TESTIMONY OF JOSEPH A. SMITH, JR.
NORTH CAROLINA COMMISSIONER OF BANKS

HOUSE SELECT COMMITTEE ON
HOME FORECLOSURES

Raleigh, North Carolina

February 28, 2006

Chairman Church and members of the Committee, I am Joseph A Smith, Jr., North Carolina Commissioner of Banks. As always, it is privilege to appear before you. I am particularly grateful for the opportunity to speak with you about home mortgage foreclosures, an important matter for North Carolina families and the economy in general. My thanks to Speaker Black for causing this Committee to be created, to Representative Church for chairing it, and to its members for their participation.

With your permission, my testimony today will include a discussion of the structure of the mortgage industry in North Carolina, the foreclosure trend in the State and some possible reasons for the increase in foreclosures.

To begin with, it is important to note that the mortgage business today is not what it was when Rep. Church began his career in banking or when my wife Liz and I bought our first house in 1979. In those days, mortgages were generally made by thrift institutions that originated the loans, underwrote them, funded them, and serviced them. The person who made the loan was careful – sometimes unduly so -- because he or she was going to have to collect it. That is not the case today. Mortgages are often originated, underwritten, funded and serviced by separate firms, many of whom have no contact with the borrower.

A couple of exhibits to this testimony may help to put the nature of the changes to mortgage lending in context.

Exhibit 1 is a list of the twenty leading mortgage lenders in North Carolina in 2004, compiled by the Mortgage Bankers Association.[1] As the Exhibit shows, these lenders accounted for 43 % of the dollar volume of all mortgage loans originated in North Carolina in 2004. While a number of the institutions named on the Exhibit will be familiar to members of the committee, many others may not. Thirteen of the institutions on Exhibit 1, accounting for 28 % of the dollar volume of loans in 2004, are enterprises headquartered outside North Carolina.

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[1] Anomalies in Exhibit 1 are the result of MBA methodology in the preparation of the reports on which the Exhibit is based. This information is based on Home Mortgage Disclosure Act data, as to which 2004 is the most recent year for which such data is available. Accordingly, all information presented in this Testimony and Exhibits is for the year 2004 and in some cases previous years.

Exhibit 2 is a list of the twenty leading subprime lenders in North Carolina in 2004, compiled by the Mortgage Bankers Association.[2] Overall, loans by subprime lenders in North Carolina in 2004 accounted for 11.4 % of the total dollar volume of loans. The top twenty subprime lenders accounted for 73.6 % of subprime dollar volume and 8.4 % of total dollar volume. A review of the institutions listed on the Exhibit shows that all but two of the top twenty subprime lenders were institutions headquartered outside North Carolina.

How do these out-of-state lenders make loans in North Carolina? Some are secondary market lenders who either buy loans from local mortgage bankers or who fund loans originated by local mortgage brokers. Some have offices in North Carolina, either mortgage banking offices or the offices of consumer finance company subsidiaries. Some lenders may operate exclusively over the telephone or the internet. Exhibit 3 breaks down the number of mortgage banking and brokerage firms licensed by my office under the Mortgage Lending Act by type of firm, type of license and location of headquarters. The Exhibit shows, among other things, that the largest number of firms licensed by my office are domestic mortgage bankers and brokers; however, the second largest number of firms are out-of state mortgage bankers. Further, the out-of-state mortgage bankers account for the largest number of employees licensed under the MLA. It is important to note that Exhibit 3 does not include banks, thrifts, credit unions, and their employees, over whom my office has no jurisdiction.

The changes I have just described have brought with them a number of consequences that I like to call “the good, the bad and the ugly.” The “good” is a significant increase in the availability of mortgage credit that has resulted in a material increase in homeownership at all levels of income. My office receives a large number of consumer complaints regarding financial services of all kinds, particularly mortgage loans. We never get complaints that our citizens cannot get credit.

Unfortunately, the good has brought with it the “bad” and the “ugly.” The “bad” is an increased rate of foreclosures and the “ugly” comprises evil twins, predatory lending and mortgage fraud. As Exhibit 4 to this testimony shows, the rate of mortgage foreclosures in North Carolina has gone up dramatically in recent years. Further, as Exhibits 5 and 6 show, mortgage issues account for a substantial majority of all of the complaints my office receives. While I don’t get any complaints about a lack of credit; I <u>do</u> get a lot of complaints about what happens when people get loans.

