TESTIMONY OF

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On behalf of the

CONFERENCE OF STATE BANK SUPERVISORS

On

"MODERNIZING BANK SUPERVISION AND REGULATION"

Before the

SENATE COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS

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Introduction

Good morning, Chairman Dodd, Ranking Member Shelby, and members of the Committee. My name is Joe Smith, and I am the North Carolina Commissioner of Banks. I also serve as incoming Chairman of the Conference of State Bank Supervisors (CSBS) and a member of the CSBS Task Force on Regulatory Restructuring. I am pleased to be here today to offer a state perspective on our nation's financial regulatory structure -- its strengths and its deficiencies, and suggestions for reform.

As we work through a federal response to this financial crisis, we need to carry forward a renewed understanding that the concentration of financial power and a lack of transparency are not in the long-term interests of our financial system, our economic system or our democracy. This lesson is one our country has had to learn in almost every generation, and I hope that the current lesson will benefit future generations. While our largest and most complex institutions are no doubt central to a resolution of the current crisis, my colleagues and I urge you to remember that the health and effectiveness of our nation's financial system also depends on a diverse and competitive marketplace that includes community and regional institutions.

While changing our regulatory system will be far from simple, some fairly simple concepts should guide these reforms. In evaluating any governmental reform, we must ask if our financial regulatory system:

- Ushers in a new era of cooperative federalism, recognizing the rights of states to protect consumers and reaffirming the state role in chartering and supervising financial institutions;

- Fosters supervision tailored to the size, scope and complexity of an institution and the risk it poses to the financial system;
- Assures the promulgation and enforcement of consumer protection standards that are applicable to both state and federally chartered institutions and are enforceable by state officials;
- Encourages a diverse universe of financial institutions as a method of reducing risk to the system, encouraging competition, furthering innovation, insuring access to financial markets, and promoting efficient allocation of credit;
- Supports community and regional banks, which provide relationship lending and fuel local economic development; and
- Requires financial institutions that are recipients of governmental assistance or pose systemic risk to be subject to safety and soundness and consumer protection oversight.

We have often heard the consolidation of financial regulation at the federal level is the “modern” answer to the challenges our financial system. We need to challenge this assumption. For reasons more fully discussed below, my colleagues and I would suggest to you that an appropriately coordinated system of state and federal supervision and regulation will promote a more effective system of financial regulation and a more diverse, stable and responsive financial system.

The Role of the States in Financial Services Supervision and Regulation

The states charter and supervise more than 70 percent of all U.S. banks (Exhibit A), in coordination with the FDIC and Federal Reserve. The rapid consolidation of the industry over the past decade, however, has created a system in which a handful of large national banks control the vast majority of assets in the system. The more than 6,000 banks supervised and regulated by the states now represent less than 30 percent of the assets of the banking system (Exhibit B). While these banks are smaller than the global institutions now making headlines, they are important to all of the markets they serve and are critical in the non-metropolitan markets where they are often the major sources of credit for local households, small businesses and farms.

Since the enactment of nationwide banking in 1994, the states, working through CSBS, have developed a highly coordinated system of state-to-state and state-to-federal bank supervision. This is a model that has served this nation well, embodying our uniquely American dynamic of checks and balances – a dynamic that has been missing from certain areas of federal financial regulation, with devastating consequences.

The dynamic of state and federal coordinated supervision for state-chartered banks allows for new businesses to enter the market and grow to meet the needs of the markets they serve, while maintaining consistent nationwide standards. Community and regional banks are a vital part of America's economic fabric because of the state system.

As we continue to work through the current crisis, we need to do more to support community and regional banks. The severe economic recession and market distortions caused by bailing out the largest institutions have caused significant stress on these institutions. While some community and regional banks have had access to the TARP's capital purchase program, the processing and funding has grown cumbersome and slow. We need a more nimble and effective program for these institutions. This program must be administered by an entity with an understanding of community and regional banking.

This capital will enhance stability and provide support for consumer and small business lending.

In addition to supervising banks, I and many of my colleagues regulate the residential mortgage industry. All 50 states and the District of Columbia now provide some regulatory oversight of the residential mortgage industry. The states currently manage over 88,000 mortgage company licenses, over 68,000 branch licenses, and approximately 357,000 loan officer licenses. In 2003, the states, acting through the CSBS and the American Association of Residential Mortgage Regulators, first proposed a nationwide mortgage licensing system and database to coordinate our efforts in regulating the residential mortgage market. The system launched on January 2, 2008 on time and on budget. The Nationwide Mortgage Licensing System (NMLS) was incorporated in the federal S.A.F.E. Act and, as a result, has established a new and important partnership with the United States Department of Housing and Urban Development, the federal banking agencies and the Farm Credit Administration. We are confident that this partnership will result in an efficient and effective combination of state and federal resources and a nimble, responsive and comprehensive system of regulation. This is an example of what we mean by “a new era of cooperative federalism.”

Where Federalism Has Fallen Short

For the past decade it has been clear to the states that our system of mortgage finance and mortgage regulation was flawed and that a destructive and widening chasm had formed between the interests of borrowers and of lenders. Over that decade, through participation in GAO reports and through congressional testimony, one can observe an ever-increasing level of state concern over this growing chasm and its reflection in the state and federal regulatory relationship.

Currently, 35 states plus the District of Columbia have enacted predatory lending laws.[1] First adopted by North Carolina in 1999, these state laws supplement the federal protections of the Home Ownership and Equity Protection Act of 1994 (HOEPA). The innovative actions taken by state legislatures have prompted significant changes in industry practices, as the largest multi-state lenders have adjusted their practices to comply with the strongest state laws. All too often, however, we are frustrated in our efforts to protect consumers by the preemption of state consumer protection laws by federal regulations. Preemption must be narrowly targeted and balance the interest of commerce and consumers.

