

Authors:

Kristie D. Kully

+1.202.778.9301

kris.kully@klgates.com

Kerri M. Smith

+1.202.778.9445

kerri.smith@klgates.com

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Minding the Gap - Servicers Subject to Regulatory Scrutiny

The downturn of the housing market has caused a flurry of state legislative activity, prompting policymakers to adopt measures that attempt to preserve homeownership by protecting homeowners in foreclosure actions or bankruptcies. Those measures have included extending the timelines for foreclosure, adopting new disclosure requirements for default notices, and establishing toll-free numbers for borrowers to seek advice regarding their mortgage problems. In focusing on troubled borrowers, many states have discovered gaps in their regulators' authority to police loan servicing activities. As a result, a number of state policymakers are taking regulatory aim at loan servicers: to assert authority over current loss mitigation efforts and to establish guidelines for future servicing conduct.

Introduction

Approximately 35 states require licensing of entities that service first- or subordinate-lien residential mortgage loans in their own portfolios or for others for a fee. In addition, approximately 11 states require licensing of entities that merely hold the servicing rights of mortgage loans, but do not conduct the servicing activities associated with those loans. For those states that currently impose a licensing obligation on loan servicers, the recent trend is to strengthen regulatory supervision by dictating more pervasive practice requirements. For instance, many states are implementing servicer reporting obligations to act as early warning systems regarding borrowers with adjustable rate mortgages scheduled to reset to help them assess options and avoid foreclosure. For those states lacking a mortgage servicer licensing regime, the obvious trend is to implement one. This supervision will enable regulators to determine whether servicing activities are pushing borrowers into default, or are working to keep borrowers in their homes to the extent possible. Further, by allowing state regulators to scrutinize a servicer's loss mitigation efforts, state laws are expressly or impliedly authorizing regulators to directly interject themselves in the foreclosure process.

North Carolina, New York, Illinois, and Maryland among others,¹ have been quick to act, while other states, such as California and New Jersey, have legislation pending. Another notable licensing change for servicers is an amendment to the New Hampshire Regulation of Mortgage Loan Servicers Act that will impose a registration obligation for servicers of second-lien mortgage loans in addition to first-lien mortgage loans, effective January 1, 2009. Other states, such as Alabama² and South Carolina,³ previously had pending bills in their state legislatures that would extend a licensing obligation on loan servicers, but those bills were not enacted.

In addition to state supervision, federal eyes will begin watching loan servicers. The Federal Reserve Board ("FRB") recently finalized new rules under the Truth in Lending Act that prohibit certain practices of servicers of closed-end consumer credit transactions secured by a consumer's principal dwelling. Under those rules, generally effective October 1, 2009, no servicer may: (1) fail to credit a consumer's periodic payment as of the date received; (2) impose a late fee or delinquency charge where the late fee or delinquency

charge is due only to a consumer's failure to include in a current payment a late fee or delinquency charge imposed on earlier payments; or (3) fail to provide an accurate payoff statement within a reasonable time of request.

This alert will discuss recently enacted or pending state legislation, as well as regulatory action, that imposes new reporting, licensing, and practice obligations on mortgage loan servicers. First, the alert addresses the newly enacted North Carolina legislation, which imposes a licensing obligation on mortgage loan servicers, and a host of new practice restrictions. Next, the alert discusses the newly enacted New York legislation, which imposes a registration requirement on mortgage servicers, and authorizes the New York banking regulators to regulate servicing practices without an explicit legislative framework of prohibited practices. Further, we discuss the Maryland and Illinois regulators' requirements on licensed loan servicers to report loan data and loss mitigation efforts. Lastly, we discuss the pending or introduced state bills that impose a registration requirement on loan servicers, or additional reporting obligations on licensed loan servicers. In efforts to forestall foreclosures, state attention has turned to loan servicers, which are perceived as the last hope for loss mitigation activities and preventing avoidable foreclosures.