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[2] Information in Exhibit 2 may have anomalies based on MBA methodology.

What has caused the dramatic increase in foreclosures? I believe it is a combination of factors, including:

- The growth of the mortgage market generally and the subprime market in particular. This growth has brought greater risk into the market and some increase in foreclosures is virtually certainly the outcome of such increased risk.

- Financial distress to borrowers caused by excessive indebtedness. While some of this distress has undoubtedly been brought about by such external factors as loss of employment, health emergencies and the like, a substantial portion may also be explained by excessive personal consumption. Consumer indebtedness generally is at an all-time high. To assume that the increase in foreclosures is unrelated to this phenomenon is, in my opinion, naïve.

- Liberalized underwriting standards for loans, including low or no downpayment loans and "reduced documentation" or "stated income" loans. "Non-traditional" loans such as interest only ARMs are generally included in this category. Given the levels of interest rates in the past, I think interest only ARMs are not likely to be the cause of past problems. They are highly likely to be the cause of the next wave of problems.

- Funding of loans through securitization, making it less likely that late payments and the like will be addressed early and locally.

- Fraud. This category covers a multitude of sins, including the use of false or misleading inducements to get unwitting consumers into inappropriate or fictitious loans, falsification of documents, flipping and related conduct.

- Predatory conduct. This category includes fraud but in my thinking it involves conduct that harms innocent and generally gullible consumers, ruins their credit and leaves them holding the bag. The manifestations of such conduct are many and various.

While I am reasonably sure that each of the foregoing factors has contributed to the foreclosure epidemic, I am not sure of the size of each category's contribution. My colleagues and I are responsible under the MLA to address fraud and predatory conduct and we are doing so. In cooperation with other governmental and law enforcement agencies, we have our hands full.

What can be done to reduce and reverse the foreclosure epidemic? Because the causes are many and various, I don't think it is likely that a single simple answer is available to you. That said, I do think there are things that can be done to reduce the likelihood of foreclosures:

- Using existing legal and regulatory tools to weed out incompetents and crooks in the mortgage origination process. My colleagues and I are working flat-out on this aspect of the cure. Having implemented the licensing system required by the MLA, enhanced enforcement is now Job 1.

- Raising the bar for mortgage originators. The MLA set helpful minimum requirements for mortgage licensing; however, it is in the industry's interest to require that originators exceed the statutory minimum. In that regard, I have been working with the mortgage industry to develop an industry standard that is higher than the minimum. We have made progress and you will be hearing the formal announcement of our work in the near future.

- Public disclosure of the identity of the originators of mortgage loans. The Charlotte Observer has recently run a series of articles on foreclosures in the Queen City, as a result of which it has been suggested that disclosure of loan originators on mortgage documents would facilitate legal and regulatory action in respect of originators who make a large number of foreclosed loans. This is a sensible suggestion and, assuming it is workable for the keepers of mortgage records, would be a great assist in addressing origination concerns.

- Consumer financial education. I think it is fair to say that many foreclosed loans are the result of a lack of understanding by borrowers of what they are getting into. Borrower counseling would be helpful in addressing this shortcoming. The North Carolina Anti-Predatory Lending statute includes a counseling requirement that has been unused because the industry has engineered around the statute. It may be desirable in the case of the most vulnerable borrowers to consider a more general counseling requirement. This idea brings with it a fair number of complications, not the least of which is cost of administration.

I hope that this testimony is helpful to you and look forward to working with the committee on this important issue.

Thank you again for inviting me to testify.

