual and corporate unique ID number applied to it. This is a significant advancement in terms of transparency and accountability and has implications for every participant in the mortgage process: consumers, originators, mortgage purchasers, securitizers, investors, and, last but not least regulators. I note that Fannie Mae, Freddie Mac and FHA require — or are in the process of requiring — use of the NMLS unique identifier. The comprehensive nature of the NMLS will help regulators, such as myself, do our work and will help increase confidence in the mortgage industry. One of the mantras of those who drove passage of Dodd-Frank was “nowhere to hide” — at least in the mortgage arena, with your help and support, we are getting a lot closer to that goal.

I would like to highlight another manner in which the SAFE Act has really tied together state and federal regulators. The U.S. Department of Housing and Urban Development has been a key partner in this effort, and I would be remiss if I didn’t express our appreciation for the work of the folks in HUD’s SAFE Act office. HUD’s

role under the SAFE Act, soon to be transferred to the Consumer Financial Protection Bureau, is that of a referee.

As Congress set things up in the SAFE Act, HUD ensures and helps better define the minimum standards, which drives consistency in implementation. The state agencies must still identify and make decisions concerning numerous and sundry implementation issues, with HUD through its rulemaking determining where the boundaries are. So far this has worked well – several of the concerns of industry at the passage of the SAFE Act, such as that licensing requirements on loss mitigation specialists would shut down loan workouts, have not come to pass.

While collaboration of state and federal regulators was necessary for creation of the NMLS, it was not sufficient. The system would not be here without long and intense collaboration between regulators and the mortgage (and now banking) industry. The NMLS works because its development included substantial industry comments, criticism and suggestions. This conference is a continuation of that dialogue and I am sure that the system and its stakeholders are all better for it.

Making this work has required more than just developing uniform forms (though that was no easy task, as Gavin can attest) or building a web-based system to house these applications. Making it work means:

- Paying daily attention to a myriad of issues that arise in 58 independent sovereign governments sharing a single record for each licensee;
- Mediating inconsistencies in use and definitions; and
- Working with both simple and complex financial institutions to help them properly navigate and use the system.

These are but a few of the day-to-day tasks that make up the care and feeding of NMLS. It is a constant effort among SRR staff, the Financial Industry Regulatory Authority (FINRA) and the regulators. And I am not going to list for you the numerous weekly conference calls in which a variety of folks — including some of you in this room — participate.

So much for the past: what's next? No surprise to all of you, the future is not terribly clear. As participants in the housing finance system, we all face some significant challenges — and some potential opportunities.

While the last Congress did Herculean work to deal with many of the systemic and technical aspects of our financial system, the structure of the GSEs, which now account for over 90% of the mortgage market, remains to be addressed. The Administration is working on a proposal, which is expected to be released in the near future. If and when that happens, it will be but one step in a much larger undertaking — an undertaking that will involve Congress, the industry, the Administration, financial and housing regulators, housing advocates and a whole host of other stakeholders. And the issue really is broader than the future of the housing GSEs. It is about something

absolutely critical to those of you who have invested the time and money to attend this conference. It is about the structure of the entire housing finance system: who will be able to access mortgage credit, who will make that credit available and from what funding sources this credit will come.

As the debate and policy process continues, state regulators will evaluate any proposals against some core principles focused on:

- Preserving and promoting a diverse industry that supports a variety of business models, including locally responsive lending institutions;
- Providing for a multitude of regulatory perspectives; and
- Ensuring a system that both benefits and protects consumers.

Moving from these broad, conceptual issues to something more concrete, the current focus on servicing issues — robo-signing, weaknesses in loss mitigation and foreclosure prevention activities, and all that has emerged from these developments — points to a near term need to look at servicing practices, the servicing business model and its incentive structures. This is an important effort that we all need to be part of — not only is it important to the long term viability of your industry; it is also an important ingredient for economic recovery.

