

## Section Two:

**Historical information and background regarding the subprime mortgage market and specifics about the regulatory environment in Washington and at the Federal level.**

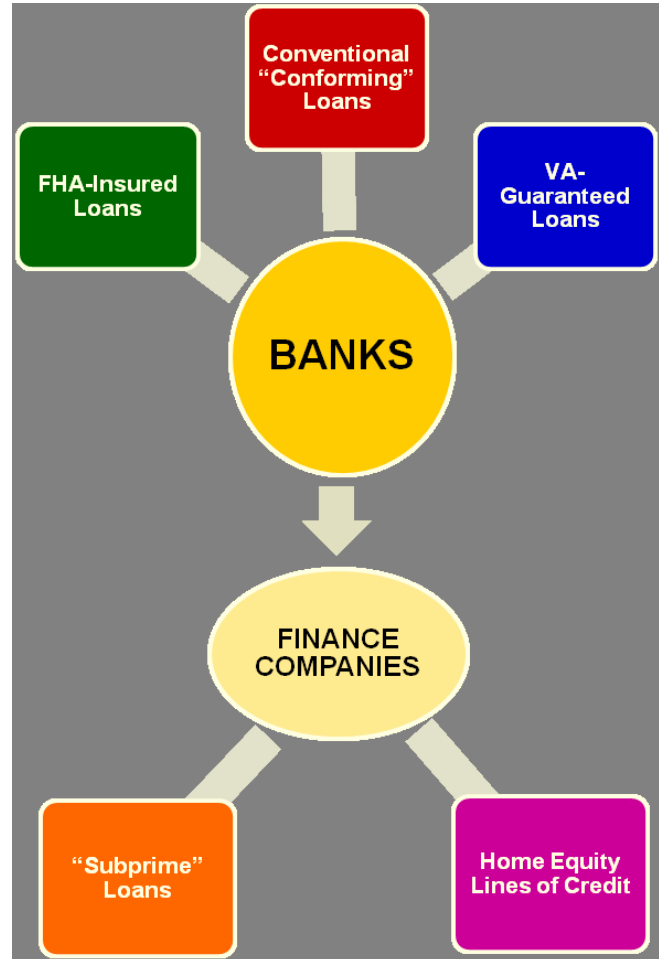


# Mortgage Lending Industry Overview

## Just 25 Years Ago . . .

Just 25 years ago, residential mortgage lending was a lot different than it is today. What you saw then was predominantly “brick-and-mortar” bank lending – conventional, FHA and VA. Finance companies were nearly the only “subprime” and home equity lenders. Conventional lending was predominantly “conforming” loans approved by Fannie Mae and Freddie Mac. FHA-insured loans were the typical way that first-time home buyers, with little down-payment, were able to afford a home. FHA permitted a 3% down payment, albeit, with strict requirements. For active military personnel, veterans and their dependents, VA-guaranteed loans permitted a 0% down payment with strict requirements. Adjustable rate mortgages (ARMs) were practically unheard of.

Back then, banks held on to their loans and servicing more than today. While Fannie Mae and Freddie Mac were the predominant secondary market sources, the relatively small private secondary market was mostly insurance companies.

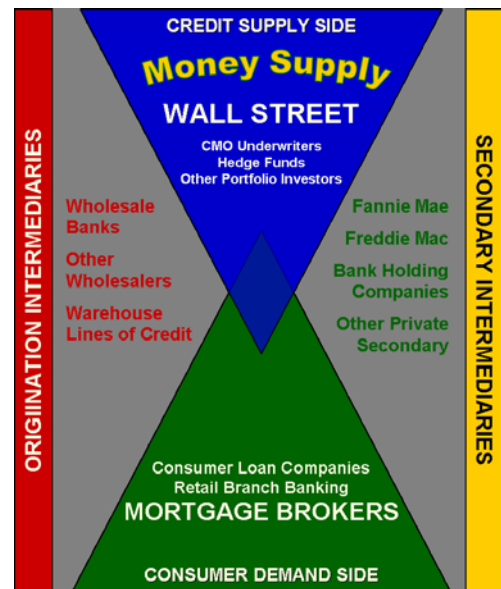


However, the market was at a near stand-still because retail mortgage loan rates had risen to an all-time high approaching 21%.

## ... But Today Is Different

**The Consumer Demand Side.** Residential mortgage lending today is different than it was 25 years ago. Today, mortgage brokers service the demand side – dominating retail mortgage lending with 58% (\$1.7 Trillion) of all originations in 2006.<sup>5</sup> In addition, mortgage brokers directly access wholesale markets, often bypassing banks.

