Summary of Session Law 2007-352 (House Bill 1817): 2007 Update to North Carolina Anti-Predatory Lending and Mortgage Regulation Laws

- Session Law 2007-352 (House Bill 1817 or "2007 Predatory Lending Update") amends Chapters 24 and Chapter 53 of the North Carolina General Statutes; and
- Expands coverage of the high-cost home loan protections.

The 2007 Predatory Lending Update becomes effective on January 1, 2008. The Office of the Commissioner of Banks provides this summary of the law to ensure licensees are aware of this new statute.

Section 1

This section expands North Carolina's existing high cost home loan protections by including all broker {*<u>throughout this interpretation, read "broker" to include a lender acting as a broker</u>*} compensation (no matter the source and without regard to whether received directly or indirectly from borrower), including yield spread premiums and payments made in table-funded transactions, in the calculation of "points and fees." Licensees will need to update their high-cost loan calculations to ensure that yield spread premiums and other broker compensation are included in determining if a loan is a high-cost home loan. Fees related to bona fide secondary mortgage market transactions are not included.

Section 2

This section adds a definition of "mortgage broker" and "table-funded transaction" to the high-cost home loan section in order to clarify the use of those terms as used in Section 1 above. The term "mortgage broker" is defined by cross-reference to G.S. 53- 243.01(14). The term "table-funded transaction" is defined as a loan transaction closed in the mortgage broker's name with funds advanced by a person other than the mortgage broker and the loan is assigned contemporaneously, or within one business day, to the person that advanced the funds.

Section 3

This section amends the high-cost home loan statute to establish that mortgage brokers who broker high-cost loans are jointly and severally liable with lenders for violations of the High Cost Home Loan statute. Thus, if a mortgage loan violates the high-cost home loan statute, the borrower will be able to hold the mortgage broker liable for violations, to the same extent as if the broker were the lender in the transaction.

Section 4

This section creates new protections and limitations for subprime loans. This section defines subprime loans (called “rate spread home loans”) by reference to the formula used by lenders for reporting higher cost loans for the federal Home Mortgage Disclosure Act (HMDA). This section then describes a series of limitations and protections for this class of loans.

Subsection (a) of Section 4 contains a list of definitions to specify what types of home loans are covered. In particular, subsection (a) defines a “rate spread home loan” as a loan in which the APR exceeds both the existing HMDA rate spread trigger (3% over US Treasuries with a comparable maturity for first liens and 5% over comparable Treasuries for second liens) and a new mortgage-based rate trigger (1.75% over conventional mortgage rate for first liens and 3.75% over conventional mortgage rate for junior liens). The HMDA trigger would be tracked in accordance with existing HMDA rules; the mortgage rate trigger would be tracked based on the Freddie Mac mortgage commitment data published every Friday by the Fed in its Statistical Release H.15. Both limits must be exceeded for the loan to be classified as a “rate spread home loan.” A sample trigger point determination for a rate spread home loan is attached to this memo as Appendix A.

Subsections (b) and (c) of Section 4 identify the limitations on “rate spread home loans”:

- Subsection (b) prohibits prepayment penalties for rate spread home loans.
- Subsection (c) prohibits the making of a rate spread home loan unless the lender reasonably believes that the borrower(s) have the ability to repay the loan and to pay any required real estate taxes and insurance premiums. .The lender must consider all liens in analyzing the capacity to repay, including loans it knows about that are being simultaneously originated by other lenders Subsection (c) contains four subdivisions further defining the responsibility of the lender to determine capacity to repay the loan:
    - Subdivision (1) requires the lender, in analyzing the borrower’s capacity to repay, to take into account “consideration of the obligor's credit history, current and expected income, current obligations, employment status, and other financial resources other than the obligor's equity in the real property that secures repayment of the rate spread home loan.”
    - Subdivision (2) requires that reasonable steps be taken to verify information contained in the loan application. In so doing, the lender may make reference to “tax returns, payroll receipts, bank records, reasonable alternative methods, or reasonable third-party verification.” This provision addresses a belief that “stated income” and other non-verified information on loan applications have contributed to abuses in the subprime mortgage market.

- Subdivision (3) further defines the responsibilities of the lender in determining the borrower's capacity to repay an adjustable rate loan. Foremost among these requirements is the stipulation that the "fully indexed rate" be used in calculating the borrower's capacity to repay.
- Subdivision (4) permits a lender to "utilize reasonable commercially recognized underwriting standards and methodologies, including automated underwriting systems, provided the standards and methodologies comply with the provisions of this section."

Subsection (d) provides that any rate spread home loan that violates subsections (b) or (c) is usurious under North Carolina law and that any prepayment penalty on a rate spread home loan is unenforceable. The provisions of this section are enforceable by the Attorney General and the Commissioner of Banks, in addition to the borrower. Finally, a mortgage broker who brokers a rate spread home loan that violates the provisions of this section shall be jointly and severally liable with the lender.

Subsection (e) provides that lenders may not subdivide loans or otherwise create subterfuges in order to avoid compliance. Subsection (f) grants to lenders a right to cure loans in two sets of circumstances, similar to the cure provisions in the High Cost Home Loan statute. Subsection (g) provides that the various sections of the Rate Spread Home Loan statute are severable and a court's determination that one section is invalid or unenforceable will not affect any other section.

Section 5

This section amends G.S. 24-10.2, dealing with consumer protections in certain home loans, the portion of the 1999 anti-predatory lending law that prohibits practices such as flipping and financing single premium credit insurance. Section 5 of H-1817 stipulates that a "mortgage broker who brokers a consumer home loan that violates the provisions of this section shall be jointly and severally liable with the lender."

