Remarks by

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Before the

Housing Policy Council of
The Financial Services Roundtable

May 19, 2011

Thank you. It's a pleasure to join you today to talk about developments in the mortgage lending and mortgage servicing businesses, and the uncertain future the industry faces.

The housing industry has suffered a deep decline across the country – outright collapse in parts of the southeast and southwest – and the national housing industry remains seriously depressed. Home prices nationwide remain far below where they were five years ago, and prices in many regions show little sign of heading back up. There are many reasons why the housing market is having so much trouble finding a bottom, including high unemployment, a glut of foreclosures hanging over the market, and the uncertainty many consumers feel about their economic future. Of course, bad trends feed on themselves, and so housing prices remain low because so many potential buyers think they might go lower still. Those are the kinds of problems that simply take time to work through. Analysts are now predicting that it will be at least another couple of years, if not longer, before housing markets return to something like normal.

Another factor that may be restraining activity in housing markets is the generally tighter outlook for residential mortgage credit. No-one would want a return to the excesses that we saw prior to the financial crisis, but mortgage underwriting is tight right now, in part because of the huge degree of uncertainty around the direction of housing markets, the path of foreclosures, and the future of securitization, among other things.

The mortgage servicing business is also under severe stress, its business model already challenged by the mortgage crisis, and that challenge now compounded by the foreclosure mess. The drumbeat of criticism against the industry has now gone on for years, from criticism of its slow reaction to the housing downturn in general, to its handling of mortgage modifications, and now to the complete mishandling of the foreclosure process. That routine processing of bank files and legal documents could deteriorate into safety and soundness failures requiring formal enforcement orders is simply astounding. The federal banking agencies have imposed orders on 14 large servicers, including eight national bank servicers, with the goal of fixing the very serious problems we found in foreclosure processing; ensuring that any borrowers harmed by shoddy practices receive appropriate remedies; and getting mortgage markets operating again.

In addition, the new Basel III framework takes a highly skeptical view of the value of mortgage servicing rights as bank assets, requiring that servicing rights beyond relatively modest levels be deducted from capital for regulatory capital calculations. This capital treatment of mortgage servicing is likely to make the business less attractive, since it will in effect tend to increase capital requirements for mortgage servicers.

As if these fundamental economic, performance, and policy challenges were not enough for the industry to contend with, the regulatory landscape for mortgage lenders is also changing in profound ways. While Dodd-Frank will change the way that all financial services companies operate, the changes are particularly dramatic for mortgage lenders. There are 15 to 20 new mortgage lending requirements in the regulatory pipeline, and their impact on the mortgage and servicing businesses will be more tsunami than simple wave. I suspect that even in this audience, there are many who haven't stopped to take account of all the new requirements facing your business.

There are lots of good ideas in Dodd-Frank, but the challenge is that there are so many new requirements coming at once, no matter the individual merits of any one of them. I have used the image of drug interactions: you take one pill that's good for your head, another that helps your heart, but taken together they flatten you. With respect to the mortgage industry, one regulation may strengthen the quality of capital; another might fix problems with the servicing process; and yet another may ensure that compensation policies don't encourage banks to take excessive risks. All of those goals are worthy, but it is hard to predict how they may all work together. For example, we don't yet know how the new treatment of mortgage servicing rights will affect the price and availability of mortgage credit. The same holds true for the risk-retention rules and other changes. It's possible that the total effect may be more than the sum of the parts.

The fundamental concern here isn't the banking industry itself, although I think banks will face increased costs and reduced revenues as we implement a whole series of new requirements affecting mortgages and servicing. Banks will find a "new normal." The real concern is the housing market and the millions of American homeowners who rely on it to acquire and trade their single biggest asset, their home; the millions more who aspire to home ownership; and the nation's economic health, which is so dependent upon the strength of the housing industry.

It's too early to argue that lenders and servicers are leaving the business, or that activity is again migrating outside regulated institutions. But there is no arguing that burden is building for servicers, increasing their costs, while opportunities to make a profit are constrained. And all of these significant regulatory changes are coming at a time when housing and mortgage markets are struggling. The potential for unintended side effects is higher when the patient is weak.

And the pace of change is dramatic and continuing. For example, last October new rules took effect requiring registration for residential mortgage loan originators, and on April 1, two additional changes mandated by the Dodd-Frank Act became effective. These provisions set new requirements for appraisal independence and established limits on loan originator compensation practices.