**The Wall Street Supply Side.** On the other hand, Wall Street controls the supply side, dominating the *wholesale* and *secondary* market. In July 1983, the collateralized mortgage obligation (CMO) was first introduced by Lehman Brothers, ushering in mortgage lending's "Age of Wall Street." Loans are now often "committed" for sale to the secondary market before they are even closed. Wall Street and major bank holding companies directly compete with Fannie Mae and Freddie Mac.



**The Commoditization of Mortgage Lending.** Wall Street's influence has created or expanded the underwriting of *products* which allow mortgage loans to be bought and sold as a *commodity*. "Subprime" lending is a staple within the U.S. mortgage market.<sup>6</sup> Most lenders make home equity loans, not just finance companies. ARM loans are now common. Private sector low- or zero-down lending has surpassed FHA and VA lending. "Stated-income" and "no doc" loans for self-employed persons became common in the last 10 years.

**The Wall Street Macro-Business Model.** The Wall Street-style *risk-based capital business model* has replaced traditional mortgage lending. Nationwide and regional banks are doing more wholesale lending. Branch bank lending concentrates more on originating fee income, not holding on to loans. Banks sell most of their fixed rate loans and portfolio their ARMs. Sale of servicing is very common. Banks are frequently self-insuring their risk of default rather than requiring PMI.

<sup>5</sup> Based on the August 2007 release of the Mortgage Brokers 2006 Report, prepared by Wholesale Access Research & Consulting, Inc., and sponsored by the nation's largest wholesale lenders.

<sup>6</sup> While there are estimates that "subprime" lending is as high as 25% of total originations, it is preferable to rely upon the figure of 14% as shown in the Mortgage Bankers Association® Delinquency Survey for 2<sup>nd</sup> QTR 2007. While this is based upon only 44 million loans reported to MBA (which may not be the total number of loans serviced), it is an accurate measure of what is truly "subprime" among the 44 million loans surveyed.

## What Is Subprime Lending?

“Subprime” mortgage lending does *not* refer to any specific products per se. However, “subprime” borrowers are often sold higher risk products. “Subprime” borrowers will almost always be charged higher interest rates than “prime” borrowers.

**“Prime” and “Subprime”.** A “subprime” borrower is a consumer whose credit score is less favorable than that of “prime” borrowers. In the midst of confusing information about the industry, it is better to define “subprime” by, first, illustrating what “prime” lending is and then generally applying the label “subprime” to all other mortgage loans. Certainly, a “prime” credit risk is generally perceived as someone whose mortgage would be acceptable to Fannie Mae’s purchasing guidelines as a “conforming” loan (except for Fannie Mae’s exclusion for “jumbo” loans above a certain loan amount). Factors in judging a “prime” borrower are:

- ☑ **Acceptable FICO Score.** The FICO Risk Score range is 300\* to 850. The median FICO score in the U.S. is 723. The average FICO score in the U.S. is 678. The average FICO score in Washington State is 690. A “prime” borrower would, in combination with other acceptable factors, have a FICO score *above the median*.
- ☑ **Acceptable Debt-to-Income (DTI) Ratios.** The front-end ratio is the percentage of total housing costs (rent for renters, and PITI, hazard insurance, and HOA dues for homeowners) to gross income. The back-end ratio is the percentage of total monthly and other debts (including housing costs) to gross income. A “prime” borrower would typically have front-end and back-end ratios, respectively, no greater than 28/36.
- ☑ **Acceptable Combined Loan-to-Value (CLTV) Ratio.** A “prime” borrower would typically have a combined loan-to-value (CLTV) ratio of 90% or less (i.e., 10% or more down payment or equity) and a total front-end debt-to-income ratio of 36% or less.
- ☑ **Other Factors.** Examples of other factors in judging a “prime” borrower include such matters as concerns raised on the face of the property appraisal.

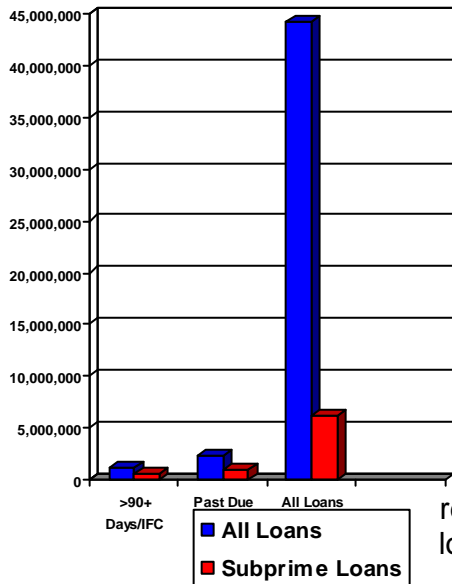
If a borrower has an excellent FICO Score and CLTV ratio but a higher DTI ratio, or if the borrower is self-employed and relying on “stated” (rather than verified) income, he or she may qualify with some lenders for what is known as alternative “A” (or Alt “A”) loan rates. Alt “A” may also be applied to borrowers with peculiar miscellaneous factors, such as concerns about the appraisal. But, generally, unless one has an acceptable FICO score, DTI ratios, CLTV ratio and other factors, one is automatically a candidate for a “subprime” loan.