In addition to the extensive regulatory and legislative efforts, state attorneys general and state regulators have cooperatively pursued unfair and deceptive practices in the mortgage market. Through several settlements, state regulators have returned nearly one billion dollars to consumers. A settlement with Household resulted in $484 million paid in restitution, a settlement with Ameriquest resulted in $295 million paid in restitution, and a settlement with First Alliance Mortgage resulted in $60 million paid in restitution. These landmark settlements further contributed to changes in industry lending practices.

But successes are sometimes better measured by actions that never receive media attention. States regularly exercise their authority to investigate or examine mortgage companies for compliance not only with state law, but with federal law as well. These examinations are an integral part of a balanced regulatory system. Unheralded in their

[1] Source: National Conference of State Legislatures.

everyday routine, enforcement efforts and examinations identify weaknesses that, if undetected, might be devastating to the company and its customers. State examinations act as a check on financial problems, evasion of consumer protections and sales practices gone astray. Examinations can also serve as an early warning system of a financial institution conducting misleading, predatory or fraudulent practices. Attached as Exhibit C is a chart of enforcement actions taken by state regulatory agencies against mortgage providers. In 2007, states took nearly 6,000 enforcement actions against mortgage lenders and brokers.

These actions could have resulted in a dialog between state and federal authorities about the extent of the problems in the mortgage market and the best way to address the problem. That did not happen. The committee should consider how the world would look today if the ratings agencies and the OCC had not intervened and the assignee liability and predatory lending provisions of the Georgia Fair Lending Act had been applicable to all financial institutions. I would suggest we would have far fewer foreclosures and may have avoided the need to bailout our largest financial institutions. It is worth noting that the institutions whose names were attached to the OCC's mortgage preemption initiative — National City, First Franklin, and Wachovia–were all brought down by the mortgage crisis. That fact alone should indicate how out of balance the system has become.

From the state perspective, it has not been clear for many years exactly who was setting the risk boundaries for the market. What is clear is that the nation's largest and most influential financial institutions have been major contributing factors in our regulatory system's failure to respond to this crisis. At the state level, we sometimes perceived an environment at the federal level that is skewed toward facilitating the business models and viability of our largest financial institutions rather than promoting the strength of the consumer or our diverse economy.

It was the states that attempted to check the unhealthy evolution of the mortgage market and apply needed consumer protections to subprime lending. Regulatory reform must foster a system that incorporates the early warning signs that state laws and regulations provide, rather than thwarting or banning them.

Certainly, significant weaknesses exist in our current regulatory structure. As GAO has noted, incentives need to be better aligned to promote accountability, a fair and competitive market, and consumer protection.

Needed Regulatory Reforms: Mortgage Origination

I would like to thank this committee for including the Secure and Fair Enforcement for Mortgage Licensing Act (S.A.F.E.) in the Housing and Economic Recovery Act of 2008 (HERA). It has given us important tools that continue our efforts to reform mortgage regulation.

CSBS and the states are working to enhance the regulatory regime for the residential mortgage industry to ensure legitimate lending practices, provide adequate consumer protection, and to once again instill both consumer and investor confidence in the housing market and the economy as a whole. The various state initiatives are detailed in Exhibit D.

Needed Regulatory Reforms: Financial Services Industry

Many of the problems we are experiencing are both the result of “bad actors” and bad assumptions by the architects of our modern mortgage finance system. Enhanced supervision and improved industry practices can successfully weed out the bad actors and address the bad assumptions. If regulators and the industry do not address both causes of our current crisis, we will have only the veneer of reform and will eventually repeat our mistakes. Some lessons learned from this crisis must be to prevent the following: the over-leveraging that was allowed to occur in the nation's largest institutions; outsourcing of loan origination with no controls in place; and industry consolidation to allow institutions to become so large and complex that they become systemically vital and too big to effectively supervise or fail.

While much is being done to enhance supervision of the mortgage market, more progress must be made towards the development of a coordinated and cooperative system of state-federal supervision.

Preserve and Enhance Checks and Balances/Forge a New Era of Federalism

The state system of chartering and regulating has always been a key check on the concentration of financial power, as well as a mechanism to ensure that our banking system remains responsive to local economies' needs and accountable to the public. The state system has fostered a diversity of institutions that has been a source of stability and strength for our country, particularly locally-owned and controlled community banks. To promote a strong and diverse system of banking—one that can survive the inevitable economic cycles and absorb failures—preservation of state-chartered banking should be a high priority for Congress. The United States boasts one of the most powerful and dynamic economies in the world because of those checks and balances, not despite them.

Consolidation of the industry and supervision and preemption of applicable state law does not address the cause of this crisis, and has in fact exacerbated the problem.

The flurry of state predatory lending laws and new state regulatory structures for lenders and mortgage brokers were indicators that conditions and practices were deteriorating in our mortgage lending industry. It would be incongruous to eliminate the early warning signs that the states provide. Just as checks and balances are a vital part of our democratic government, they serve an equally important role in our financial regulatory structure. Put simply, states have a lower threshold for crisis and will most likely act sooner. This is an essential systemic protection.

Most importantly, it serves the consumer interest that the states continue to have a role in financial regulation. While CSBS recognizes the financial services market is a nationwide industry that has international implications, local economies and individual consumers are most drastically affected by mortgage market fluctuations. State regulators must remain active participants in mortgage supervision because of our knowledge of local economies and our ability to react quickly and decisively to protect consumers.