North Carolina

A. Overview

North Carolina is at the forefront of the movement to oversee the loan servicing industry. In 2007, the North Carolina legislature passed House Bill 1374 to respond to consumer advocates' claims that homeowners were being harmed on numerous levels, such as by recent North Carolina court decisions that procedurally barred certain borrowers from bringing claims of abusive lending, an unfair foreclosure process, and abusive loan servicing (specifically, the misapplication of payments, the improper charging of fees, and the refusal to provide homeowners with accurate information about the loan that shows why the loan is considered in default).⁴ In House Bill 1374, the state overturned two North Carolina Supreme Court decisions that made it harder for homeowners to sue for illegal lending practices, thereby expanding the ability of North Carolina borrowers to bring civil claims

against both out-of-state assignees and servicers of mortgage loans.⁵ Further, it established the Mortgage Debt Collection and Servicing Act (the "Collection and Servicing Act") to expressly require loan servicers to notify homeowners of any fees charged in connection with a loan and to provide a full accounting of how they handle payments and assess fees. Although many states restrict the loan servicer from charging certain fees, not many regulate the timing and assessment of fees, the processing of payments, or the servicer's responses to a borrower's request for information to the extent found in the Collection and Servicing Act. So with the passage of House Bill 1374 in 2007, North Carolina lawmakers showed their desire to be leaders in the charge to regulate the loan servicing industry.

Apparently, prescribing a list of new practice restrictions on loan servicers was not enough for the North Carolina legislature. On July 8, 2008, legislators passed House Bill 2463, the "Regulate Mortgage Servicers Bill," which subjects mortgage servicers to substantial additional regulatory supervision, including imposing a licensing requirement, express duties on servicers, and prohibitions on an array of mortgage servicing activities. The bill also authorizes the Commissioner of Banking ("COB") to suspend foreclosures when there is evidence that a material violation of law has occurred in the origination or servicing of a loan. The Regulate Mortgage Servicers Bill, which amends the Mortgage Lending Act, is generally effective on January 1, 2009, but all exempt entities who are engaged in the mortgage-servicing business on October 1, 2008 must file a form with the North Carolina regulators on or before that date. Governor Easley signed the Regulate Mortgage Servicers Bill, along with the Emergency Foreclosure Reduction Program Bill, H.R. 2623 (to be discussed in a future alert), on August 18, 2008.

We describe below North Carolina's new licensing requirements under the Regulate Mortgage Servicers Bill and the COB's subsequent enforcement authority over loan servicers. We also discuss mortgage servicers' new duties under the amended Mortgage Lending Act, including reporting obligations, the express practice restrictions of the amended Act, as well as the restrictions in the Collection and Servicing Act, and the remedies available for violations of these restrictions.

B. Licensing Requirements and Enforcement Authority

Under the recently enacted Regulate Mortgage Servicers Bill, which amends the North Carolina Mortgage Lending Act, a “mortgage servicer,” defined as an entity that directly or indirectly “acts as a mortgage servicer”⁶ or who meets the definition of “servicer” under the Real Estate Settlement Procedures Act (“RESPA”),⁷ must obtain a license from the COB, unless otherwise exempt.⁸ The definition to “act as a mortgage servicer” is notable in that it applies both to third party servicing and the servicing of one’s own debt, unless otherwise exempt. Further, since the definition of mortgage servicer includes an entity that indirectly engages in servicing activities, it is unclear whether an entity merely holding the servicing rights of mortgage loans without directly engaging in the collection of payments would be required to obtain a license. The licensing obligations are not limited to servicing performing loans, therefore strengthening the conclusion that a mortgage loan servicer is subject to the restrictions of the Mortgage Lending Act, whether it is servicing performing or defaulted mortgage loans, and not subject to the purview of the Collection Agency Act.