\* Correction made April 04, 2008

# What Are the Current Market Conditions?

## Overall Nationwide Market Conditions

According to the respected Mortgage Bankers Association® Delinquency Survey, as of September 30, 2007, about 5,990,000 out of 45,417,215 loans reported in the survey<sup>7</sup> (or about 13.2%) were “subprime.” And about 2.6 million of all reporting mortgage loans, or 5.8%, were past due. Of these, 1.34 million loans, or about 2.95%, were seriously delinquent (i.e., 90+ days or more past due or in foreclosure).



And of the 5,990,000 million *subprime* mortgages nationwide reported to Mortgage Bankers Association®, nearly 1 million (about 16.7%) were past due. And of these, over 680,000 (over 11.8%) were seriously delinquent or in foreclosure.

This represents a continued upward trend from past quarters. While the situation may continue to accelerate, it is important to keep matters in perspective. The statistics above indicate that past due and seriously delinquent subprime loans represented *only* 2.2% and 1.5%, respectively, of *all* reporting loans nationwide.

## National Trend in Default/Foreclosure<sup>8</sup>

**Historic Trend: 2002-2007.** Some types of mortgage loans are riskier, depending on general economic and employment conditions in the U.S. Coming out of a general recession beginning in 1<sup>st</sup> QTR 2003, default and foreclosure rates in the riskier “subprime” category trended downward until 4<sup>th</sup> QTR 2005. But while default and foreclosure rates for fixed-rate subprime loans evened out and have remained relatively constant since 4<sup>th</sup> QTR 2005, the most risky of loans for both lenders and borrowers – subprime ARM loans – experienced a dramatic rise in combined default and foreclosure rate throughout 2006 and continuing into 2007.

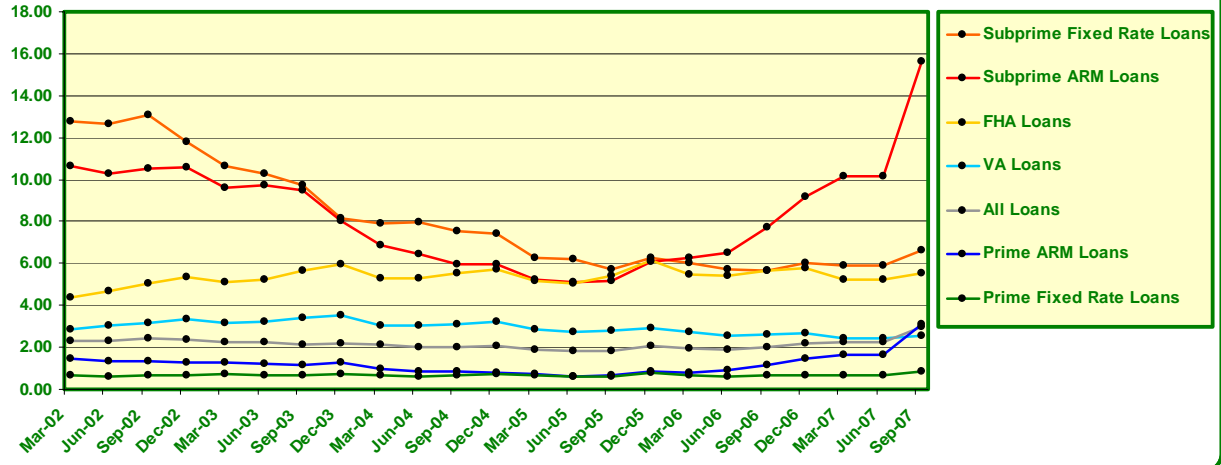
For additional information on the historic trends in delinquencies and foreclosures, including 2006 data analyses, see [Appendices](#) attached, at Page 52.

**Where Will It End?** Industry analysts expect combined default rates to drift higher through at least May 2008. And this prediction may even be an underestimate. Huge numbers of subprime ARM loans were issued in 2005. Many will be burdened by big rate increases in the next 12 months.

<sup>7</sup> Some servicers may not report some or all of their information to Mortgage Bankers Association®. Therefore, while the MBA National Delinquency Survey is well-respected, it may not be 100% accurate.

<sup>8</sup> Sources: Friedman Billings Ramsey Research Report, cited in *Mortgage Servicing News*, August 28, 2007; www.Fortune.com. August 28, 2007.