Therefore, CSBS urges Congress to implement a recommendation made by the Congressional Oversight Panel in their "Special Report on Regulatory Reform" to eliminate federal preemption of the application of state consumer protection laws to national banks. In its report, the Panel recommends Congress "amend the National Banking Act to provide clearly that state consumer protection laws can apply to national banks and to reverse the holding that the usury laws of a national bank's state of incorporation govern that bank's operation through the nation."[2] We believe the same policy should apply to the Office of Thrift Supervision. To preserve a responsive system,

[2] The Congressional Oversight Panel's "Special Report on Regulatory Reform" can be viewed at http://cop.senate.gov/documents/cop-012909-report-regulatoryreform.pdf.

states must be able to continue to produce innovative solutions and regulations to provide consumer protection.

The federal government would better serve our economy and our consumers by advancing a new era of cooperative federalism. The S.A.F.E. Act enacted by Congress requiring licensure and registration of mortgage loan originators through the Nationwide Mortgage Licensing System provides a model for achieving systemic goals of high regulatory standards and a nationwide regulatory roadmap and network, while preserving state authority for innovation and enforcement. The Act sets expectations for greater state-to-state and state-to-federal regulatory coordination.

Congress should complete this process by enacting a federal predatory lending standard. A federal standard should allow for further state refinements in lending standards and be enforceable by state and federal regulators. Additionally, a federal lending standard should clarify expectations of the obligations of securitizers.

Consumer Protection/Enforcement

Consolidated regulation minimizes resources dedicated to supervision and enforcement. As FDIC Chairman Sheila Bair recently told the states' Attorneys General, "if ever there were a time for the states and the feds to work together, that time is right here, right now. The last thing we need is to preempt each other." Congress should establish a mechanism among the financial regulators for identifying and responding to emerging consumer issues. This mechanism, perhaps through the Federal Financial Institutions Examination Council (FFIEC), should include active state regulator and law enforcement participation and develop coordinated responses. The coordinating federal entity should report to Congress regularly. The states must retain the right to pursue independent enforcement actions against all financial institutions as an appropriate check on the system.

Systemic Supervision/Capital Requirements

As Congress evaluates our regulatory structure, I urge you to examine the linkages between the capital markets, the traditional banking sector, and other financial services providers. Our top priority for reform must be a better understanding of systemic risks. The federal government must facilitate the transparency of financial markets to create a financial system in which stakeholders can understand and manage their risks. Congress should establish clear expectations about which regulatory authority or authorities are responsible for assessing risk. The regulator must have the necessary tools to identify and mitigate risk, and resolve failures.

Congress, the administration, and federal regulators must also consider how the federal government itself may inadvertently contribute to systemic risk—either by promoting greater industry consolidation or through policies that increase risk to the system. Perhaps we should contemplate that there are some institutions whose size and complexity make their risks too large to effectively manage or regulate. Congress should aggressively address the sources of systemic risk to our financial system.

While this crisis has demanded a dramatic response from the federal government, the short-term result of many of these programs, including the Troubled Asset Relief Program (TARP), has been to create even larger and more complex institutions and greater systemic risk. These responses have created extreme disparity in the treatment of financial institutions, with the government protecting those deemed to be too big or too complex to fail, perhaps at the expense of smaller institutions and the diversity of our financial system.

At the federal level, our state-chartered banks may be too-small-to-care but in our cities and communities, they are too important to ignore. It is exactly the same dynamic that told us that the plight of the individual homeowner trapped in a predatory loan was less important than the needs of an equity market hungry for new mortgage-backed securities.

There is an unchallenged assumption that federal regulatory reforms can address the systemic risk posed by our largest and most complex institutions. If these institutions are too large or complex to fail, the government must give preferential treatment to prevent these failures, and that preferential treatment distorts and harms the marketplace, with potentially disastrous consequences.

Our experience with Fannie Mae and Freddie Mac exemplifies this problem. Large systemic institutions such as Fannie and Freddie inevitably garner advantages and political favor, and the lines between government and industry blur in ways that do not reflect American values of fair competition and merit-based success.

My fellow state supervisors and I have long believed capital and leverage ratios are essential tools for managing risk. For example, during the debate surrounding the advanced approach under Basel II, CSBS supported FDIC Chairman Sheila Bair in her call to institute a leverage ratio for participating institutions. Federal regulation needs to prevent capital arbitrage among institutions that pose systemic risks, and should require systemic risk institutions to hold more capital to offset the grave risks their collapse would pose to our financial system.

Perhaps most importantly, Congress must strive to prevent unintended consequences from doing irreparable harm to the community and regional banking system in the United States. Federal policy to prevent the collapse of those institutions considered too big to fail should ultimately strengthen our system, not exacerbate the weaknesses of the system. Throughout the current recession, community and regional banks have largely remained healthy and continued to provide much needed credit in the communities where they operate. The largest banks have received amazing sums of capital to remain solvent, while the community and regional banks have continued to lend in this difficult environment with the added challenge of having to compete with federally subsidized entities.

Congress should consider creating a bifurcated system of supervision that is tailored to the size, scope, and complexity of financial institutions. The largest, most systemically significant institutions should be subject to much more stringent oversight that is comprehensive enough to account for the complexity of the institution. Community and regional banks should be subject to regulations that are tailored to the size and sophistication of the institutions. In financial supervision, one size should no longer fit all.

Roadmap for Unwinding Federal Liquidity Assistance and Systemic Responses

The Treasury Department and the Federal Reserve should be required to provide a plan for how to unwind the various programs established to provide liquidity and prevent systemic failure. Unfortunately, the attempts to avert crisis through liquidity programs have focused predominantly upon the needs of the nation's largest institutions, without consideration for the unintended consequences for our diverse financial industry as a whole, particularly community and regional banks. Put simply, the government is now in the business of picking winners and losers. In the extreme, these decisions determine survival, but they also affect the overall competitive landscape and relative health and profitability of institutions. The federal government should develop a plan that promotes fair and equal competition, rather than sacrificing the diversity of our financial industry to save those deemed too big to fail.