Presentation to House Select Committee on Home Foreclosures

February 28, 2006

Joseph A. Smith, Jr.
North Carolina Commissioner of Banks

Top 20 Mortgage Lenders in NC

Lending Institution	All Originations (NC) Dollar Volume ($000)	%	All Originations (Nation) Dollar Volume ($000)	%
1 WELLS FARGO BANK, NA (COMMERCIAL BANK)	3,149,598	6.5	167,882,649	6.7
2 COUNTRYWIDE HOME LOANS (MORTGAGE COMPANY)	2,729,233	5.7	161,758,649	6.4
3 BRANCH BANKING AND TRUST CO (COMMERCIAL BANK)	3,053,456	6.3	7,292,730	0.3
4 BANK OF AMERICA, N.A. (COMMERCIAL BANK)	2,701,442	5.6	82,880,233	3.3
5 NATIONAL CITY BANK, INDIANA (COMMERCIAL BANK)	1,269,370	2.6	76,697,407	3.1
6 WACHOVIA MORTGAGE (MORTGAGE COMPANY)	1,546,486	3.2	13,916,812	0.6
7 STATE EMPLOYEES CREDIT UNION (CREDIT UNION)	1,235,351	2.6		
8 CHASE MANHATTAN MORTGAGE CORP. (MORTGAGE COMPANY)	1,348,428	2.8	63,799,657	2.5
9 NATIONAL BANK OF COMMERCE (COMMERCIAL BANK)	985,170	2		
10 SUNTRUST MORTGAGE, INC (MORTGAGE COMPANY)	604,178	1.3	23,816,998	0.9
11 AMERICAN HOME MORTGAGE (MORTGAGE COMPANY)	538,399	1.1	21,610,959	0.9
12 ABN AMRO MORTGAGE GROUP, INC. (MORTGAGE COMPANY)	893,660	1.9	38,983,282	1.6
13 CENDANT MORTGAGE (MORTGAGE COMPANY)	362,913	0.8	21,597,809	0.9
14 FIRST HORIZON HOME LOAN CORP (MORTGAGE COMPANY)	595,221	1.2	27,850,490	1.1
15 RBC CENTURA (COMMERCIAL BANK)	620,887	1.3		
16 FIRST-CITIZENS BANK & TRUST CO (COMMERCIAL BANK)	587,716	1.2		
17 VANDERBILT MORTGAGE (MORTGAGE COMPANY)	95,299	0.2		
18 HSBC MORTGAGE CORP (MORTGAGE COMPANY)	699,986	1.5	23,907,750	1
19 DECISION ONE MORTGAGE (MORTGAGE COMPANY)	307,388	0.6	9,124,911	0.4
20 CTX MORTGAGE COMPANY, LLC (MORTGAGE COMPANY)	312,037	0.6	9,775,232	0.4

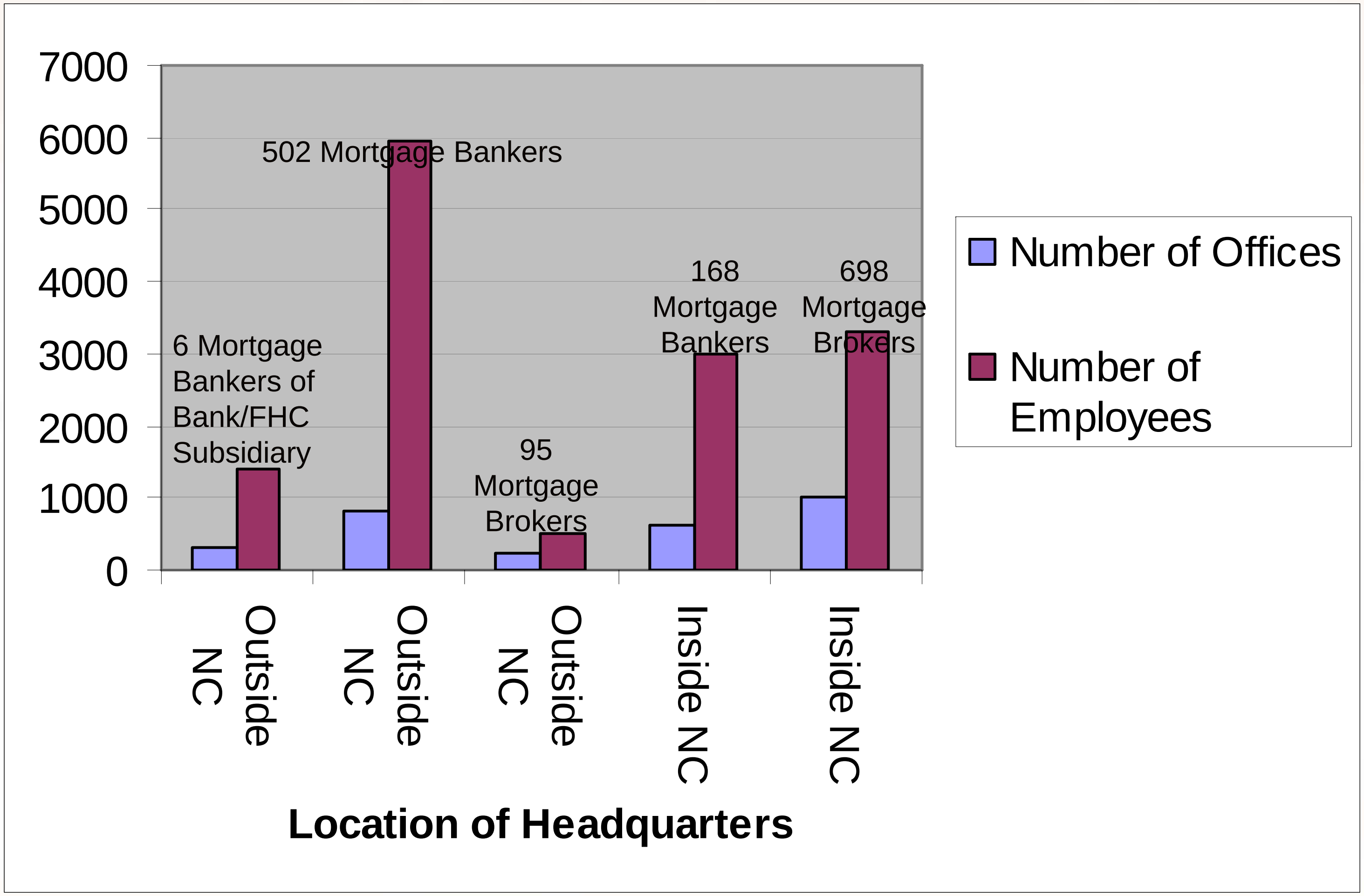
Source: Mortgage Bankers Association, 2004 Mortgage Market Summary