## NATIONAL COMBINED DELINQUENCY (90+ DAYS) & PENDING FORECLOSURE RATES (2002-2007)



Source: Mortgage Bankers Association® National Delinquency Survey -- 3<sup>rd</sup> Quarter 2007

The chart above, compiled from data published in the Mortgage Bankers Association® Delinquency Survey, shows the national trend in serious delinquencies and foreclosures for all loan types from 1<sup>st</sup> QTR 2002 through 3<sup>rd</sup> QTR 2007. Now, with the release on December 6, 2007 by the Mortgage Bankers Association® of its 3<sup>rd</sup> QTR 2007 Delinquency Survey (for the period ending September 30, 2007), we can see a further upward trend in serious delinquencies and pending foreclosures nationwide, particularly for subprime ARM loans. Based upon those loans which are reported to the Mortgage Bankers Association® (about 80% of the estimated national total), the 3<sup>rd</sup> QTR 2007 national data shows a continued national rise in serious delinquencies and foreclosures, particularly with subprime ARM loans:

## NATIONWIDE DELINQUENCIES AS OF SEPTEMBER 30, 2007

	ALL LOANS MBA Reported Only	ALL PAST DUE*			SERIOUSLY DELINQUENT*		
		MBA Reported	Adjusted Est.***	Percentage	MBA Reported	Adjusted Est.***	Percentage
All Loans	<b>45,417,215</b>	2,638,740	3,298,425	5.81%	1,339,808	1,674,760	2.95%
Subprime ARM	<b>2,959,267</b>	579,720	<b>724,650 est.</b>	<b>19.59%</b>	462,533	<b>578,166 est.</b>	<b>15.63%</b>
Subprime Fixed	<b>2,751,751</b>	351,399	439,249	12.77%	181,891	227,364	6.61%
Prime ARM	<b>6,346,076</b>	334,438	418,047	5.27%	197,998	247,498	3.12%
Prime Fixed	<b>27,559,715</b>	738,600	923,250	2.68%	228,746	285,932	0.83%
FHA	<b>3,089,370</b>	417,683	522,104	13.52%	171,151	213,939	5.54%
VA	<b>1,112,903</b>	76,456	95,570	6.87%	28,490	35,613	2.56%

\* 30 Days or More Past Due. \*\* 90+ Days Past Due or Foreclosure Pending.

\*\*\* ASSUMPTION: Total nationwide loans reporting to MBA (both current & delinquent) were 45,417,215. Based upon the assumption that this represents 80% of the estimated national total (as estimated by Mortgage Bankers Association®), the adjusted estimate would be 56,770,000.

## Where Does Washington Stand?

In contrast to the picture nationwide, Washington State is substantially below the national delinquency rates for all types of loans – both for serious delinquent loans and all past due loans. However, the delinquency rates, especially in the area of subprime ARM loans, should be monitored closely, even in Washington State. For all past due subprime ARM loans, Washington had a delinquency rate by 3<sup>rd</sup> QTR 2007 of 12.91% (compared with 19.59% nationwide). For seriously delinquent loans (i.e., loans 90+days past due or in foreclosure), the Washington delinquency rate on subprime ARM loans was 7.10% (compared with 15.63% nationwide). Moreover, even FHA loans in Washington (with their stricter underwriting standards) had a delinquency rate for the period of 8.46% (compared with 13.52% nationwide). With these trends likely to get worse before they get better – particularly as the interest rates on many subprime ARM loans reset – Washingtonians should remain watchful.

### WASHINGTON STATE DELINQUENCIES AS OF SEPTEMBER 30, 2007

	ALL LOANS MBA Reported Only	ALL PAST DUE*			SERIOUSLY DELINQUENT**		
		MBA Reported	Adjusted Est.***	Percentage	MBA Reported	Adjusted Est.***	Percentage
All Loans	1,204,416	36,012	45,015	2.99%	13,489	16,861	1.12%
Subprime ARM	70,186	9,061	11,326 est.	12.91%	4,983	6,229 est.	7.10%
Subprime Fixed	50,072	4,136	5,170	8.26%	1,783	2,229	3.56%
Prime ARM	208,636	5,758	7,198	2.76%	2,253	2,816	1.08%
Prime Fixed	777,619	10,576	13,220	1.36%	2,255	2,819	0.29%
FHA	48,824	4,131	5,164	8.46%	1,411	1,764	2.89%
VA	37,556	1,821	2,276	4.85%	627	784	1.67%

\* 30 Days or More Past Due. \*\* 90+ Days Past Due or Foreclosure Pending.