Conclusion

Chairman Dodd, Ranking Member Shelby, and members of the committee, the task before us is a daunting one. The current crisis is the result of well over a decade's worth of policies that promoted consolidation, uniformity, preemption and the needs of the global marketplace over those of the individual consumer.

If we have learned nothing else from this experience, we have learned that big organizations have big problems. As you consider your responses to this crisis, I ask that you consider reforms that promote diversity and create new incentives for the smaller, less troubled elements of our financial system, rather than rewarding the largest and most reckless.

At the state level, we are constantly pursuing methods of supervision and regulation that promote safety and soundness while making the broadest possible range of financial services available to all members of our communities. We appreciate your work toward this common goal, and thank you for inviting us to share our views today.

Exhibit A: Percentage of Charters by Regulator

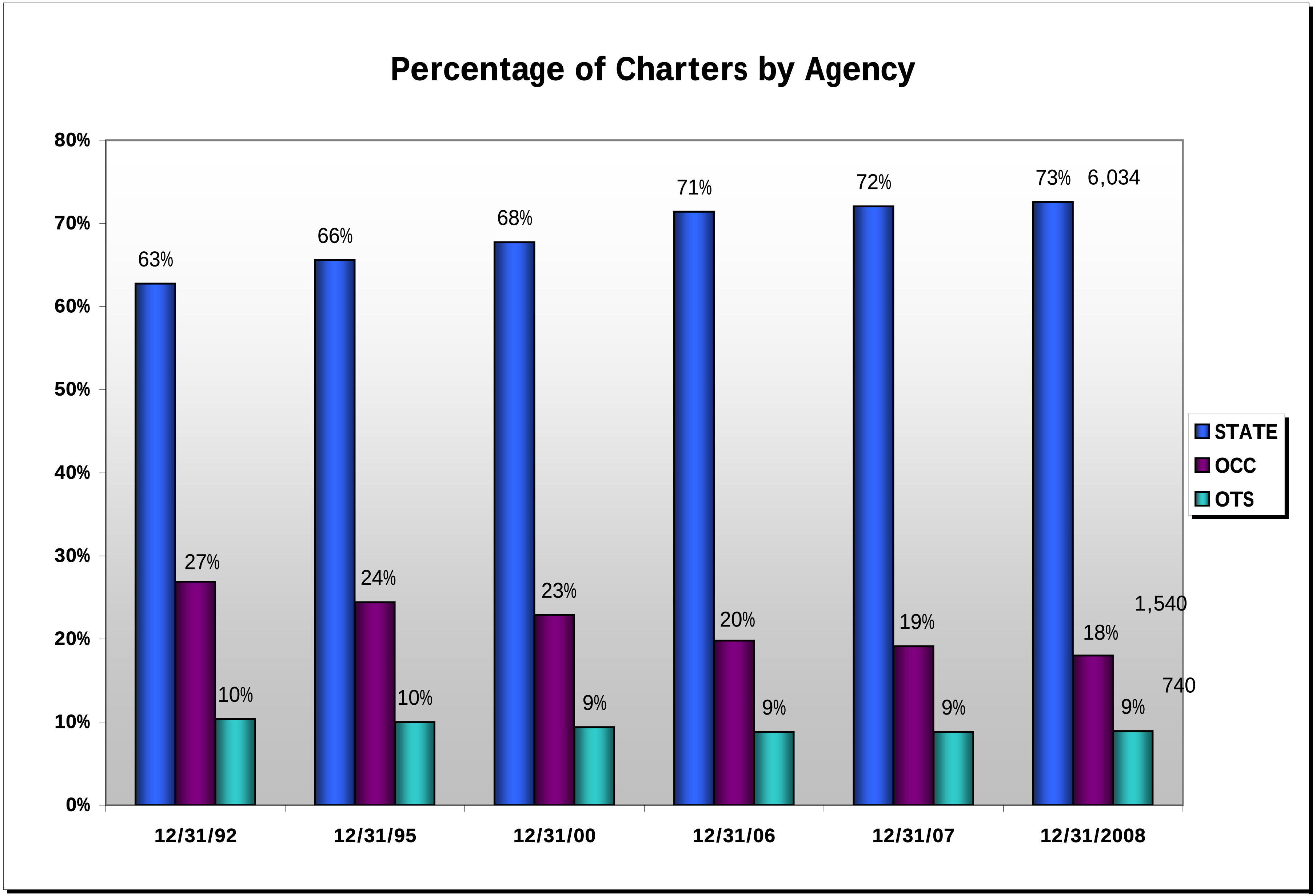


Exhibit B: Percentage of Assets by Regulator

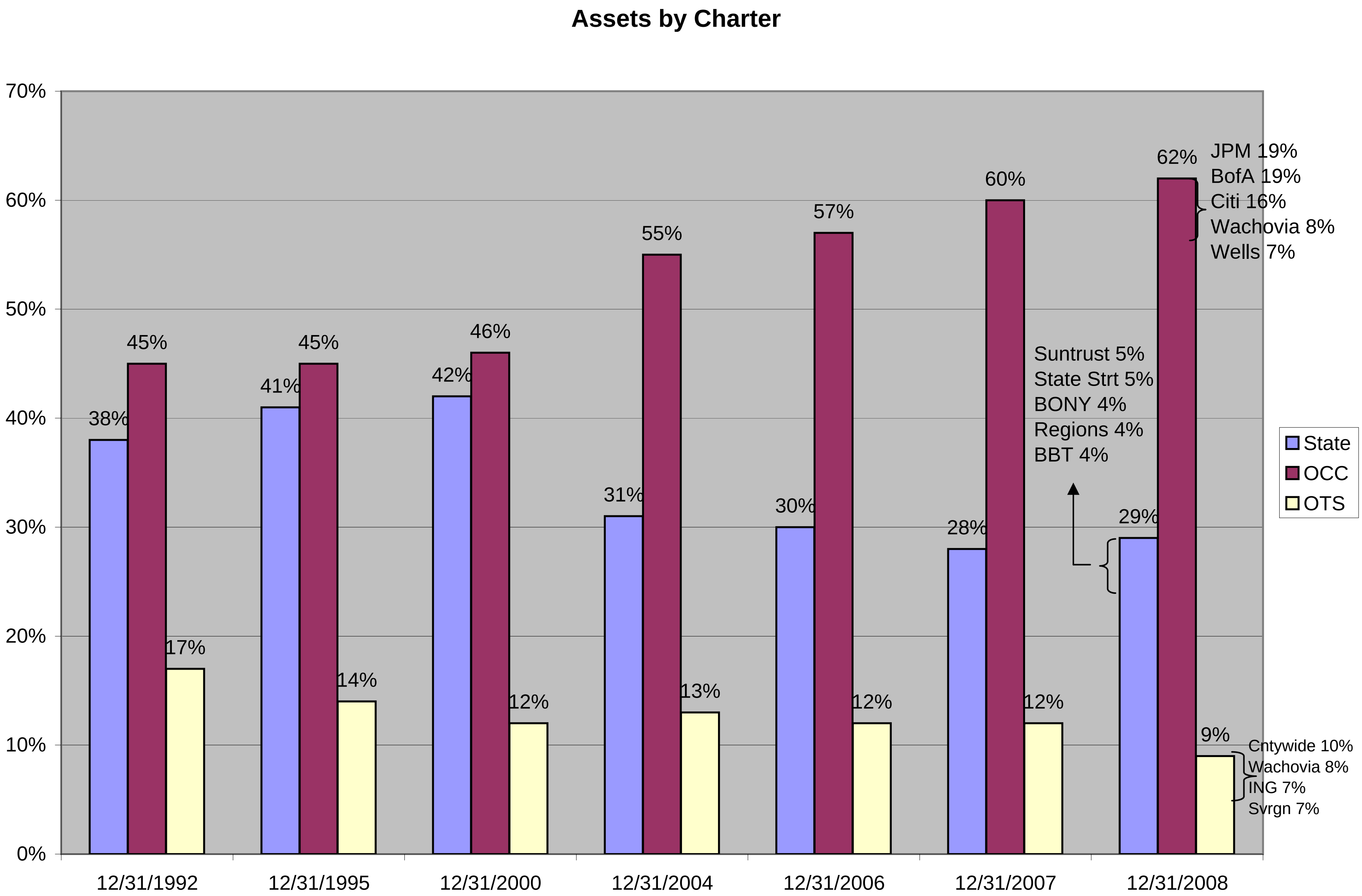
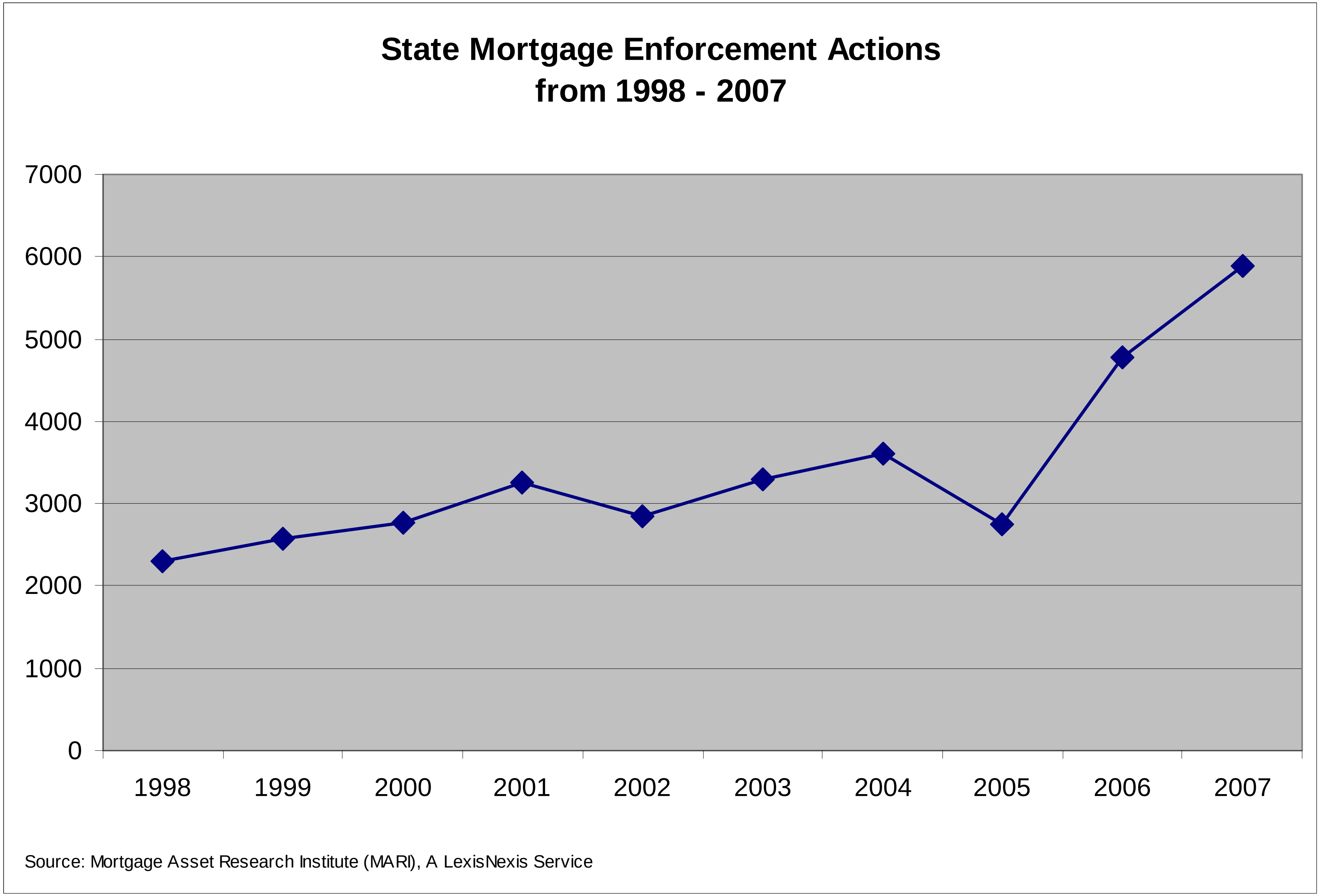


