



State of North Carolina
OFFICE OF THE COMMISSIONER OF BANKS

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GOVERNOR

September 4, 2008

JOSEPH A. SMITH, JR.
COMMISSIONER OF BANKS

TO: All Mortgage Lenders and Mortgage Brokers

FROM: North Carolina Commissioner of Banks Office

RE: **S.L. 2008-228**-Servicer Licensure and MLA Changes,
S.L. 2008-226 - Foreclosure Prevention,
S.L. 2008-227 – Servicing Fee Disclosure, High-cost loans, and Certain
compensation limitations related to Rate-Spread Loans,
NC Admin. Codes Changes.

The legislature in its 2008 session enacted three laws affecting mortgage servicing, foreclosures, North Carolina’s “high-cost loan” statute, and the Mortgage Lending Act generally. In addition changes proposed by the NC Commissioner of Banks (NCCOB) to the North Carolina Administrative Code became effective immediately upon completion of the 2008 General Assembly session.

Highlights of Significant Changes:

- Yield-spread premiums for subprime loans (“rate spread” loans) will not be permitted after September 30, 2008;
- Requires companies that service mortgage loans to obtain a license, as of January 1, 2009. Licensed mortgage bankers will need to file notice to NCCOB if they service loans. Servicers will have to adhere to certain standards and are prohibited from various practices;
- Clarifies that principal and branch offices cannot be located in personal residences;
- Clarifies that loan officers must be paid as W-2 employees;
- Requires loan officers to receive 24 hours of pre-licensure education and to have credit score of at least 600 to obtain a license;
- Requires mortgage brokers to maintain a net worth of \$25,000 and at least \$10,000 in liquid assets (cash) at all times;
- Requires mortgage bankers to maintain a net worth of \$100,000;
- Provides for licensees to reimburse NCCOB for examination expenses;

- Creates new State Home Foreclosure Prevention Project to assist homeowners facing foreclosure on subprime loans to communicate with mortgage servicers to find alternatives to foreclosure; and
- Requires mortgage bankers and brokers to file quarterly reports on origination activity and notification of repurchase requests. As of the date of this memo, the form for the quarterly reports has not been developed.

What follows is a summary of the three enacted laws, as well as the administrative changes are set out below and references are to the Section numbers of the Bill. This summary is to assist those affected by the Bill, but should only be read in conjunction with the language of the Bill not as a substitute for it. The full text of these laws and regulations related to the Mortgage Lending Act are available on our website at: www.nccob.org.

Summary of 2008 Laws Related to Mortgage Lending

I. Regulation of Mortgage Servicing, S.L. 2008-228 (HB 2463)

Section 1.

Revises definition of loan officer to include solicitation of loan, negotiation of loan, issuance of loan commitment or interest rate lock, whether done by telephone, electronically, mail, or in person.

Defines servicers of mortgage loans to be those persons, who for compensation or gain or for their own account service mortgage loans.

Clarifies that branch offices must be “commercial” space in that homes will not be eligible to be licensed as a principal or branch office.

Clarifies that loan officers must be W-2 employees.

Clarifies that a person who “owns” 10%, or more, of a company is deemed to be a “controlling person” of a company.

Redefines “managing principal” to be “qualifying individual” to be in conformity with Nationwide Mortgage Licensing System (NMLS) terminology.

Clarifies that a seller of real estate who receives, as part of the purchase price, a note secured by a deed of trust and sells no more than five pieces of property with seller financing per year is exempt from licensure.

Provides that licensed mortgage bankers, who also service loans, are not required to apply separately for or obtain an additional license to service those loans held for its own account or serviced for others. Such person would be required to advise this office that it was engaged in the loan servicing business, and would be subject to the MLA’s provisions regarding servicing.

Section 2.

Adds mortgage servicer category to licensing requirement qualifications under G.S. 53-243.02.

Further revises this section to clarify that MLA applies to any individual who seeks to avoid its application by subterfuge; and substituting “qualifying individual” for “managing principal” to be in conformity with NMLS terminology.

Section 3.

Revises application’s misdemeanor disclosure requirements to require disclosure of convictions within ten years to include those involving fraud, false statements or omissions, theft, wrongful taking, bribery, perjury, forgery, counterfeiting, extortion, or conspiracy to commit any of foregoing or involving any financial services or related business.

Section 4.

Changes dates of license renewal and education requirements to conform to NMLS dates. Renewals are required to be completed between November 1 and December 31 annually. Changes the individual late renewal/reinstatement fee to \$100 from \$50, payable for renewal if renewal is completed on or after January 1 and before the last day of February in any year.

Section 5.

Substitutes “qualifying individual” for “managing principal” to be in conformity with NMLS terminology. All licensees must submit through the NMLS an additional “qualifying individual” if they engage in mortgage loan servicing activities.

Section 6.

Clarifies that a home may not be licensed as a place of business under the MLA and that licenses are to be displayed in plain view to the public in the place of business.

Section 7.

