

**THE NORTH CAROLINA MORTGAGE LENDING ACT: RESULTS OF THE
FIRST YEAR, CHALLENGES TO COME**

**Address To Charlotte Area Mortgage Lenders
Myers Park Country Club
Charlotte, North Carolina**

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North Carolina Commissioner of Banks**

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It is a pleasure to be with you again to discuss matters of mutual interest. As you are aware, we have a lot to talk about.

Since we last met, a number of events have occurred that affect mortgage lending in North Carolina. I was re-appointed by Governor Easley and confirmed by the General Assembly for a term running through March 2007, a very positive development from my point of view and, I hope, from yours. The Comptroller of the Currency has expressly pre-empted the Georgia predatory lending statute and, through proposed rulemaking, appears to want to pre-empt North Carolina's law as well. I am unhappy with the Comptroller's proposed rules; however, I expect that my opinion is not shared by everyone in this room. The refinancing boom has crested without undue harm to the mortgage lending industry; circumstances which I expect we can agree are beneficent, at least when compared to some possible outcomes.

A few matters have come to my attention since I was last with you that I think all of us view with concern, if not alarm. Foreclosures continue at a record pace, resulting in disaster for the mortgagors and virtually certain losses for the holders of the loans. The economic problems of North Carolina are almost certainly the major contributing factors behind this phenomenon, but I believe

that lending excesses also contributed significantly. More disturbing still, fraudulent activity in the marketplace has reached a disturbing level, as recently reported in the Charlotte Observer. The Federal Home Loan Bank of New York recently did not pay a dividend because of losses stemming from its purchase of bad manufactured housing paper. Lehman Brothers has sued two California developers for selling it \$140 million of fraudulently originated paper from high-income developments, \$60 million of which was then securitized and sold to the Federal Home Loan Bank of San Francisco. Capital markets are feeling a little stress these days, and fraudulent transactions of the kind just mentioned – whether marginal, as I hope, or widespread, as I fear – make matters worse.

Given the importance of the mortgage lending to North Carolina, it will come as no surprise to you that two of the four major goals I have set for the Office of Commissioner of Banks for the next four years relate to your industry. I would like to discuss these goals with you, after which I will take this opportunity to announce the release of a declaratory ruling regarding so-called “net branching.”

Mortgage Lending Act Implementation

Implementation of the Mortgage Lending Act (MLA) involves licensing of lenders, brokers and loan officers; examination of mortgage lenders and brokers; and investigation and enforcement. I will discuss each of these activities in the order in which I have just mentioned them.

Licensing. I have recently reported to the Governor about MLA licensing during the year ended June 30, 2003. The report is available to you in the “Commissioner’s Page” section of the OCOB website (<http://www.nccob.org>). I hope you will take time to read it at your leisure. We have just completed the first round of annual renewals under the MLA. I believe it is fair to say that our licensing activities are improving with experience. We have spent a substantial amount of money to upgrade our IT systems and hope to have licensing renewals and changes completely automated by next year or the year following at the latest. In spite of the reduction in refinancing volume, OCOB continues to receive applications for new licenses at the rate of 75 to 100 per week.

Examinations. For reasons I will discuss in the next few minutes, the proper conduct of business by mortgage lenders and

brokers is fundamentally important to the accomplishment of the policy goals embodied in the MLA. The statute gives my office authority to conduct examinations and we will soon begin to do just that. OCOB currently has three mortgage examiners and we will hire a fourth in the near future. We have reviewed our examination guidelines with industry leaders and intend that the process will be both efficient and fair. I hope and believe our examination process will improve with time and experience in the same way as the licensing process.

Investigations and Enforcement. During the last year, OCOB has also substantially enhanced its consumer complaints and investigations functions. We now have two full-time complaints people and our full compliment of four investigators. Regrettably, all of these people are fully employed. We are heading for a record year in consumer complaints and will likely handle between 1,500 and 2,000 formal written complaints, and a multiple of that number in informal complaints. Over seventy-five percent of these complaints involve conduct by mortgage lenders, brokers and loan officers, primarily the latter two groups. We also receive a substantial number of referrals from industry sources and other law enforcement agencies. It is our goal to aggressively investigate allegations of MLA violations and to prosecute them, directly or

through criminal prosecution by district attorneys and / or the Attorney General's office, where the circumstances warrant it.

Industry Best Practices

The third goal that I have set for this term of office is: encouragement of the adoption and implementation of best practices in the mortgage lending and consumer finance industries. This goal is based on the assumption that industry self-regulation is more efficient and likely of success than top down regulation by government. I also believe that industry participation in the definition of best practices will give OCOB a strong practical basis for enforcement actions against persons and firms that don't follow them.

Frankly, I thought that this goal would be a lay-up. The leading firms in the consumer lending industry in North Carolina, generally as the result of recent unhappy experiences, have adopted best practices. By and large, the firms that have adopted best practices are following them and the result has been a noticeable reduction in consumer complaints against them. Although a number of mortgage lending and brokerage firms may have

adopted best practices, I have not been able to find any for the industry. This is surprising. I have been in touch with the leadership of trade groups for the industry and hope you will support their efforts as they work with OCOB to develop best practices.

Net Branching

I would now like to take a few moments to discuss a phenomenon in mortgage brokerage, including the brokerage activities of mortgage lenders, that is of great concern to me: “net branching.” This mode of operation involves the conduct of brokerage business by an independently operated office or offices under the license of a mortgage broker (generally out-of-state). The licensed mortgage broker offers minimal services to the branch, takes little or no responsibility for its operation, and takes a cut of the business that the branch generates. This method of operation is a serious breach of the MLA because it violates one of the statute’s major premises: that loan officers must be employees of mortgage brokers or lenders who provide supervision, oversight, education and training. Net branching is at its essence a “charter rental” by the mortgage broker in which the broker avoids or denies all of the responsibilities just mentioned, with the possible

exception of subjecting itself to claims by injured consumers on its bond. Such operations are characterized by little or no screening or training of employees, little or no oversight of operations, unqualified or underqualified branch management, and an “eat what you kill” culture that emphasizes volume and fees to the exclusion of legal and regulatory compliance.

Net branching violates the MLA and has done so since that statute became effective. Anyone who owns, operates or works for a net branching operation is in violation of the MLA and is subject to prosecution under that statute to its full extent. Any lender that knowingly does business with a net branching operation is an aider and abettor of such violations. Next to outright mortgage fraud, net branching is the single most important target of my office’s examination and investigative functions. It will continue to be so until we have substantially reduced or eliminated it from the mortgage market in North Carolina.

To emphasize the importance that I attach to this issue, I have today issued a declaratory ruling on net branching. The ruling defines with particularity the conduct in question and its consequences. I would emphasize that this ruling is not an extension of current law; it is a restatement of what the MLA

clearly says and what any mortgage professional, in the exercise of due care, should already know. The declaratory ruling has been drafted to be compatible with prior guidance on this topic by the federal government and a number of other states. The next statements my office will make with regard to net branching will be with subpoenas and / or notices of hearings to levy fines and revoke licenses.

Conclusion

Thank you again for having me this afternoon. I have enjoyed working with your leadership to promote a healthy and competitive mortgage market in North Carolina and look forward to continuing that work in the future.