\*\*\*ASSUMPTION: Total Washington State loans reporting to MBA (both current & delinquent) were 1,204,416. Based upon the assumption that this represents 80% of the estimated total, the adjusted estimate would be 1,505,550.

Nonetheless, according to the 3<sup>rd</sup> QTR 2007 MBA Delinquency Survey, Washington State – in comparison with all other states – ranked near the bottom in terms of delinquencies and pending foreclosures. When measuring total loans past due by state, Mississippi was highest with 10.6% total past due loans; while Washington State (ranked 46<sup>th</sup> in this category among the states), had only 2.99% in total past due loans. Of the seriously delinquent loan (90+ days past due or pending foreclosure), Ohio ranked highest with 5.44% total past due; while Washington State (ranked 48<sup>th</sup>) had only 1.12% in overall past due loans. Even in the riskier area of subprime ARM loans, Washington State ranked near the bottom. Mississippi had the highest percentage of total past due subprime ARM loans (at 30.16%), while Washington State (ranked 46<sup>th</sup> among the states) had 12.91% total past due subprime ARM loans. And in the category of seriously delinquent subprime ARM loans, Washington State ranked 48<sup>th</sup> among the states, with only 7.1% compared with highest ranking OHIO, at 25.67%.

## Where Does Washington Stand? (continued)

In terms of actual numbers (see assumptions above), Washington State had an estimated number of total past due loans in all categories for 3<sup>rd</sup> QTR 2007 of about 45,000, nearly 17,000 loans seriously delinquent. **In the area of subprime ARM loans, Washington State had an estimated 11,326 loans past due, with an estimated 6,229 seriously delinquent. This significantly varies from the magnitude of the problem nationwide and in practically all other states. Washington remains in much better condition than the rest of the country.**

The Task Force has analyzed subprime loan volume data for select Standard Metropolitan Statistical Areas in Washington State based upon the most recent available data. These data are included in [Appendices](#), attached, at Pages 58-65.

# Causes of the Present Problem

## Relaxation of Credit Standards

Of the five principle factors that lay behind the changes in the residential mortgage lending market in the last 25 years, only one – *relaxation of credit standards* – might possibly be viewed by some observers as a cause of the present mortgage situation. The positive, direct effects of information technology have far outweighed certain unintended, indirect consequences. Likewise, the positive effect of an increase in the supply of mortgage money and the consequent growth in demand for mortgage products has, by and large, stimulated home ownership and greatly improved the financial well-being of most Americans.

Twenty five years ago a lot of doors were closed in this country – including Washington State – to large numbers of would-be homeowners. Today, however, the largest percentage of households ever – about 69%<sup>9</sup> – are homeowners.

The general economic stimulation that initiated this phenomenon was a major achievement for federal government policy. Moreover, relaxation of credit standards *per se* has not been a cause of the present “subprime” and “foreclosure” situation. Rather, it has been the relaxation of credit standards *without* consistent, adequate safeguards which bears some of the responsibility.

## Lack of Adequate Underwriting

A major cause of the present mortgage situation has been the lack of adequate safeguards. Some examples of the inappropriate underwriting standards include:

**Overuse of “Little or Nothing Down”.** Historically, sound underwriting practice was to require a minimum down payment for two reasons: (1) as a hedge for the mortgage holder against market deflation in the event of default, and (2) as a disincentive to the borrower going into default in the first place. Accordingly, the recent phenomenon of “low down” and “nothing down” arrangements has a built-in higher risk for which lenders nationwide should have taken appropriate precautions to safeguard against a down-turn in local home prices. In 2003 alone, 28% of first-time home buyers purchased a home with no down payment, according to National Association of Realtors. When the final statistics are compiled, this percentage is likely to be much higher.

**Overuse of “No Upfront Verifications”.** While “low doc,” “no doc” and “no income verification” loans were designed to ease underwriting standards for deserving self-employed persons, the practice eventually grew into widespread abuse through loan officers, underwriters and hundreds of individuals committing outright mortgage fraud.

---

<sup>9</sup> 2005 U.S. Census Bureau (68.9%). Washington State homeownership was 67.6% in 2005 (U.S. Census Bureau).

## Causes of the Present Problem (continued)

**Over-Acceptance of “High Debt-to-Income Ratios”.** During 2006, underwriting standards on *subprime* loans became progressively worse with each successive month, with debt-to-income ratios rising from 46% in May to 47% in June.<sup>10</sup>

**Reliance on Teaser Interest Rates.** One of the practices was underwriting borrowers at a “teaser” discounted interest rate on an adjustable rate mortgage (ARM), not on the rate at which the loan would, soon after the loan closed, adjust to – often leaving the borrower with an inability to afford the new payment.

**Shoddy Appraisals.** As the volume of originations got so big, property appraisals were often shoddy and over-inflated, and many lenders and/or funders did not properly review or question them.

