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MEMORANDUM

DATE: January 26, 2023

TO: House Appropriations Committee

FROM: Lise Kruse, Commissioner

SUBJECT: Testimony in Support of House Bill No. 1068 –

As presented to the House Industry, Business and Labor Committee on January 4, 2023.

Mr. Chairman and members of the Committee, House Bill 1068 creates and enacts a new Chapter 13-13 of the North Dakota Century Code relating to residential mortgage loan servicers.

The Department of Financial Institutions is tasked with the oversight of banks, credit unions and several nonbank entities that provide financial services in North Dakota. The non-depository institutions include trust companies, collection agencies, payday lenders, money transmitters, debt settlement service providers, and all nonbank lenders (money brokers), and mortgage loan originators. The typical structure for residential mortgages includes a lender who originates the loan and a servicer who services the loan. Companies may originate loans, service loans, or both. In North Dakota only the loan originators are required to have a license. This Bill would also require servicers to be licensed.

A servicer is the company responsible for the administration of the loan beginning after the loan closing and sale of the loan to the final owner, and continuing until the loan is paid off. A servicer is responsible for collecting borrower payments including principal, interest, taxes, and insurance, then remitting or forwarding those payments to investors, taxing authorities or insurance providers. If a borrower is delinquent on payments, the responsibility falls to the servicer to do everything it can to collect the payment and any late fees or penalties authorized under the original loan contract. Servicers are responsible for managing loss mitigation and borrower forbearance of payments and initiating foreclosure proceedings when a borrower reaches a certain stage of delinquency. Servicers also manage a variety of administrative responsibilities including accounting, record keeping, investor reporting and advancing unpaid amounts to investors, taxing authorities and insurance providers.

Since the financial crisis in 2007 to 2009, mortgage lending has shifted from banks and credit unions to nonbanks. The Wall Street Journal reported in June of 2021 that nonbanks issued 68% of all mortgages in the U.S. in 2020, and seven of the 10 largest mortgage lenders were non-banks. Similarly, nonbank mortgage servicing has grown from 6% to 60% of the government agency mortgage market in the last 10 years, and about 45% of the $11 trillion single-family residential mortgage market is serviced by nonbank servicers. Bank mortgage servicers are regulated by federal law; the nonbank servicers who now dominate the industry are primarily overseen by states as established in state law. Although the Consumer Financial Protection Bureau (CFPB) is a limited regulator of nonbank mortgage servicers, the agency enforces consumer compliance but has not established standards pertaining to the financial condition of nonbank mortgage servicers. State governments are currently the only option for comprehensive oversight for nonbank mortgage servicers, meaning we are the entity with ability to license, as well as examine, investigate, and enforce compliance with consumer protection regulations, as well as financial condition and corporate governance requirements. As such, states are the "primary" and "prudential" regulator of nonbank mortgage servicers.

Due to the significant market share and certain servicers being large companies operating nationwide, these entities have a significant impact on the overall U.S. economy. A bank servicer has a consistent funding source through deposits and other financial services income provided by the bank. A nonbank servicer's funding comes from investors and bank loans. This can be problematic if there is pressure on liquidity. If borrowers are unable to make their mortgage payments and go into default, the servicers are still required to meet their financial commitments, and they have no other source of funds. The domino effect in our economy can have detrimental impacts. Added to this concern, there has been no uniform standards establishing minimum capital requirements, liquidity maintenance, or corporate governance for mortgage servicers. States have recognized this issue and have coordinated to issue prudential standards for nonbank mortgage servicers. These prudential standards were approved by my state counterparts, with input from the mortgage servicer industry. The standards apply to larger and more complex servicers and cover capital, liquidity, and corporate governance expectations. This Bill adopts these prudential standards for large mortgage servicers.

Rapid industry growth means nonbank mortgage servicers are responsible for a greater share of consumer care and protection. Sound financial condition and safe management practices are essential to performing compliance and consumer protection obligations, yet some nonbank mortgage servicers are historically thinly capitalized with insufficient nonborrowed liquid capacity. Additionally, significant failings at the institutional level in corporate governance and board oversight have occurred as well as documentation problems leading to wrongful foreclosures, accounting problems leading to unreconciled escrow accounts, lost or misappropriated consumer funds or incorrectly assessed fees. Further, when a servicer fails, loan transfers to a stable servicer are not a simple undertaking. In a best-case scenario, transactions may be suspended as loans are boarded and issues are sorted through. In a worst-case scenario, documents are lost, funds are misapplied or misplaced, interrupted payments cause derogatory reports on consumer’s records, or other consumer harm results.

The nonbank mortgage servicing industry is diverse, ranging from small firms with straightforward operations to large, complex institutions and asset managers with multiple business lines. By employing a de minimis coverage trigger and existing standards or generally accepted business practices, the prudential standards minimize regulatory burden for small, less complex servicing firms while establishing uniformity and standardization for the industry. In the definitions on page 2 of the Bill we use “large servicer” to identify the entities the prudential standards apply to. These are the ones with portfolios of 2,000 or more residential mortgage loans serviced or subserviced for others and operating in two or more states.

If a mortgage servicer was to have difficulties making its commitments on behalf of borrowers, North Dakota currently has no requirements to enforce, nor do we have a “seat at the table” to represent our North Dakota homeowners. The majority of states, including our surrounding states, now oversee this important industry. Due to these entities’ importance in the economy and the impact they have on homeowners, there is a need for consistent standards addressing how these companies operate and service loans to North Dakota residents. State oversight of this important industry can only work if states are engaged. A state’s failure to properly oversee the mortgage servicing industry with reasonable prudential standards encourages federal regulators such as the CFPB to step in and preempt the state’s right to oversee businesses at the state level. Therefore, when our Department goes through our national accreditation, which provides us with credibility and ensures we meet minimum industry standards, we have been criticized for our inability to oversee mortgage servicers. The Department believes that the state of North Dakota is better positioned to oversee mortgage servicers and is better positioned to understand North Dakota homeowners than is the federal government. This Bill will help limit the risk of federal preemption.

This Bill includes a fiscal note, which includes the addition of two FTEs. The total fiscal amount is $463,000, which covers salaries and benefits, examination travel, examiner training, and related NDIT costs. This will allow for licensing, examinations, and oversight of mortgage servicers. Due to the size of these entities, we network with other state regulators to minimize the burden on the companies. Therefore, examinations are typically done in conjunction with our other state counterparts to also better leverage resources. Due to the specific nature of these companies, additional FTEs are requested since examinations take considerable resources of time to complete. Adding supervisory authority without the resources to execute the law gives a false indication of consumer protection, which is why additional resources are necessary. It is important to note that our Department is completely self-funded, and the additional resources required will be funded by licensing and examination fees.

Mr. Chairman, thank you for the opportunity to provide this testimony. I would be happy to answer any questions the Committee may have.