Then there is the impact of the enforcement actions the federal banking agencies took against the 14 largest servicers that will change the servicing business in significant ways. Meanwhile, state AGs and other federal agencies are still engaged in talks with those banks seeking additional remedies for the same violations. The Consumer Financial Protection Bureau is scheduled to start up in July, and that agency will also have significant rulemaking authority with respect to the Truth-in-Lending Act and other consumer laws.

Looking farther ahead, by year-end I hope we will have in place comprehensive mortgage servicing standards that will apply to all servicers, banks and nonbank alike. This is a project that began with proposals from the OCC and the Fed, and is now the subject of talks with the FDIC, the Federal Housing Finance Agency and the Consumer Financial Protection Bureau.

The credit risk-retention rule, which also includes servicing standards, will fundamentally overhaul the securitization business by requiring securitizers to retain an economic interest of not less than five percent of the assets in a pool, unless the mortgages meet very high underwriting requirements. That should become a final rule later this year and take effect a year thereafter.

Fannie Mae and Freddie Mac plan to issue detailed guidelines for mortgage servicing and delinquency management, including financial sanctions for servicers that fail to reach borrowers, collect key documents, evaluate documents for modifications, and comply with foreclosure timeline standards. Other rulemakings that we expect to be completed within the next 18 months or so include requirements for analyzing consumers' ability to repay mortgage loans, restrictions on prepayment penalties, and comprehensive new mortgage disclosure rules.

I could go on, but that quick litany makes the point: change is coming and it will affect almost every aspect of your business. So let me focus the rest of my remarks on a few areas of particular significance, and then offer some thoughts on what these developments mean for the future of the business.

The enforcement actions that the federal banking agencies took against the large servicers were intended, in the first instance, to fix the very serious problems we found in foreclosure processing, and in the second to ensure that any borrowers harmed by shoddy practices receive appropriate remedies. The problems we found ranged from the highly-publicized "robo-signing" to the failure of servicers to have required documents at the time they filed foreclosures. But while the compliance collapse was troubling, a potentially more troubling issue was the prospect that some foreclosures should not have taken place at all, because of a bankruptcy filing or protections members of the military are entitled to under the Servicemembers Civil Relief Act.

We began our work by launching an intensive horizontal exam in concert with the Federal Reserve, the FDIC, and the Office of Thrift Supervision, and evaluated a sample of 2,800 foreclosures. Fortunately, we found relatively few cases in which a foreclosure should not have proceeded: although a small number of borrowers were entitled to protection because of a modification in process, bankruptcy filing, or military status, all foreclosed borrowers in the sample were seriously delinquent. And while the sample was small, I don't expect to see much change in those proportions. Our mortgage metrics project, which captures loan-level data on 63 percent of all first-lien mortgages in the country, found that 94 percent of borrowers foreclosed upon in 2010 were at least six months past due on their payments.

However, we did find very significant compliance weaknesses, and our enforcement actions put into place a program that is intended both to ensure the process is fixed and that any borrower harmed by shoddy practices is compensated. Under our orders, banks will be required to develop a plan to ensure a comprehensive review of past foreclosure actions and to retain an independent consultant to conduct that review and make sure borrowers who suffered financial harm are identified and given an appropriate remedy.

The enforcement actions set out a number of steps that banks must follow to correct those deficiencies, and for those banks, the orders are *de facto* servicing standards. We think that these orders will ensure that the banks responsible for servicing 68 percent of the nation's mortgages will be observing standards that ensure that every borrower, particularly those experiencing distress, are receiving every protection they are entitled to under law.

Those standards won't be easy to meet. One of our large national banks announced it would be hiring up to 3,000 employees to comply with the orders, and another is setting up an additional 28 service centers around the country to help borrowers facing foreclosure. But however expensive and difficult compliance may be, these standards must be met. The processing scandal eroded public confidence not just in the fairness of the foreclosure process, but in the competence of our nation's banks. It subjected the industry to widespread criticism, including from members of Congress, the media, the judges who hear foreclosure cases, and consumer advocates.

And the legal problems stemming from the foreclosure processing mess are far from over. In all honesty, I can't recall a case in which so many governmental bodies were engaged in investigating program and legal violations by one industry. In addition to the federal banking agencies, the 50 state Attorneys General, the Department of Justice, the Department of Housing and Urban Development, the Federal Housing Finance Agency and others are all involved.

While we don't know what an overall settlement will look like, the right outcome is for the state servicing requirements to complement ours. Our enforcement action sets up a framework, and requires the banks to fill in that framework in a way that is acceptable to us. Much of what the states are seeking can fit within that framework – the details we are requiring banks to provide when they submit their action plans could and should be met by the detailed steps the states are seeking. If so, that would be very welcome.