**Lax Lending by Builder Affiliates.** In an effort to sell newly constructed houses, lender affiliates of builders often engaged in lax underwriting by permitting combinations of the above.

### **Predatory Lending Tactics**

**Risky Products.** In many cases, the loan products themselves might have been inherently too risky for many borrowers. This is particularly true of loans products that were originally designed for certain borrowers with higher risk tolerance, but which were then marketed to other types of borrowers with an inability to manage or absorb higher risk.

**Case Study – Option ARM Loans.** One example of *over-marketing* a loan product that was perfectly well-suited for some borrowers under the right market conditions is the Option ARM loan. An “option ARM” is a loan where the borrower has the option of making either a specified minimum payment, an interest-only payment, or a 15-year or 30-year fixed rate payment in a given month. Option ARMs became popular in the last few years because they were usually offered with a very low initial “teaser” interest rate and a low minimum payment, which permitted borrowers to qualify for a much larger loan than would otherwise be possible. However, rather than underwriting a loan applicant’s suitability for an Option ARM at the fully-indexed rate, borrowers were placed into these loans based on their ability to pay only the “teaser” rate. Moreover, while Option ARMs were best suited to people in fields with sporadic income, such as some self-employed people or those in a highly seasonal business, they were often marketed to anyone with a desire to take advantage of its low minimum-payment. In addition, they were often marketed to people with such high debt-to-income ratios that they could never afford payments at a fully-indexed interest rate. Moreover, the Option ARM has the potential for *negative amortization*, in which the loan will not pay off within the 15- or 30-year term. As with any loan with potential negative amortization, the increased loan balance will reduce or eliminate the borrower’s equity in the

---

<sup>10</sup> Mortgage Bankers Association®. Note: The traditional “prime” standard of 28% front-end and 36% back-end ratios had become increasingly rare due to the “credit orientation” of society in general.

## **Causes of the Present Problem (continued)**

financed property, or if the value of the property declines, increase the chance that the borrower won't be able to sell the property for an amount that will repay the loan.

**Up-Pricing “Prime” Borrowers.** Many homeowners whose credit scores entitled them to a “prime” rate mortgage loan were sold “subprime” rate loan products. In some cases, this was the result of affinity fraud through ethnic, religious or other social relationships common to the borrower and the loan officer. However, this could not have occurred in such numbers without negligent or complicit underwriting standards.

### **Wall Street’s Role**

Globalization of the capital markets and unprecedented liquidity brought eager investors who found their way to the secondary market. Knowing this, private equity firms and hedge funds – looking for ever-higher yields – encouraged riskier subprime loans. Investor assessment of risk was often corrupted by inconsistent standards among originating lenders. But with no liability as loan assignees, private equity firms and hedge funds had no incentive to engage in sounder underwriting. Wall Street relied on risk-taking models previously foreign to mortgage lending, ignoring the fundamental 3 C’s of credit – creditworthiness, capacity and collateral. As Wall Street made money easy, non-institutional lenders and mortgage brokers – whose only stake was fees – were encouraged to make even riskier loans.

# **State and Federal Regulatory Roles**

## **Residential Mortgage Regulation**

**Underlying Features of Residential Mortgage Regulation.** Federal agencies often have different missions which can lead to competing agendas – in part reflecting intense competition and occasional animosity among the different types of financial institutions which they each serve. Laws and regulations – both federal and state – have not kept pace with the explosive growth and innovation in the residential lending industry. The result of federal-state conflict, federal inter-agency tension, and the pace of innovation in the private sector has become a *tangled web of rulemaking, supervision and enforcement*.

**Federal vs. State Regulation.** Actual jurisdiction to supervise and enforce residential lending compliance policy lies chiefly with only 5 federal agencies, each with its own “turf” over often-competing industries. With the Office of the Comptroller of the Currency (OCC), Office of Thrift Supervision (OTS) and National Credit Union Administration (NCUA) asserting sole jurisdiction over federally chartered operating subsidiaries (and even “exclusive agents”), the OCC, OTS and NCUA have predominant influence over residential lending compliance in the U.S. Washington State (like the majority of other states) is equipped to perform the bulk of regulation of residential lending compliance laws and regulations, since Washington State routinely enforces the 13 major federal statutes and/or regulations in this area, plus 8 state licensing and enforcement statutes of its own. In contrast to the 12 federal agencies regulating this field, Washington State enforces federal and state policy through only 4 state agencies: Attorney General’s Office (AGO), the Department of Financial Institutions (DFI), Department of Licensing (DOL), and Office of Insurance Commissioner (OIC). When the enforcement power of Department of Housing & Urban Development (HUD) and the Federal Trade Commission (FTC) are added to the equation, coupled with the indirect supervision of the Federal Financial Institutions Examination Council (FFIEC) and the indirect enforcement authority of the Department of Justice (DOJ) over anti-discrimination prosecutions, *it appears as if the federal agencies have a near “lock” on residential lending supervision and enforcement*.

