

**Testimony of Joseph A. Smith, Jr., North Carolina Commissioner of Banks,
to a Joint Hearing of the Subcommittees on Housing and Financial Institutions of
the House Financial Services Committee**

May 24, 2005

Rep. Ney, Rep. Bachus, Rep. Waters, Rep. Sanders, members of the Committee, I am Joseph A. Smith, Jr., North Carolina Commissioner of Banks. I appreciate this opportunity to testify today on the very important topic of “Legislative Ideas to Address Predatory Lending.”

My duties as Commissioner of Banks include licensing and regulation of over 1,500 mortgage bankers and brokers and over 15,000 individual mortgage loan officers doing business in North Carolina. I also work with my friend and colleague Attorney General Roy Cooper to enforce North Carolina’s consumer protection laws relating to mortgage lending, including our pioneering anti-predatory lending law. I will present to you today a few relevant lessons I have learned from this experience.

Let me begin with an obvious but important truth: residential mortgage lending is a local activity that is financed globally. Deregulation, advances in information technology and the growth and development of capital markets have revolutionized an activity that was at one time conducted primarily by locally-based institutions. Mortgage lending has been “deconstructed” so that origination, funding, and servicing are often conducted by different firms, often with no connection to local markets or the consumer. An activity that was based on relationships is now transactional.

This revolution has brought with it an array of outcomes for consumers: generally good, sometimes bad and occasionally ugly. The good news has been an increase in liquidity and availability of mortgage finance for consumers at virtually all levels of income and wealth; the bad news, an increase in foreclosures; the ugly, predatory lending and mortgage fraud.

The North Carolina General Assembly, by large and bipartisan majorities, has addressed predatory lending by enacting an anti-predatory lending law and a law regulating certain mortgage lenders and brokers. North Carolina is not alone in addressing predatory lending through legislation; a number of other states have taken similar actions. The reason for action at the state level is obvious: the damage done by predatory lending is local. It occurs where we live. States legislatures have acted with regard to predatory lending because federal laws and regulations did not protect their citizens from loan terms and lender conduct that they found to be unconscionable.

State anti-predatory lending laws have been criticized by a number of private and public sector sources. At the risk of over-simplifying, these criticisms are basically that such laws have created a patchwork of compliance issues for the industry that increases its costs, reduces its efficiency and restricts access to mortgage finance for low and moderate income borrowers. I would find the critiques of North Carolina’s laws more

convincing if they were accompanied by a single actual example of a low or moderate income person in the Tar Heel State who has been denied home mortgage credit because of our laws.

I will leave technical analysis of the impact of North Carolina's anti-predatory lending law to the experts. Let me suggest to you a few practical consequences of the law:

- The law appears to have substantially improved the conduct of lenders in our market. There have been very few instances where the borrower counseling required by the law has been sought. This fact, supported by our monitoring of the market, suggests that lenders have complied with the law by removing predatory loan terms from contracts and ceasing predatory conduct.
- I have seen no evidence whatsoever that credit availability has been reduced. If low and moderate income borrowers are being denied credit, that circumstance has not been brought to my attention or, to my knowledge, to the attention of any member of the North Carolina General Assembly.
- Of the roughly 1,500 consumer complaints received by my office each year, two-thirds involve mortgage lending. These complaints do not involve denials of credit; rather, they involve issues that arise when consumers do get credit.
- The foreclosure rate in North Carolina has doubled over the last five years. This does not strike me as evidence of the denial of credit. It does suggest issues to be addressed regarding the lending that is being done.

In sum, I would submit to you that the evidence from actual experience in North Carolina, as distinct from the "virtual" North Carolina created by our laws' critics, suggests that our approach to predatory lending has been successful.

The efforts by states to address predatory lending are examples of federalism at its best. The enactment of such laws has resulted in a debate on an important issue of public policy, including this consideration of the issue by the Congress. In light of the experience of the states, I would hope that Congress would consider the following issues in addressing predatory lending:

- Is federal action necessary at all? It is not clear to me that capital markets have been seriously affected by state laws; rather, they have adapted to them and have continued to operate. I would suggest that federal action is necessary only if the cost of compliance to mortgage bankers and secondary markets clearly outweighs the interest of states in protecting

vulnerable borrowers and the markets themselves from predatory practices.

- If federal action is necessary, the experience of the states in setting standards for market activity should be the basis for federal standards.
- State authority to enforce federal standards should be included in any federal legislation. The effects of predatory conduct in the mortgage market are local and severe. Further, abuses that are immaterial from a global or national perspective are very material from a local one.
- Inclusion of the states in market oversight should be incorporated in federal legislation. The mortgage industry is a diverse one, including both large national and international organizations and small locally-owned firms. One size does not fit all in terms of regulation. The public interest is best served by a system that coordinates state and federal efforts.
- Federal legislation should incorporate the ongoing efforts of state regulators to create and implement a coordinated national licensing system for mortgage bankers and brokers and a centralized database with regard to market participants, both firms and individuals. Working through the Conference of State Bank Supervisors and American Association of Residential Mortgage Regulators, we have made significant progress on these important projects and expect the licensing system to be fully operational by the end of 2006.

The residential mortgage market is a vibrant and important national asset. Preserving its health is a matter of both state and national concern. I hope that this hearing and the debate that follows lead to action that enhances both the health and fairness of the market. I appreciate the opportunity to participate in this debate and would be happy to answer any questions you may have.

Thank you.