Top 20 Subprime Lenders in NC

Lending Institution	All Originations (NC) Dollar Volume ($000)	%	All Originations (Nation) Dollar Volume ($000)	%
1 GREENPOINT MORTGAGE FUNDING (MORTGAGE COMPANY)	520,085	9.5		
2 ARGENT MORTGAGE COMPANY (MORTGAGE COMPANY)	332,937	6.1	44,014,234	10.9
3 OPTION ONE MORTGAGE CORP. (MORTGAGE COMPANY	311,197	5.7	22,056,866	5.5
4 DECISION ONE MORTGAGE (MORTGAGE COMPANY)	307,388	5.6	9,124,911	2.3
5 AMERIQUEST MORTGAGE COMPANY (MORTGAGE COMPANY)	270,927	4.9	32,538,287	8.1
6 FREMONT INVESTMENT & LOAN (COMMERCIAL BANK)	238,680	4.3	23,804,037	5.9
7 SOUTHSTAR FUNDING (MORTGAGE COMPANY)	230,668	4.2	4,220,865	1.0
8 CITIFINANCIAL SERVICES, INC (MORTGAGE COMPANY)	217,695	4.0		
9 EQUITY ONE, INC (MORTGAGE COMPANY)	214,751	3.9		
10 NEW CENTURY MORTGAGE CORPORATION (MORTGAGE CO)	200,325	3.6	36,463,549	9.0
11 EQUIFIRST CORPORATION (MORTGAGE COMPANY)	199,122	3.6		
12 BENEFICIAL (MORTGAGE COMPANY)	192,290	3.5	7,729,003	1.9
13 LONG BEACH MORTGAGE CO. (MORTGAGE COMPANY)	159,166	2.9	15,958,524	4.0
14 FIRST GREENSBORO HOME EQUITY (MORTGAGE COMPANY)	142,913	2.6	479,850	0.1
15 ACCREDITED HOME LENDERS INC, (MORTGAGE COMPANY)	130,621	2.4	12,398,345	3.1
16 NOVASTAR MORTGAGE INC (MORTGAGE COMPANY)	126,340	2.3	1,694,274	0.4
17 WELLS FARGO FINANCIAL NC (MORTGAGE COMPANY)	120,290	2.2		
18 AIG FSB (FEDERAL SAVINGS INSTITUTION)	117,810	2.1	10,528,997	2.6
19 HFC (MORTGAGE COMPANY)	117,338	2.1	7,507,911	1.9
20 CENTEX HOME EQUITY COMPANY LLC (MORTGAGE COMPANY)	114,144	2.1	4,578,638	1.1