Section 6

This section amends G.S. 53-243.04 to authorize the Commissioner of Banks to implement and interpret the provisions of G.S. 24-1.1E, 24-1.1F and 24-10.2 as they apply to licensees under the Mortgage Lending Act (MLA).

Section 7

Section 7 amends the MLA to add six new duties of mortgage brokers and modifies one existing duty. Section 7 modifies the duty to make reasonable efforts to secure a loan reasonably advantageous to the borrower by removing language that limits this duty to the lenders with whom the broker regularly does business. This change clarifies that a mortgage broker's duties extend beyond simply connecting a borrower with a lender that will make a loan.

The six new statutory duties of a mortgage broker are:

- To timely and clearly disclose to the borrower material information as specified by the Commissioner that may be expected to influence the borrower's decision and is reasonably accessible to the mortgage broker, including the total compensation the mortgage broker expects to receive from any and all sources in connection with each loan option presented to the borrower.
- To notify before closing each lender of the particulars of each of the other lender's loans if the mortgage broker knows that more than one mortgage loan will be made by different lenders contemporaneously to a borrower secured by the same real property.
- To ensure that any services offered to any applicant shall be available and offered to all similarly situated applicants on an equal basis.
- In transactions where the broker has the ability to make credit decisions, to use reasonable means to provide borrower with prompt credit decisions on its loan applications and, where the credit is denied, to comply fully with the notification requirements of applicable state and federal law.
- To ensure that its advertising materials are designed to make customers and potential customers aware that mortgage brokers may not discriminate on any prohibited basis.
- To provide applicants to whom credit has been denied opportunities to correct or explain adverse or inadequate information, or to provide additional information.

Section 8

This Section amends the MLA to add three new prohibited activities and modifies the provision on appraisal influence. This section removes the requirement that appraisal influence be the result of "coercion, extortion, or bribery," and replaces that with a more general prohibition against attempting to "improperly influence" an appraiser.

The three new prohibited activities are:

- brokering a subprime ARM without disclosing to the borrower the availability of a fixed rate loan offered by the same lender at the lowest APR for which the borrower qualifies;
- failing to comply with any applicable law or regulation related to mortgage lending; and

- engaging in unfair, misleading or deceptive advertising related to the solicitation for a mortgage loan.

Section 9

This section amends the MLA to authorize the Commissioner of Banks to prohibit, by order, acts and practices of licensees he finds to be unfair, deceptive, or designed to evade North Carolina statutes or that are not in the best interests of the borrowing public.

Appendix A: A Sample Trigger Point Determination of Rate Spread Home Loan

To determine if a loan is a rate spread loan the lender or broker will need to keep abreast of the market rates being offered. Therefore, it is suggested that one should check the published rates and then determine if the rate being quoted exceeds the base rate.

To be deemed a rate spread loan, a loan must meet or exceed two triggers:
Trigger 1. HMDA Rate Spread Trigger; _*and*_
Trigger 2. Conventional Mortgage Rate Trigger.

<u>HYPOTHETICAL</u>: Assume a loan application for a first mortgage loan is taken on the 15th of September, 2007 and is for a 30-year loan.

Step 1. HMDA Rate Spread Trigger:

To determine the first trigger, the APR on the loan must be equal to or greater than 3% over U.S. Treasuries with comparable periods of maturity for first liens and 5% over comparable Treasuries for second liens as of the 15th day of the month prior to the application.

Go to http://www.federalreserve.gov/releases/h15/data.htm, and look at the "Business Day" index for 30-year "Treasury constant maturities." Look to the 15th day of the month prior to the application of the loan, in this case August. On August 15, 2007, the applicable rate was 5.00%. By adding 3.00% for first mortgages, one determines the HMDA Rate Spread Trigger to be 8.00%.

Step 2. Conventional Mortgage Rate Trigger

To determine the second trigger, the APR on the loan must be equal to or greater than 1.75% over the "conventional mortgage rate" for first liens and 3.75% over "conventional mortgage rate" for junior liens. For comparison purposes, one must examine the most recent "conventional mortgage rate" for the week preceding the week in which the rate on the loan is set. (The conventional mortgage rate is:

Contract interest rates on commitments for fixed-rate first mortgages. Source: FHLMC) Presuming for the sake of the hypothetical that the borrower's rate is set on September 21, 2007, go to http://www.federalreserve.gov/releases/h15/data.htm, and look at the "Weekly (Thursday)" index for "Conventional mortgages." Conventional mortgage contract rates for the prior week (09/13/2007) were 6.31%. By adding 1.75%, one determines the Conventional Mortgage Rate Trigger to be 8.06%

Step 3. Analysis

Thus, any loan with an APR equal to or exceeding 8.06% will be deemed a rate spread loan. **NOTE**: This is an APR determination, so if the note rate is something slightly less than 8.06%, AND the loan requires PMI or VA funding or FHA insurance, it is very likely that the APR will exceed the trigger and will be a rate spread loan. If so, one must reduce the rate or comply with the requirements applicable to a rate spread loan. Charging the borrower discount points to buy the note rate down may reduce the note rate, but will likely have little effect on the APR so that is not a recommended solution to this issue. Additionally, resetting the rate may be problematic if the trigger rate has been reduced in the interim, so the conventional mortgage rate would need to be rechecked based on the reset rate and the date that occurred.