Also, beginning in 1997, the OCC and OTS declared that state regulators cannot regulate, examine or investigate national banks, federal thrifts, their operating subsidiaries, and (in the case of Federal thrifts) their “exclusive agents.” A huge concentration of the national market, including the largest federally chartered banks and thrifts, has, with the help of this new federal policy, been given a “safe harbor” from state consumer protection regulation and enforcement. Federal banking regulators claim that these banks, thrifts and their operating subsidiaries are preempted from state regulation and have recently won narrow but important victories in the courts. See *Wachovia v. Watters* (U.S. Supreme Court – 2007). Since 1999, financial services holding companies have entered the market through relationships between their thousands of respective agents and federal thrift charter affiliates, also claiming federal preemption for their independent agents.

## State and Federal Regulatory Roles (continued)

### The “Tangled Web” of Regulation

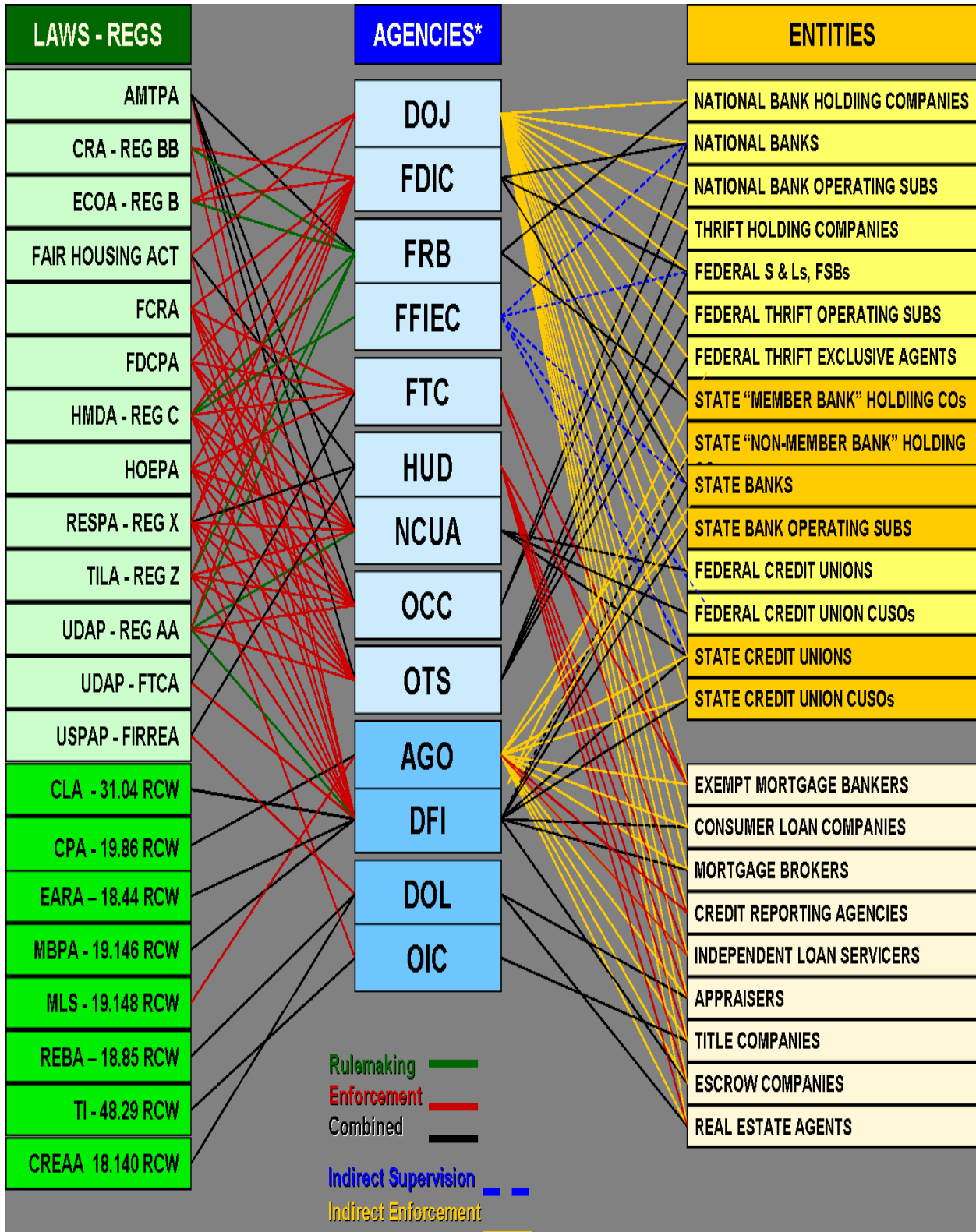
#### Major Laws – Regulations

- ☑ **Federal.** Alternative Mortgage Transactions Parity Act (AMTPA), Community Reinvestment Act (CRA), Equal Credit Opportunity Act (ECOA), Fair Housing Act, Federal Credit Reporting Act (FCRA), Federal Debt Collection Practices Act (FDCPA), Home Mortgage Disclosure Act (HMDA), Home Equity Protection Act (HOEPA), Real Estate Settlement Procedures Act (RESPA), Truth in Lending Act (TILA), Unfair and Deceptive Acts and Practices (UDAP – Regulation AA), Federal Trade Commission Act (FTCA – Section 5), Financial Institutions Reform, Recovery & Enforcement Act [FIRREA – Uniform Standard of Professional Appraisal Practice (USPAP)].
- ☑ **Washington State.** Consumer Loan Act (Ch. 31.04 RCW), Consumer Protection Act (Ch. 19.86 RCW), Escrow Agent Registration Act (Ch. 18.44 RCW), Mortgage Broker Practices Act (Ch. 19.146 RCW), Mortgage Loan Servicing (Ch. 19.148 RCW), Real Estate Brokers Act (Ch. 18.85 RCW), Title Insurers (Ch. 48.29 RCW), Certified Real Estate Appraiser Act (Ch. 18.140 RCW).

#### Major Agencies

- ☑ **Federal.** Department of Justice (DOJ), Federal Deposit Insurance Corporation (FDIC), Federal Reserve Board (FRB), Federal Financial Institutions Examination Council (FFIEC), Federal Trade Commission (FTC), Department of Housing & Urban Development (HUD), National Credit Union Administration (NCUA), Office of the Comptroller of the Currency (OCC), Office of Thrift Supervision (OTS).
- ☑ **State.** Attorney General's Office (AGO), the Department of Financial Institutions (DFI), Department of Licensing (DOL) and Office of Insurance Commissioner (OIC).