Exhibit C: State Enforcement Actions Against Mortgage Providers



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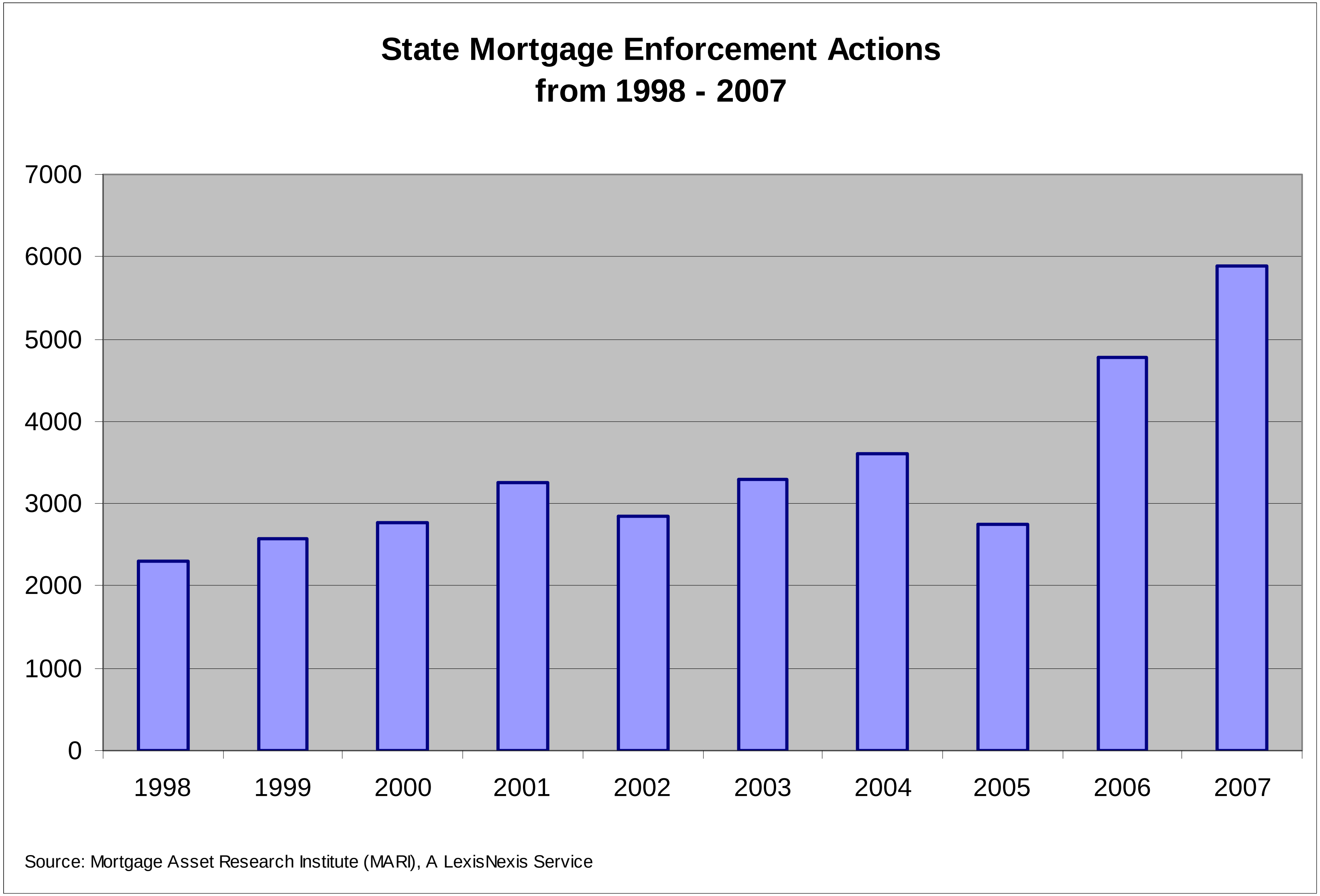
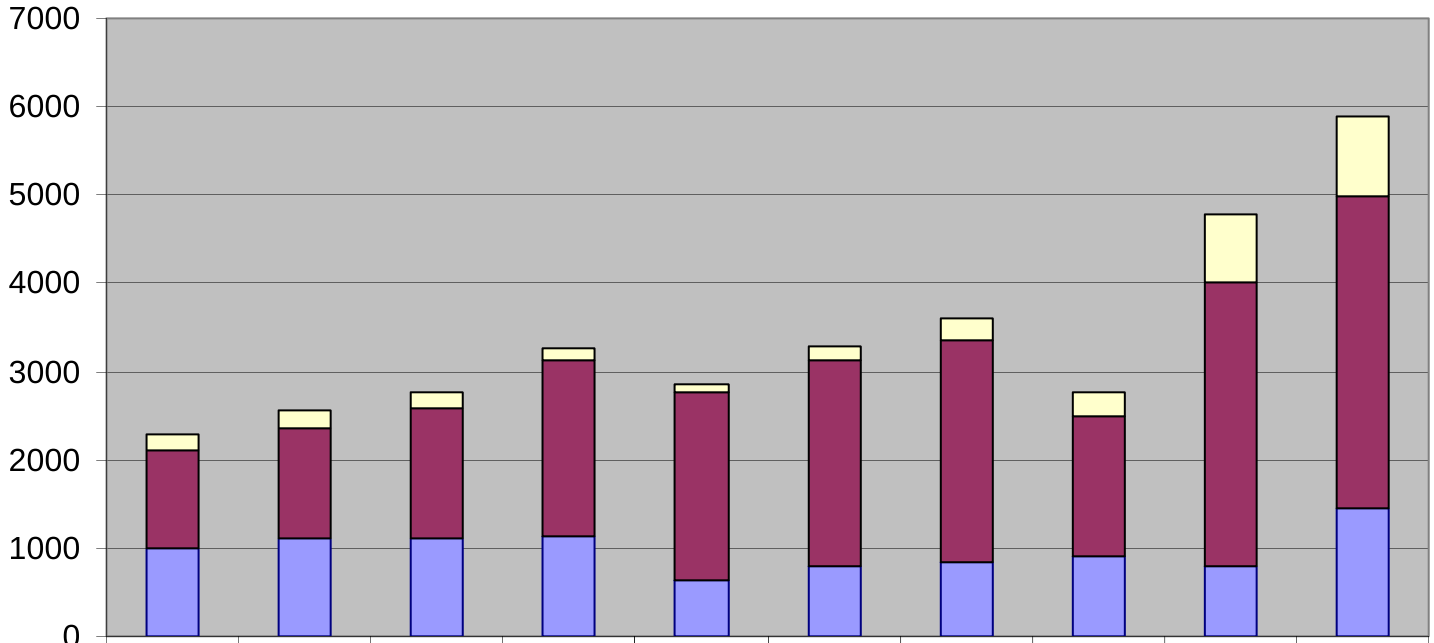


