DEPARTMENT OF CONSUMER & BUSINESS SERVICES

Department of Consumer and Business Services
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Before the
Senate Committee on
General Government, Consumer and Small Business Protection

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HB 2239

Testimony of
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Division of Finance and Corporate Securities
Department of Consumer and Business Services

For the record, my name is David C. Tatman. I am the Administrator of the Division of Finance and Corporate Securities of the Department of Consumer and Business Services. I am here today to testify in support of HB 2239, a bill to allow the department to oversee mortgage lending conducted by bank subsidiaries. This bill passed the House with a 59-0 vote, and is before this committee today.

In order to provide stronger oversight of mortgage lending activity by subsidiaries of banks and to foster a more even competitive environment for mortgage lending businesses, the department is proposing to narrow the existing exemption for subsidiaries and affiliates of financial institutions. Under House Bill 2239, these subsidiary corporations would need mortgage lending licenses like any small business broker or banker. This concept evenly applies to all banks that choose to operate subsidiary corporations in Oregon to conduct mortgage lending activities.

Oregon – as in other states – issues mortgage lending licenses to businesses. A mortgage lender license allows a banker or broker to make or negotiate residential mortgage loans with consumers. In order to obtain a mortgage lending license, a business must provide financial statements, obtain a surety bond scaled to match the business' loan volume, employ at least one licensed mortgage loan originator and use only licensed loan originators to make the mortgage loans. Businesses holding a mortgage lending license undergo regular examinations by our office to check for compliance with the Oregon Mortgage Lender Law. While the department works with lenders to bring about compliance, unscrupulous or recalcitrant mortgage lenders may be subject to administrative penalties by the department, civil suits by the state or private parties, and (in some cases) suffer criminal prosecution for mortgage fraud. The practice of licensing and examining mortgage lenders was first brought to the Legislative Assembly by the mortgage lending profession and has been in place since 1993.

Furthermore, the persons employed by licensed mortgage bankers and brokers – mortgage loan originators or MLOs – must obtain initial and continuing mortgage lending education, pass initial qualifying exams, pass a criminal history check and meet financial responsibility standards before they are eligible to be licensed as MLOs. This high standard is not required for bank employees engaged in mortgage lending, although best practices by banks usually result in bank loan officers receiving appropriate training and meeting some background standards.

Oregon law does exempt certain parties from obtaining a mortgage lending license, including attorneys, agents of the federal government, private parties lending money to others for investment purposes, and the like. One exemption includes the subsidiaries and affiliates of financial institutions, as long as another regulator (state or federal) exercises control or otherwise supervises the business' lending operations consistently with the Oregon Mortgage Lender Law.

Traditionally, subsidiary corporations of financial institutions enjoyed exclusions from state law due to the effect of federal preemption. This means that the mortgage arms of national banks did not need to obtain a mortgage lending license to operate in Oregon. This exemption extends to any corporate form of ownership where the subsidiary holds a bare majority of the ownership interests in the undertaking. For instance, a subsidiary owning 50.1% of the membership interests in an LLC may successfully claim to be exempt from mortgage lending licensing by the state.

The existing exemption was based, in part, on the ability of another regulator to supervise a subsidiary consistently as the state does under the Oregon Mortgage Lender Law. National banks are chartered, supervised and examined by the Office of the Comptroller of the Currency (OCC), a subdivision of the United States Treasury. The OCC is known as a "prudential" regulator – in other words, its examination and supervision efforts focus on the safety and soundness of financial institutions. One of the main objectives of the OCC is to ensure that the national banking system as a whole operates in a safe and sound manner. To this end, the OCC oversees around 2,000 national banks with around $9 trillion in assets. These 2,000 national banks may have one or hundreds of subsidiaries conducting different banking activities in Oregon, including residential mortgage lending. Almost all of these national banks are headquartered outside of Oregon. Just the sheer size of the OCC's responsibilities combined with the federal agency's focus on the "big picture" of credit and banking mean that subsidiaries do not likely receive the same scrutiny as the parent banks, particularly so as to the mortgage lending activity conducted by a subsidiary located in an office in Oregon.