Specifies the duties a loan servicer owes to a borrower whose loan it is servicing, as well as some of the information it must provide to the Commissioner regarding its servicing business activities. As of the date of this memo, the form for the supplemental filing with the Commissioner regarding fees and costs for servicing has not been developed. Additionally, it specifies certain information the servicer must provide to a borrower when it accepts servicing and lists additional information that must be provided in the event the servicer commences a foreclosure proceeding.

Section 8.

Expands the list of prohibited activities with the focus on the proper servicing of loans, including among others the prohibition of failing to: credit promptly payments received, provide notice of lapse prior to force placing insurance, refund premiums charged erroneously for force placed insurance, reinstate promptly upon tender of all past due amounts to bring loan current, provide timely and sufficient notice sent at least 45 days prior to foreclosure, maintain and properly account for escrow funds for taxes, insurance, etc.

Section 9.

Adds servicers to those over whom the Commissioner has disciplinary authority and permits the Commissioner to suspend licenses of those licensees who fail to respond timely to a complaint filed with the Commissioner's office regarding alleged violations of the MLA.

Permits Commissioner to suspend foreclosure process for 60 days if there is evidence of a violation of the law that occurred during origination or servicing of the loan which would defeat the right to foreclose. The servicer shall have an opportunity to cure the violation or provide information rebutting the evidence. If the violation is cured or the Commissioner is satisfied that no violation occurred, then the Commissioner shall notify the clerk the foreclosure may proceed.

Should a servicer licensee fail to respond timely (20 days) to inquiries from the Commissioner regarding a violation of law or notices regarding examination or investigations then the Commissioner may take action against the licensee, including suspension of license.

The expenses of routine examinations shall be borne by the licensee.

Section 10.

Mandates a separate escrow account be established and records be maintained to segregate any funds held by a licensee for the benefit of a customer(s) separate from the licensee's general operational business funds.

Section 11.

Reduces unlicensed activity from a felony offense to Class 3 misdemeanor.

Section 12.

Requires all persons engaged in the mortgage servicing business covered by the MLA, specifically including those claiming exempt status by virtue of being a servicer of loans, to file, on or before the effective date of October 1, 2008, certain identifying and contact information with the Commissioner.

Sections 13 to 17.

Substitutes "qualifying individual" for "managing principal" to be in conformity with NMLS terminology and makes other conforming technical amendments. Adds mortgage servicer under the Commissioner's authority under the MLA.

Section 18.

Amends Chapter 45 to reference Chapter 53 to ensure that a person conducting a foreclosure proceeding is aware that the proceedings are suspended upon notice by the Commissioner and provides for resumption of proceedings upon completion of the 60-day suspension period.

Section 19.

Adds to the requirements under Article 10, Chapter 45 that mortgage servicers comply with the prohibited activities provisions of Chapter 53.

Section 20.

Amends Chapter 45 to ensure Clerks of Superior Courts comply with the Commissioner of Bank's suspension of a foreclosure, if applicable.

Section 21.

Specifies the effective dates of various sections of the Bill which did not have an effective date set out in the section heading.

II. Emergency Foreclosure Program S.L. 2008-226**Section 1**

Adds Article 11 to Chapter 45 of the General Statutes and requires a loan servicer who is commencing a foreclosure action on a subprime mortgage loan to send a written notice 45 days prior to the filing of a foreclosure to inform the borrower among other things of the availability of resources to avoid foreclosure. Notice must also be filed in electronic format with the NCCOB and the Administrative Office of the Courts (AOC). These filings will not be accepted if the servicer has not obtained, or filed a complete accepted application for a servicer or lender license from the OCOB through the NMLS or registered as an exempt entity.

Subprime loans are defined as those loans originated on or after January 1, 2005 but before December 31, 2007 which would have met the definition of a rate spread loan under the provisions of G.S. 24-1.1F(a)(7) if it had been in effect at the time the loan was originated. A chart will be available by September 1, 2008 on the NCCOB website to assist servicers in determining if a loan meets that definition. See www.nccob.org.

NCCOB is authorized under the Act to establish a State Foreclosure Prevention Project in order to "seek solutions to avoid foreclosure for certain subprime loan" primarily through connecting borrowers with housing counselors and review of compliance with mortgage lending laws. Should the Commissioner reasonably believe that there is a prospect a subprime foreclosure could be avoided by further efforts, the Commissioner may delay the filing of foreclosure for up to an additional 30 days, with notice to the borrower, servicer, and AOC.

Sections 2 and 3

Amend the procedures controlling Power of Sale foreclosures, under G.S. §45-21.16 to require compliance with new Article 11 added to Chapter 45 by Section 1. Under the legislation, the Act expires on October 31, 2010.

Section 4

Provides for funding from NCCOB to support housing counseling services and to implement the Foreclosure Prevention Program.

Section 5

Requires NCCOB to report on the Program to the General Assembly by May 1, 2009.

Section 6

Establishes November 1, 2008 as the effective date of the Act, except for Section 4 which became effective July 1, 2008. The Act expires on October 31, 2010.

III. Earlier Notification of Mortgage Servicer Fee S.L. 2008-227

Section 1

Clarifies the duties of servicers under G.S. 45-91 regarding disclosure of fees to borrowers.

