

TESTIMONY SUBMITTED TO THE BANKS COMMITTEE
February 21, 2008

Commissioner Howard F. Pitkin
Department of Banking

SB 21 AN ACT CONCERNING MORTGAGE LENDING and
SB 182, AN ACT CONCERNING BANK AND CREDIT UNION AUTHORITY AND
NONDEPOSITORY LOANS.

Good Afternoon Chairman Duff, Chairman Barry, members of the committee, my name is Howard F. Pitkin and I am the Commissioner of the Connecticut Department of Banking. I am here to testify in favor of two pieces of legislation.

The first is, **SB 21, AN ACT CONCERNING MORTGAGE LENDING** which is a Governor's bill but the agency did work with her office in drafting the bill. The bill includes, what I feel are actions that will prevent another crises like we are currently contending with here in the State of Connecticut.

As you are aware, on April 10, 2007 the Governor convened a Task Force on Sub-Prime Lending to provide an analysis of the entire sub-prime problem as it affects Connecticut. The Task Force was charged with determining the number of families, individuals and investors currently holding sub-prime mortgages, the number in foreclosure, the opportunities for re-financing and what kind of assistance or guidance may be available for affected families. The Task Force issued its report to Governor Rell on November 9, 2007. Many of the legislative proposals contained in **AAC Mortgage Lending** come from that Task Force report.

I will mention early on in my remarks that the problem of sub-prime lending is a problem that not one, and I repeat, not one state chartered bank contributed to in any way. Unlike national banks and large thrifts throughout the country that purchased large amount of collateralized pools of sub-prime loans as well as provide warehouse lines of credit that supported this industry, state chartered banks in Connecticut did nothing of this sort. Our examiners have verified that not one sub-prime loan was made by state chartered bank in Connecticut. This is not a banking problem insofar as our state banking system is concerned. In fact, I'm proud to say that our banks learned some hard lessons following the dot.com bubble, the passage of Sarbanes-Oxley and the subsequent refinement of risk management techniques. Every industry should have learned there lessons of last resort, however this was not the case.

I come to you as the financial regulator on the state level to say that Sub-prime lending is not just a lending problem here in Connecticut. This type of lending has risen to a socio-economic problem of proportions we may not yet even know resulting in

hundreds of billions of dollars of loss for sophisticated financial institutions and raising the specter of a financial problem globally.

In spite of this, you need to have a perspective about the proportions of the sub-prime problem that allows knowledgeable discussion and debate. Approximately 80% of the sub-prime loans in our state are current and paying and 20% are seriously past due and in likelihood of foreclosure. This 20% of the \$15 Billion total equals \$3 billion. Obviously, more of these loans than \$3 billion may go into foreclosure, but that is speculative. The human cost of this is very high in terms of broken dreams, displacement and possibly homelessness because when families are through foreclosure funds are not usually abundant. Most borrowers in these loans are irreversibly caught in a situation where they can't afford the increased payments but have no equity with which to refinance the home. The other costs may involve tax roles of municipalities at least until the foreclosure process is completed and mortgagors assume tax payments, and, ultimately, the value of real estate.

SB 21 is far-reaching in the way it will change mortgage lending. We are proposing to identify sub-prime loans by price and not by any adverse credit event. The Department feels strongly that pre-payment penalties should be prohibited for loans that fall into a high cost category. In addition, we have proposed new disclosure requirements that will fully inform prospective borrowers of the risks they are taking. We are proposing to increase the net worth requirements of brokers to \$50,000 with a grace period to achieve it. Also, the bond requirement is proposed to be increased from \$40,000 to \$60,000, again phased in over a period of time for the industry to adjust.

I need to stress that **it is not the intention of this proposal legislation to adversely affect lending in our state, rather, our intention is to correct what the agency considers to be unsafe and unsound lending practices that have contributed to the sub-prime mortgage crises.** Governor Rell has developed along with CHFA a \$50 million lending program to help the borrowers who have been affected by this lax lending and the federal government has designed programs that will reach some of the borrowers. Essentially, the level of sub-prime lending has virtually curtailed due to the undesirability investors find in purchasing pools that provided liquid fuel to this industry.

The bill proposes that a lender and originator have an obligation to believe reasonably, based upon underwriting criteria, that an applicant for a loan can repay the obligation according to the terms being offered. Also, while brokers do not design the mortgage products they sell to consumers, they are the trained professional at the table with the consumer. They must first identify to consumers what brokering a transaction is and who the broker represents, collect accurate information and substantiate income with appropriate documentation. No longer should anyone make what are commonly called "liar loans" or stated income loans consumers in Connecticut.

This proposed legislation is not being offered to affect the free flow of legitimate credit needs of the consumers of Connecticut. This proposal, if enacted would raise the bar for participants in the Connecticut mortgage industry and no longer allow the type

loans that have put into question the financial future of so many residents. While there are legitimate credit needs of consumers that may indicate a credit structure similar to a sub-prime loan, I can say with confidence these are a type of loan where consumers are undertaking risks they cannot control and, in some cases, do not understand.

The final provision I will discuss is the proposed fraud statute that will make “mortgage” fraud a class D felony. This action will take in the schemes you have read about including flipping, willfully overvaluing real estate appraisals or making false statements. This is certainly a significant step in increasing the penalties for fraud the department has found that in addition to lax underwriting a significant portion of this problem was caused by fraud.

The Department of Banking realizes SB 21 needs the input of the mortgage and banking industries and looks forward to those collaborations. I can assure you of our cooperation and understanding of the issues this proposed legislation raises. We are open to all your ideas.

The next bill the agency would like to speak on ***SB 182, AN ACT CONCERNING BANK AND CREDIT UNION AUTHORITY AND NONDEPOSITORY LICENSES.*** The proposal makes a number of changes to the banking statutes related to publication of reports and notice requirements. It also deals with changes to certain license requirements as well. The main point in the bill is to authorize the commissioner to permit financial institutions to open offices and temporarily waive or suspend certain requirements in the event of an emergency. This authority would be great assistance to the department in the event of a disaster in New York City. The proposal would allow for financial institutions to operate in Connecticut during a time of crisis.

The agency is also submitting detailed memos concerning the bills. Thank you for your attention to these matters and I will answer any questions you may have on this or any other bills.