The Mortgage Lending Act, as amended, requires that loan servicer licensees post a surety bond of \$150,000,⁹ and it imposes certain educational, background, and fee requirements.¹⁰ A licensed mortgage banker and its employees do not need to obtain a separate license as a mortgage servicer, but are still subject to the loan servicing practice requirements of the Mortgage Lending Act. Similarly, all exempt loan servicers, other than a bank, savings institution, credit union, or a wholly owned subsidiary of those entities, are subject to these practice restrictions. A bank, savings institution, credit union, and their wholly owned subsidiaries are subject only to the Act’s amended “prohibited activities” provisions.

The COB will continue to have enforcement authority under the Mortgage Lending Act, which for servicers will now include the ability to: (1) examine and investigate servicers for compliance; (2) suspend, revoke, or refuse to renew a license due to a violation of the Mortgage Lending Act; (3) issue orders to compel compliance; (4) issue fines of up to \$10,000 per offense; and (5) take action if a licensee fails to respond within 20 days to the COB’s inquiries regarding complaints filed against the licensee that allege violations of the

Mortgage Lending Act. Further, the COB has authority to impose civil penalties of up to \$10,000 for violations of the Mortgage Lending Act by entities that are not licensed or exempt.

C. Mortgage Servicer Duties

As amended, the Mortgage Lending Act generally imposes a duty to act with “reasonable skill, care, and diligence,” and specifically imposes a duty to act in good faith to inform the borrower of the facts concerning the loan and the nature and extent of the delinquency or default. The Mortgage Lending Act also imposes an affirmative duty to negotiate and attempt to resolve a delinquency or act of default, although this duty is subject to a servicer’s responsibilities and obligations under the mortgage servicing contract. As loan servicers have not traditionally been subject to fiduciary-type duties vis-à-vis borrowers, these would certainly expose servicers to new varieties of litigation. Generally, the decision as to whether to foreclose on a delinquent loan or to modify it is a matter involving private contract rights between the borrower, lender, investor and servicer, and lawmakers have little if any legal authority to order the participants to modify a loan. Although state and federal banking regulators have “encouraged” institutions that they regulate to consider modifications rather than foreclosure, the Constitution sharply limits states’ abilities to enact laws that retroactively modify existing contracts between private parties.¹¹

In addition, the Mortgage Lending Act imposes duties upon servicers in connection with handling of escrow funds, and requires that at the time a servicer accepts assignment of servicing rights for a mortgage loan, it must provide a borrower (among other disclosures) a schedule of fees and charges (and must also file that schedule with the COB).¹² Interestingly, the FRB recently considered imposing a similar requirement on all servicers, but found that the transparency benefit of providing a fee schedule is limited, as the disclosure may become out of date, many third-party fees are impractical to specify, and the fee schedules may be dozens of pages long rendering them meaningless to a borrower. The FRB ultimately concluded that the limited benefit did not sufficiently offset the burdens of producing a fee schedule. However, North Carolina lawmakers obviously weighed the costs and benefits differently.

D. Reporting Obligations

At the COB's request, a licensed servicer will be required under the Mortgage Lending Act, as amended, to detail its servicing activities in North Carolina, including: (1) the number of mortgage loans it is servicing; (2) the type and characteristics of the serviced loans in North Carolina; (3) the number of serviced loans in default, along with a breakdown of 30-, 60-, and 90-day delinquencies; (4) information on loss mitigation activities, including details on workout arrangements undertaken; and (5) information on foreclosures commenced in North Carolina. The Mortgage Lending Act does not specify the timing for these reports, but rather allows the COB flexibility in determining when they are necessary.