The attendees at this conference reflect one of the most important policy priorities for state banking and mortgage regulators, such as myself — the importance of diversity in the financial services industry. One size doesn't fit all when it comes to meeting consumer credit needs, and for mortgage lenders, I wonder if “one size fits all” (that one size, by the way, being huge) is the right approach to servicing. We need to look at whether the servicing industry has become too consolidated and whether consumers and the mortgage industry are best served by the current servicing business model. As part of this inquiry, I note that the Federal Housing Finance Agency, along with the housing GSEs and HUD, recently announced an effort to look at servicer compensation structures. This is an important effort that state regulators support and we look forward to participating.

On this topic, I would like to address briefly recent calls by some to federalize the foreclosure process. Those who blame servicing weaknesses and challenges on the varying state legal requirements for foreclosure miss the point. This is about an evaluation of what can and should be done to address a business model that does not appear to have the capacity to manage the current volume of troubled and delinquent loans. As FHFA's initiative suggests, we need to understand whether the financial incentives of the current servicing business model are a significant cause of our current problems. This is not to say that greater uniformity in terms of servicer best practices would not be useful. Addressing this problem can include state, local and federal responses, but it is important to remember that foreclosure is about taking away a borrower's property — it doesn't get more local than that.

State regulators expect to be active participants in this policy debate. But we don't have the luxury of inaction as the debate proceeds. In the meantime, there are a number of things we can do to, as the saying goes, "leverage our strengths."

- We can work together to continuously improve the NMLS, increasing its capabilities, while maintaining its efficiency. The NMLS has become part of the regulatory infrastructure — the plumbing, if you will — for mortgage lending. State regulators, having seen the value of the NMLS as a licensing and regulatory tool and, recognizing the need to improve supervision of other non-bank financial services providers, have begun the effort of expanding the NMLS beyond the mortgage industry.
- Later this year, regulators will have another SAFE Act-driven tool as the industry begins to file mortgage call reports. Those of us who have experience in banking are no strangers to the call report — we value it as a regulatory tool and appreciate the added transparency and confidence that such transparency can promote. If we do this right, then both regulators and industry will benefit. Regulators will be able to use the information for a number of reasons, including conducting risk-based examinations and investigations: good shops will see fewer visits from their regulator and troubled outfits will see more.
- States can continue to work together on multi-state mortgage examinations, continuously improving the quality and efficiency of the examination staff and product, and introducing innovative technological tools that will change the way regulators work. Current state efforts related to mortgage servicers point to the growing maturity of this coordinated and collaborative approach.
- We can use the recently executed Memorandum of Understanding with the CFPB as the foundation for robust interaction and cooperation with that agency, applying the techniques of cooperative federalism that we have learned under the SAFE Act. I also expect that it will help keep all of us focused on efficient regulation.

Finally, we – and I mean government agencies and mortgage industry firms – can and should work together to address the ongoing foreclosure crisis. I began this speech by referring to my colleague in New York, Richard Neiman. His department has put into place business conduct rules for mortgage servicers. Among other things, these rules:

- Establish an enforceable duty of care and fair dealing;
- Require consideration of modification prior to foreclosure, with specific time frames for responding to borrowers and procedures to ensure homeowners do not need to submit multiple copies of required documents; and
- Call for reporting of key mortgage performance data to the Banking Department on a quarterly basis, including delinquency rates, loss mitigation activities, and any other information that the Superintendent may consider necessary.

Other states, including North Carolina, also are pursuing this path. This is what states do — we try tailored approaches to address the needs of our particular markets. States are, in fact, the laboratories of democracy — proving grounds for innovation. Good ideas can then “go viral.”

I believe that for all of us here, preservation of the state role is vital. First, it preserves the important role of state governments in the regulation of a subject matter that is their traditional jurisdiction. Secondly, it allows for regulation at optimum cost and expenditure of resources, dealing with problems at the most proximate level of government or, under principals of cooperative federalism, with the optimum combination of governmental resources. Finally, it can result in a scheme of regulation that is flexible, adaptable and cost-effective. For these reasons, I hope that this conference can refresh and strengthen not only our knowledge of the system but our commitment to making it work.

Thank you.