The focus on the larger issue of safety and soundness over individualized consumer protection, though, illustrates the issues that accompany such a regulatory gap. For example, the vast majority of our complaints related to banking revolve around the conduct of federally-chartered institutions, and our present options in the case of any corporate entity affiliated with a federal bank are limited. Just since 2009, the Division of Finance and Corporate Securities received 719 complaints involving a financial institution. 411 of those complaints related to mortgage lending, servicing, and foreclosure practices. Out of these 411 mortgage-related complaints, 373 – or 91% – involved a federally-chartered institution. The complaints we receive tend to self-report the entity involved, so our best estimate is that at least 76 complaints involved entities likely organized as subsidiaries. Since the only option for our department is to refer a citizen to the Office of the Comptroller of the Currency for possible resolution when a federally-chartered institution is involved, data on the exact number of subsidiaries subject to a complaint is not complete. By requiring a license, this concept would allow us to be able to address an Oregon borrowers' concern about a bank subsidiary without referring the complaint to the OCC's call center in Ft. Worth, TX.

Suspect mortgage lending practices have led to consequences for the businesses that engaged in the conduct. From February to October 2012, lawsuits alleging fraud or false claims related to mortgage insurance (i.e., obtaining federal mortgage insurance on loans not fit for insurance) exposed large national banks to nearly $2 billion in damages alone. The failure and acquisition of IndyMac and Washington Mutual, both federally-chartered thrifts heavily involved in the mortgage origination market, likely affected the U.S. housing market as a whole.

Unfortunately, Oregon banks were not immune from failure. At least one Oregon-chartered bank – Silver Falls Bank – failed in part because of the practices of its mortgage lending subsidiary.

We have seen the ebb-and-flow of mortgage broker lending over the last 20 years. Currently, national banks hold a significant portion of mortgage lending. According to a recent article published by the Portland Business Journal, the market share of four nationally-chartered banks consists of 42% of the mortgage market, compared to a 29% share of the mortgage market just six years ago. As the market begins to heat up again and we see more lending activity, we want to be in a position to ensure that Oregonians receive the best service and that businesses are responsive to Oregon complaints.

With the passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act, there is a clearer line between the states as the first line in consumer protection and the federal government as the regulator of the banking system as a whole. Section 1045 of the Act clarified that the National Bank Act does not preempt state law affecting subsidiaries, affiliates or agents of national banks. States are now free to decide for themselves whether or not to require subsidiaries to meet the terms of state law. Prompted by this federal shift, other states are beginning to apply existing laws to subsidiaries or remove long-standing exemptions in state law. According to the Conference of State Bank Supervisors, there are 26 states that have indicated they require licenses from mortgage lending subsidiaries. For example, in 2012 the Maryland General Assembly enacted Senate Bill 302, which removed the state's exemption for subsidiaries and affiliates of financial institutions. Hawaii and West Virginia recently amended their mortgage lending statutes to require licenses from bank subsidiaries. Arizona and Vermont preserved laws requiring licensing of subsidiaries, and recently have accepted license applications from subsidiary corporations for mortgage lending licenses.

The bill does not remove other exemptions, so entities already licensed and examined by the department under different statutory schemes – such as consumer finance licensees and banks themselves – could still operate without additional licenses. Additionally, this bill clarifies that the financial institution's holding company remains exempt from licensing as long as the holding company itself does not engage directly in mortgage lending. Furthermore, because credit unions do not technically operate subsidiary corporations but instead invest in credit union service organizations ("CUSOs"), this concept does not affect the mortgage lending activities of credit unions.

We have spoken with various industry associations representing mortgage lenders and most are generally supportive of the concept. I ask for your support of this bill and would be happy to answer any questions.