Source: Mortgage Bankers Association, 2004 Mortgage Market Summary

Mortgage Lending Act Licensees



Source: Office of the North Carolina Commissioner of Banks

The Bad:
Foreclosures in North Carolina

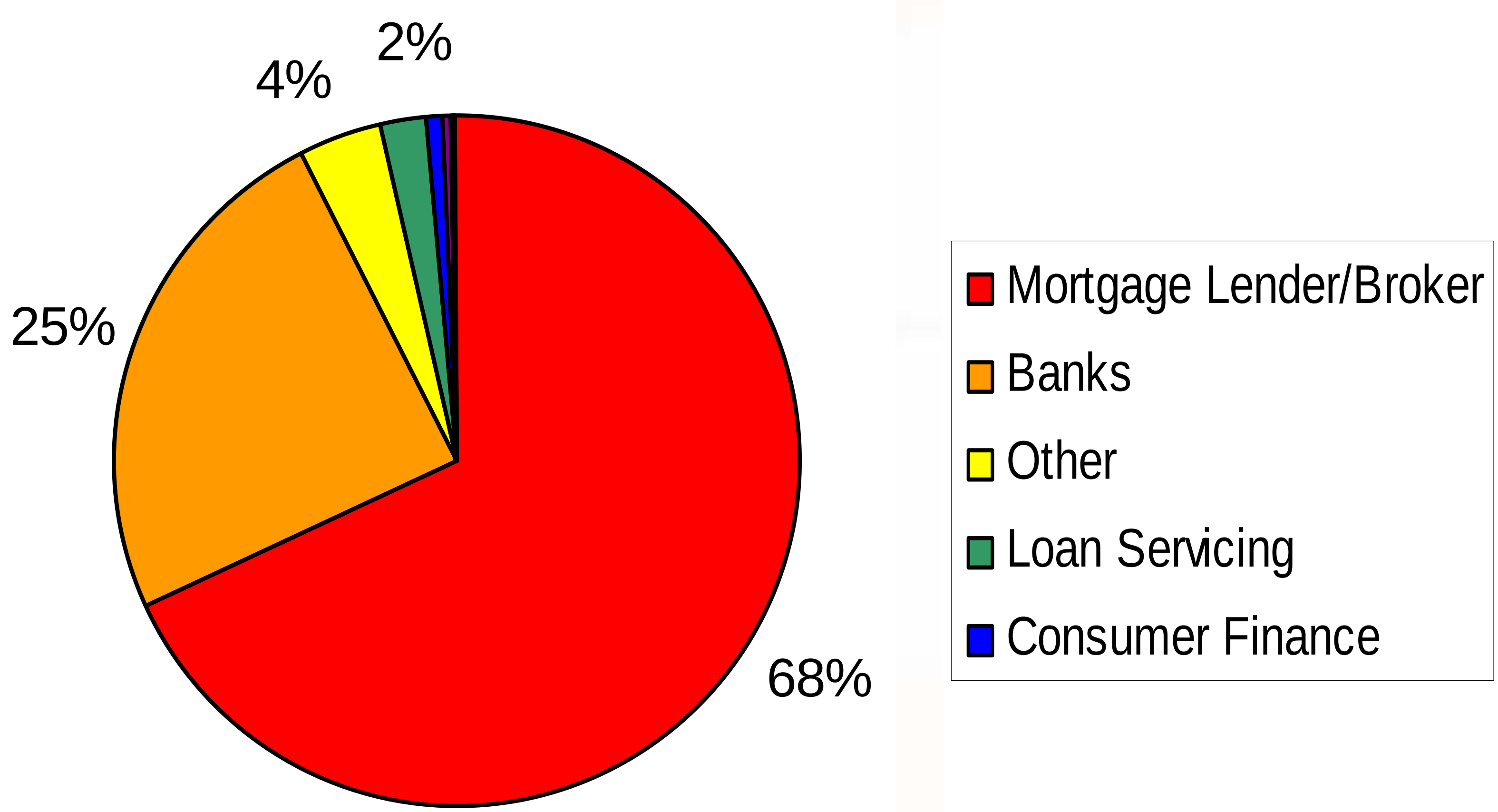
- 2000: 20,579
- 2001: 25,871
- 2002: 35,589
- 2003: 44,209
- 2004: 42,882

108 % Increase in 5 years

Source: Center for Responsible Lending, Self-Help

View of the Market Today

There are still problems in the residential mortgage market.
Total Complaints (1446) July 1, 2003 – June 30, 2004



Mortgage Complaints are varied.