## State and Federal Regulatory Roles (continued)



## **State and Federal Regulatory Roles (continued)**

### **Washington Mortgage Regulation**

**Regulation of State-Chartered Financial Institutions.** The Department of Financial Institutions regulates state-chartered commercial banks (Title 30 RCW), savings banks (Title 32 RCW) and credit unions (Ch. 31.12 RCW). All of the institutions originate and/or fund some residential mortgage loans directly and/or through mortgage brokers. As of June 30, 2007, the overall delinquency rate for Washington State-chartered commercial and savings banks (by number of loans) was less than one-half of 1% (0.42%), and the delinquency rate for Washington State-chartered credit unions was only one-half of 1% (0.5%). This compares with 0.93% delinquency rate in Washington State for all reported loans and a 2.47% nationwide as of June 30, 2007.

**Licensing and Regulation of Mortgage Brokers and Loan Originators.** The Department of Financial Institutions licenses, examines and regulates mortgage brokers and individual loan originators working for mortgage brokers under the Mortgage Broker Practices Act (MBPA, Ch. 19.146 RCW) for their compliance with federal and state consumer protection laws and regulations. With recent amendments to the MBPA initiated by Washington Association of Mortgage Brokers (WAMB) and authored by the Department of Financial Institutions, we have 15,300 applicants for the Loan Originator license. With 70% of loans nationwide being originated by mortgage brokers, this is the area where the Department of Financial Institutions has the most authority and opportunity to make a difference in helping to solve the subprime problem.

**Licensing and Regulation of Some Mortgage Lenders.** Even if a non-bank mortgage lender is exempt from mortgage broker licensing, the lender is still subject to the jurisdiction of the Department of Financial Institutions for prohibited practices set forth in the MBPA unless it is an operating subsidiary of a national bank or federal thrift. The Department of Financial Institutions conducts investigations and administratively prosecutes these exempt mortgage lenders who commit consumer protection violations. In addition, the Department of Financial Institutions licenses, examines and regulates consumer loan companies under the Consumer Loan Act (Ch. 31.04 RCW). These companies obtain a license from the Department of Financial Institutions for the privilege of making loans above 12% -- which means that these consumer loan companies almost always make subprime loans. However, because several consumer loan companies that were once the Department of Financial Institutions' licensees are national bank or federal thrift operating subsidiaries, they are no longer subject to the Department of Financial Institutions' examination and enforcement jurisdiction because of federal preemption.