Also good news is that fixing the problems we found isn't rocket science, and we will ensure that the banks work through them. This is important to getting mortgage markets up and running again. The slowdown in mortgage markets due to the foreclosure mess isn't the only issue that is preventing those markets from clearing, but it has certainly contributed to a glut of foreclosures.

As I noted earlier, we are also engaged in interagency talks intended to create a comprehensive set of nationwide servicing standards for the industry, building upon requirements in our consent orders. The standards we're looking at would apply to almost every aspect of the business. They would govern the handling and crediting of borrower payments, ensure that borrowers receive full and accurate information about their accounts, and require servicers to respond promptly to borrower questions or complaints, among other things. They will also apply to everyone involved in mortgage servicing, bank and non-bank. I believe this will be a positive step forward because the assurance of a fair and predictable process should help restore public confidence.

But all of this rule writing raises a number of concerns, starting with timing. With the housing market still struggling, is this the right time to change the ground rules so fundamentally? Are we trying to do too much, too quickly? Are we, the regulators, working to ensure consistency? Every law and every regulation, no matter how well defined, carries the potential for unintended consequences. How can we evaluate each rule, see how it works, and decide if adjustments are needed? How can we judge the individual, cumulative, and interactive impact of so many major new requirements affecting every aspect of the business?

I believe comprehensive mortgage servicing standards are necessary, and that the standards proposed by the OCC all make good sense. But they will change the servicing business in important ways, and it may be that some providers will decide that the high-volume, low-margin, technology-dependent model no longer works financially. If major players scale down or leave the business, how will that affect the mortgage markets and access to homeownership?

Add to those changes new compensation requirements, new appraiser independence provisions, and new risk-retention requirements. Risk retention by itself would be quite a large meal for the industry to digest; how much more if it is just one change in a long list.

There has been a hue and cry raised about the 20 percent down payment requirement for a Qualified Residential Mortgage, or QRM. The complaint is that such a high down payment will make homeownership less affordable, but that criticism misses the point: the QRM is not supposed to be a universal standard, but an exception to a general risk retention rule. It is supposed to be the best of the best – mortgages of such high quality that risk retention is not necessary. Dodd-Frank clearly contemplated that most mortgages would be subject to risk retention, and if the market is to recover, it will have to do so on the terms laid down in the law.

I can assure you that the agencies will be looking very closely at the comment letters, and trying very hard to take a balanced approach that is mindful of congressional intent, attentive to safety and soundness, but also aware of the impact of increased regulatory burden on the industry. So in the QRM rulemaking, we have asked for evidence of reduced default with a lower down payment combined with Purchased Mortgage Insurance. If payment terms can be made more flexible, consistent with the law, we are certainly open to change.

But taking up rules one by one, receiving your comments on the rules one by one, may not get us where we need to go. I'm an old think-tank guy, and when I confront a problem like 20 impending changes to mortgage markets – all known to me in legal text or draft form – I'd like to see the affected industry study the individual and cumulative impact of the changes so they can engage knowledgeably in the public debate. For market participants, it is essential to define likely impacts: how they will affect the business, and how markets may evolve. For policymakers, we want to identify potential conflicts, gaps, and overshooting in proposed rules so we can consider ways to avoid those problems. We can't afford to wait several years for all the rules to take effect and a few years more for the full effects to be felt. Waiting to comment on individual rules, and wringing hands in the meantime, does not address the problem.

And that brings me to a final concern: are we appropriately recalibrating the level of risk in the system? We've just been through a financial crisis that was unprecedented in my lifetime, and we are likely to be feeling the economic repercussions of the crisis for years to come. So it's essential to eliminate practices that placed the financial system at such risk. But what are the implications if we overshoot and wring too much risk out of the system? Banking is a risk taking business; banks suffer credit losses; and we cannot eliminate all risk of future crises. To do so would be misguided; in fact, counterproductive.

Corporate America can't grow and develop and compete with the rest of the world without a financial system that allows lenders to take on reasonable and manageable risks. Local communities won't thrive without local banks that are willing to take some reasonable risk in the extension of credit and have the wherewithal to manage that risk. Families cannot buy homes and build wealth to improve their lives without lenders willing to take a chance on them. We need to make sure the pendulum doesn't swing so far that in the process of reducing risk, we extinguish the impulse to take appropriate risks, stifle the economy, and hurt ordinary people. We need to find a middle ground that manages risk in the system without sacrificing the energy and vitality that has brought so much prosperity to so many.

Thank you. I look forward to your questions.