Exhibit C: State Enforcement Actions Against Mortgage Providers

State Mortgage Enforcement Actions from 1998 - 2007



	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
Disciplinary / Fines	185	212	180	133	93	171	249	260	761	912
Cease & Desist	1121	1242	1480	2002	2117	2343	2534	1595	3227	3527
Criminal / Revocation	992	1116	1106	1126	638	782	829	904	788	1457

Source: Mortgage Asset Research Institute (MARI), A LexisNexis Service

APPENDIX ITEMS

Exhibit D: State Initiatives to Enhance Supervision of the Mortgage Industry

CSBS-AARMR Nationwide Mortgage Licensing System
The states first recognized the need for a tool to license mortgage originators several years ago. Since then, states have dedicated tremendous monetary and staff resources to develop and enact the Nationwide Mortgage Licensing System (NMLS). First proposed among state regulators in late 2003, NMLS launched on time and on budget on January 2, 2008. The Nationwide Mortgage Licensing System is more than a database. It serves as the foundation of modern mortgage supervision by providing dramatically improved transparency for regulators, the industry, investors, and consumers. Seven inaugural participating states began using the system on January 2, 2008. Only 15 months later, 23 states are using NMLS and by January 2010—just two years after its launch—CSBS expects 40 states to be using NMLS.

NMLS currently maintains a single record for every state-licensed mortgage company, branch, and individual that is shared by all participating states. This single record allows companies and individuals to be definitively tracked across state lines and over time as entities migrate among companies, industries, and federal and state jurisdictions. Additionally, this year consumers and industry will be able to check on the license status and history of the companies and individuals with which they wish to do business.

NMLS provides profound benefits to consumers, state supervisory agencies, and the mortgage industry. Each state regulatory agency retains its authority to license and supervise, but NMLS shares information across state lines in real-time, eliminates any duplication and inconsistencies, and provides more robust information to state regulatory agencies. Consumers will have access to a central repository of licensing and publicly adjudicated enforcement actions. Honest mortgage lenders and brokers will benefit from the removal of fraudulent and incompetent operators, and from having one central point of contact for submitting and updating license applications.

The hard work and dedication of the states was ultimately recognized by Congress as they enacted the Housing and Economic Recovery Act of 2008 (HERA). The bill acknowledged and built upon the work that had been done in the states to protect consumers and restore the public trust in our mortgage finance and lending industries.

Title V of HERA, titled the Secure and Fair Enforcement for Mortgage Licensing Act of 2008 (S.A.F.E. Act), is designed to increase uniformity, reduce regulatory burden, enhance consumer protection, and reduce fraud by requiring all mortgage loan originators to be licensed or registered through NMLS.

In addition to loan originator licensing and mandatory use of NMLS, the S.A.F.E. Act requires the states to do the following:

1. Eliminate exemptions from mortgage loan originator licensing that currently exist in state law;

2. Screen and deny mortgage loan originator licenses for felonies of any kind within seven years and certain financially-related felonies permanently;
3. Screen and deny licenses to individuals who have ever had a loan originator license revoked;
4. Require loan originators to submit personal history information and authorize background checks to determine the applicant's financial responsibility, character, and general fitness;
5. Require mortgage loan originators to take 20 hours of pre-licensure education in order to enter the state system of licensure;
6. Require mortgage loan originators to pass a national mortgage loan originator test developed by NMLS;
7. Establish either a bonding or net worth requirement for companies employing mortgage loan originators or a recovery fund paid into by mortgage loan originators or their employing company in order to protect consumers;
8. Require companies licensed or registered through NMLS to submit a Mortgage Call Report on at least an annual basis;
9. Adopt specific confidentiality and information sharing provisions; and
10. Establish effective authority to investigate, examine, and conduct enforcement of licensees.

