

Financial Institution Reform Initiative: OTS Proposal

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There is little debate that, given a choice, the current regulatory structure of the financial services industry would be organized differently. Whether it is the regulation of the banking, securities, insurance or other financial services companies, the existing framework is the result of events of the past and not a comprehensive organizational plan. With some regularity, every few years, a proposal to reorganize the regulation of financial services companies is drafted. Sometimes the suggestions are borne from a crisis; while other times they are promoted as a means to avert a future crisis or to streamline the existing structure.

The latest version of a plan to modernize the financial services regulatory structure was issued by the Department of Treasury in March 2008 as a Blueprint for Modernized Financial Regulatory Structure. Even though the timing of the release of the document coincided with the collapse of Bear Stearns and the escalating mortgage crisis, Treasury staff had been working on the document for a year or more, during which time there had been numerous meetings and an advanced notice of proposed rulemaking. While a number of the suggestions appeared to respond to these events, in fact, the plan is much broader in scope.

The Treasury Blueprint contains short term, medium term and long term suggested changes to the regulatory structure. Many of the changes make sense when taken out of the context of the regulatory structure as it has evolved. The document contains sweeping suggestions that address all areas of financial services regulation. This article looks at one of the short term changes and one of the intermediate term changes and addresses how the goals of one of the underlying suggestions can be accomplished but not necessarily the way described by the Treasury. An alternative proposal would replace the elements of the short term objective to form a Mortgage Origination Commission (MOC) and the intermediate goal of eliminating the Office of Thrift Supervision (OTS) and instead create a federal regulatory oversight for mortgage companies by expanding the OTS's authority.

In recognition that the regulation and supervision of mortgage companies should be reviewed, one of the short term objectives of the report is to establish a MOC, the members of which would be the principals of the federal banking agencies, or their designees. Generally, the idea for the MOC is a good one and bears a resemblance to the Federal Financial Institution Examination Council. The ultimate result would be to have federal oversight over the mortgage origination and mortgage brokerage business. Any form of federal oversight of the mortgage origination industry would move in the direction of achieving an important goal – the establishment of a level playing field for all mortgage lenders.

¹ The views expressed are those of the author and do not necessarily reflect those of the Office of Thrift Supervision.

One of the intermediate objectives identified in the report would be the elimination of the OTS and combination of the agency's functions with those of the Office of the Comptroller of the Currency. Among the reasons stated for this change is that the purpose for which the predecessor of the OTS was established is no longer applicable.

An alternative to this idea would be to build on the strengths of OTS and to expand its regulatory reach to entities in the mortgage arena that do not currently have a federal supervisor. The Federal Home Loan Bank System, of which the Federal Home Loan Bank Board was a part, was formed in the 1930's to provide a source of stable financing for mortgage loans. The proposal builds on OTS's expertise to use resources already available rather than creating a new entity or framework for regulating mortgage companies and mortgage brokers. Instead of eliminating the agency, as Treasury suggests, OTS would evolve as a federal regulator of the mortgage origination business, in a role similar to the one it had at its inception.

OTS Proposal

The OTS has developed an alternative proposal for providing federal oversight of independent mortgage companies and mortgage brokers. The proposal involves the development of a partnership with the OTS and the state regulatory authorities that license and supervise independent mortgage companies and mortgage brokers. This partnership would draw on the expertise that the OTS and its predecessor have developed in regulating and supervising mortgage lenders over the past seventy five years, while working with state regulators.

This new regulatory structure for mortgage companies would be housed in a new division of OTS that would regulate and supervise the companies in cooperation with their state regulators. There are successful and longstanding models for this type of collaboration. The OTS has worked for almost 20 years with the state regulators for state savings associations and has had information sharing agreements with the state insurance authorities. Further, the states have agreements with the FDIC and with the Federal Reserve to jointly supervise state chartered nonmember and member banks. Examination protocols would be developed jointly for both consumer protection and prudential regulation.

The state authorities would continue to charter mortgage companies and a federal mortgage company charter would not be created. The National Mortgage Licensing System (NMLS) that has been developed by the Conference of State Bank Supervisors and the American Association of Residential Mortgage Regulators would be a mechanism for the licensing and registration of mortgage companies and the individuals that work for them in those states that have adopted the NMLS. The development of the NMLS provides a uniform application process by which mortgage lenders will supply background information and a data base is created of each of the licensed companies or individuals.

Those mortgage companies that are affiliated with insured depository lenders would continue to be examined by the primary federal regulator of the depository institution. All mortgage companies would be subject to the same requirements. For a number of years, insured depository institutions engaged in mortgage originations have sought requirements and regulations that are enforced against all lenders offering the same products.

The other element of this proposal would be the licensing and registration of individual mortgage brokers. Through the use of the NMLS, the varying requirements of the different states would be minimized. However, the OTS proposal would go further. The licensing and registration of mortgage brokers is an important element in bringing some parity to the supervision of mortgage brokers, but other factors include establishing a meaningful bond or capital requirement and addressing some of the compensation issues that have driven the actions of mortgage brokers in the recent past. As part of the licensing requirement, brokers would have to meet specific education and testing thresholds. The application also would require the submission of personal and financial background information, including a fingerprint check.

The proposal appears to be simple, but there are a number of questions that arise and complications to be addressed in advance of the finalization of any plan. To achieve the basic change, the Home Owners' Loan Act would need to be amended to authorize the OTS to supervise mortgage companies. OTS also would have to work with the individual states to coordinate examinations and requirements as well as protocols for mortgage companies. In addition, the logistics of supervising individual mortgage brokers, even on a back up basis, are difficult. Finally, ancillary changes, including amendments to the consumer protection regulations and requirements, would be made to accommodate a revised structure. The consumer protection requirements in each state would have to be addressed in order to achieve the result desired – a level playing field for all mortgage originators.

Federal oversight of the mortgage origination process and mortgage lenders is likely and the OTS suggests that rather than creating a new entity, it makes more sense to use the current framework to take advantage of an existing infrastructure and expertise to reach that goal.