Section 2

Modifies the high-cost loan “threshold” under 24-1.1E(a)(6). Specifically, the fee threshold calculation now includes “total points and fees *as defined in G.S. 24-1.1E(a)(5)*” to determine if the points and fees are more than 5% of the total loan amount.

Section 3

Amends the list of prohibited activities to limit certain compensation in connection with “rate-spread home loans.” The Act prohibits compensation provided by the lender or received by the broker which is based upon changes in the terms of the loan, other than compensation based upon the principal balance of the loan. It is our belief that this eliminates yield-spread premiums on “rate-spread loans.”

“Rate-spread loans” are defined under the previously enacted G.S. 24-1.1F. In addition to other requirements regarding the borrower, nature of the loan, and purpose of the debt, the essential element for the definition is whether the loans “Annual Percentage Rate” or APR is equal to or greater than both of two trigger rates. The first trigger rate is the yield¹ on a U.S. treasury security of comparable term plus 3 percentage points for a first lien or 5 percentage points for subordinate liens. The second trigger rate is the “conventional market rate” for fixed rate mortgages² plus 1.75 percentage points for first liens or 3.75 percentage points for subordinate liens.

e.g. Assume an application for a 30-year mortgage was taken the the week of October 3, 2008, after the new statutory provisions go into effect, and that it meets all other requirements for “rate-spread loans” under G.S. 24-1.1F. Also assume that the yield on a 30-year treasury on the September 15, 2008 was 4.5%. Finally, assume that the loan is priced on October 30, 2008 that the conventional market rate on October 23, 2008 was 6.5%³.

¹ Using the yield published in the Federal Reserve’s Historical Statistical Release H. 15 on the fifteenth of the month prior to the month in which the application is taken

² Using the last daily rate published in the Federal Reserve’s Historical Statistical Release H. 15 for the week prior to which the credit decision is made.

³ Licensees should refer to the Federal Reserves Historical Statistical Release H.15 for the actual rates - <http://www.federalreserve.gov/releases/h15/data.htm>

The two trigger rates to determine if the loan is a “rate-spread loan” are 7.5%, using the U.S. treasury, and 8.25% using the “conventional market rate.”

If the APR is lower than *either* trigger rate, it is not a “rate-spread-loan.” Therefore, assuming all of the above, in order to be subject to all restrictions regarding “rate-spread loans” the annual percentage rate for the loan would have to be equal or greater than 8.25%.

Given that at the present time, the origination activity involving loan terms that generate APRs as high as this amount are limited, it is our expectation the prohibition of “yield-spread” premiums will have negligible effect on the market as a whole and the availability of credit.

IV. ADMINISTRATIVE RULE CHANGES

The Banking Commission adopted changes to the Administrative Code as it relates to the MLA. Those rule changes have varying effective dates with the last effective date being July 18, 2008. Although the rule changes are currently effective, it will be several days before the Mortgage Licensing Division implements and begins enforcing those rules.

04 NCAC 03M .0101 Definitions

Revises and adds certain definitions which are necessary in the rules which were amended or added.

04 NCAC 03M.0205 Financial Responsibility

Clarifies factors considered to be deemed to be financially responsible by adding:

- A) the requirement that a mortgage banker/lender must:
 - (i) have a net worth, as shown on an audited statement of financial condition, of \$100,000 and
 - (ii) demonstrate liquidity by showing a line of credit or other funds available of a least \$1,000,000.

- B) the requirement that a mortgage broker must:
 - (i) provide a statement of financial condition, certified by the managing principal or other authorized person, that the company has a net worth of \$25,000 and
 - (ii) demonstrate liquidity in the amount of \$10,000 by having bank statements or other documents showing liquid funds available with which to operate the business.

- C) the requirement that a loan officer must:
 - (i) produce a credit report with a Beacon score of 600 or greater, and
 - (ii) demonstrate a history of satisfying debt obligations in a timely manner as indicated by an absence of outstanding judgments or tax liens within the last seven (7) years.

04 NCAC 03M .0301 Approval of providers and programs

Requires that the loan officer fundamentals course be an instruction program of twenty-four (24) hours dealing with certain basic mortgage lending information including ethical considerations.

04 NCAC 03M .0401 Annual reporting requirements

Clarifies certain annual reporting requirements regarding a licensee's business in North Carolina must be reported on a calendar year basis and clarifies that financial statements of condition are to be reported on a fiscal year of the company basis.

(In the calendar year report, information will be the same and in the same format as that required by the Nationwide Mortgage Licensing System to include characteristics of loan applications taken and closed, as well as other information regarding the terms and features thereof and performance or payment history as it may relate to defaults or foreclosures.)

Provides that on a quarterly basis within forty-five (45) days of the close of each calendar quarter, licensees shall provide information in an electronic format regarding the characteristics of closed loans.

Provides licensees (mortgage lenders, brokers or loan officers) shall report within thirty (30) days of receipt, any request to repurchase any loan made or brokered by it based on an alleged misstatement made in such loan.

The updated statutes and rules may be accessed through our website at www.nccob.org place cursor on Mortgage and click on Legal Compliance References on the popup menu to access the full text of these changes.