Taken together, these background checks, testing, and education requirements will promote a higher level of professionalism and encourage best practices and responsible behavior among all mortgage loan originators. Under the legislative guidance provided by Congress, the states drafted the Model State Law for uniform implementation of the S.A.F.E. Act. The Model State Law not only achieves the minimum licensing requirements under the federal law, but also accomplishes Congress' ten objectives addressing uniformity and consumer protection.

The Model State Law, as implementing legislation at the state level, assures Congress that a framework of localized regulatory controls are in place at least as stringent as those pre-dating the S.A.F.E. Act, while setting new uniform standards aimed at responsible behavior, compliance verification and protecting consumers. The Model State Law enhances the S.A.F.E. Act by providing significant examination and enforcement authorities and establishing prohibitions on specific types of harmful behavior and practices.

The Model State Law has been formally approved by the Secretary of the U.S. Department of Housing and Urban Development and endorsed by the National Conference of State Legislatures and the National Conference of Insurance Legislators. The Model State Law is well on its way to approval in almost all state legislatures, despite some unfortunate efforts by industry associations to frustrate, weaken or delay the passage of this important Congressional mandate.

Nationwide Cooperative Protocol and Agreement for Mortgage Supervision

In December 2007, CSBS and AARMR launched the Nationwide Cooperative Protocol and Agreement for Mortgage Supervision to assist state mortgage regulators by outlining a basic framework for the coordination and supervision of Multi-State Mortgage Entities (those institutions conducing business in two or more states). The goals of this initiative are to protect consumers; ensure the safety and soundness of institutions; identify and prevent mortgage fraud; supervise in a seamless, flexible, and risk-focused manner; minimize regulatory burden and expense; and foster consistency, coordination, and communication among state regulators. Currently, 48 states plus the District of Columbia and Puerto Rico have signed the Protocol and Agreement.

The states have established risk profiling procedures to determine which institutions are in the greatest need of a multi-state presence and we are scheduled to begin the first multi-state examinations next month. Perhaps the most exciting feature of this initiative is the planned use of robust software programs to screen the institutions portfolios for risk, compliance, and consumer protection issues. With this software, the examination team will be able to review 100% of the institution's loan portfolio, thereby replacing the "random sample" approach that left questions about just what may have been missed during traditional examinations.

CSBS-AARMR Reverse Mortgage Initiatives

In early 2007, the states identified reverse mortgage lending as one of the emerging threats facing consumers, financial institutions, and supervisory oversight. In response, the states, through CSBS and AARMR, formed the Reverse Mortgage Regulatory Council and began work on several initiatives:

- *Reverse Mortgage Examination Guidelines (RMEGs).* In December 2008, CSBS and AARMR released the RMEGs to establish uniform standards for regulators in the examination of institutions originating and funding reverse mortgage loans. The states also encourage industry participants to adopt these standards as part of an institution's ongoing internal review process.
- *Education materials.* The Reverse Mortgage Regulatory Council is also developing outreach and education materials to assist consumers in understanding these complex products before the loan is made.

CSBS-AARMR Guidance on Nontraditional Mortgage Product Risks

In October 2006, the federal financial agencies issued the *Interagency Guidance on Nontraditional Mortgage Product Risks* which applies to insured depository institutions. Recognizing that the interagency guidance does not apply to those mortgage providers not affiliated with a bank holding company or an insured financial institution, CSBS and AARMR developed parallel guidance in November 2006 to apply to state-supervised residential mortgage brokers and lenders, thereby ensuring all residential mortgage originators were subject to the guidance.

CSBS-AARMR-NACCA Statement on Subprime Mortgage Lending

The federal financial agencies also issued the *Interagency Statement on Subprime Mortgage Lending*. Like the *Interagency Guidance on Nontraditional Mortgage Product Risks*, the Subprime Statement applies only to mortgage providers associated with an insured depository institution. Therefore, CSBS, AARMR, and the National Association of Consumer Credit Administrators (NACCA) again developed a parallel statement that is applicable to all mortgage providers. The Nontraditional Mortgage Guidance and the Subprime Statement strike a fair balance between encouraging growth and free market innovation and draconian restrictions that will protect consumers and foster fair transactions.

AARMR-CSBS Model Examination Guidelines

Further, to promote consistency, CSBS and AARMR developed state Model Examination Guidelines (MEGs) for field implementation of the *Guidance on Nontraditional Mortgage Product Risks* and the *Statement on Subprime Mortgage Lending*.

Released on July 31, 2007, the MEGs enhance consumer protection by providing state regulators with a uniform set of examination tools for conducting examinations of subprime lenders and mortgage brokers. Also, the MEGs were designed to provide consistent and uniform guidelines for use by lender and broker compliance and audit departments to enable market participants to conduct their own review of their subprime lending practices. These enhanced regulatory guidelines represent a new and evolving approach to mortgage supervision.

Mortgage Examinations with Federal Regulatory Agencies

Late in 2007, CSBS, the Federal Reserve System (Fed), the Federal Trade Commission (FTC), and the Office of Thrift Supervision (OTS) engaged in a pilot program to examine the mortgage industry. Under this program, state examiners worked with examiners from the Fed and OTS to examine mortgage businesses over which both state and federal agencies had regulatory jurisdiction. The FTC also participated in its capacity as a law enforcement agency. In addition, the states separately examined a mortgage business over which only the states had jurisdiction. This pilot is truly the model for coordinated state-federal supervision.