E. Prohibited Activities

The amended Mortgage Lending Act lists new prohibited activities, including many in connection with mortgage servicing activities, addressing force-placement of insurance,¹³ payments of moneys into escrow account,¹⁴ and pre-foreclosure notification. The prohibitions apply to all types of entities engaged in mortgage servicing, including banks, savings associations, and credit unions. The Mortgage Lending Act, as amended, provides a statutory reinstatement right for borrowers,¹⁵ and similar to laws amending the foreclosure process in other jurisdictions, the Mortgage Lending Act imposes a new notice requirement specifically on loan servicers 45 days prior to initiating foreclosure, in addition to those required by holders of mortgages prior to foreclosure.¹⁶

Under the list of prohibited activities, a loan servicer may not charge or collect any fee or rate of interest, or service any mortgage loans where the terms of the loan or the practice of servicing the loan violate Chapter 24 (Interest), Chapter 45 (Mortgages and Deeds of Trust) or Chapter 54 (Cooperative Organizations) of North Carolina law.¹⁷ A loan servicer must also comply with requirements under RESPA regarding mortgage loan servicing transfers, escrow account administration, or borrower inquiry responses, as well as with the requirements of the Collection and Servicing Act.

F. Collection and Servicing Act

As mentioned above, the North Carolina legislature enacted the Collection and Servicing Act (effective April 1, 2008), which requires full accounting of how servicers handle loan payments and assess fees. Significant new provisions in the Collection and

Servicing Act pertain to the assessing of fees, crediting of payments, responding to borrowers' written requests, and handling of escrow funds.

According to the Collection and Servicing Act, all fees a servicer charges must be permitted by law and set forth in the loan contract, must generally be assessed within 45 days of accrual, and explained to the borrower in a statement within 30 days after assessing the fee.¹⁸ If the servicer does not comply with these procedures, it is not entitled to the fee and is subject to liability for the remedies described below. Further, under the Collection and Servicing Act the servicer must credit all payments within one business day, provided that the borrower has made the full contractual payment and provided sufficient information regarding the account to allow for proper crediting. The Act stipulates that if a servicer were to use the scheduled method of accounting, any regularly scheduled payment made prior to the scheduled due date must be credited no later than the due date. In this way, the Act prohibits a servicer from holding a payment that would send a borrower into default. This crediting obligation is similar to FRB's recently finalized rule, which requires same-day crediting, but the FRB allows for delays so long as a late entry does not result in a charge or penalty on the consumer's account. Lastly, the Act requires notification to the borrower within 10 business days by mail if the payment is received and not credited, with the notice explaining why the payment was not credited to the account, and the actions necessary to make the loan current.¹⁹ However, the Act does not expressly state what are permissible reasons not to credit a payment (beyond not receiving a full payment).

Under the Collection and Servicing Act, a borrower has a right to submit a "request for information" and to dispute his or her account, requiring the servicer to respond within 10 business days. Further, the Act provides an additional qualified written request procedure, enabling the borrower to allege error in his or her account and obtain an explanation from the servicer and a copy of the underlying promissory note, which must be provided within 25 days. This timing is shorter than the time allowed under RESPA to comply with the "qualified written request."²⁰ RESPA does not preempt the Collection and Servicing Act, as RESPA preempts only inconsistent state laws, and a state law is not considered inconsistent with any provision of RESPA if it gives greater protection to the consumer.²¹

G. Remedies

In both recent enactments, the North Carolina legislature also amends the remedies available to an injured borrower from a violation of the servicing provisions. First, a violation of the Collection and Servicing Act (which also constitutes a violation of the Mortgage Lending Act, as both acts require cross-compliance) allows for a private right of action against the servicer for actual damages, including reasonable attorneys' fees. The Collection and Servicing Act also allows the COB, the state Attorney General, or any party to a home loan to bring an action against the servicer for a violation of the Act. Interestingly, the Collection and Servicing Act allows for a servicer's right to cure a violation, requiring an injured party to provide the servicer prior notice of his or her intent to bring a civil action, and allowing the servicer the ability to cure the error within 30 days.

Second, the Mortgage Lending Act, as amended, gives the COB authority to issue civil penalties against a servicer for violations of the Act, and to suspend foreclosure proceedings on a mortgage for 60 days if the COB has evidence that a material violation of law has occurred in the origination or servicing of a loan being foreclosed or in the threat of foreclosure. The Mortgage Lending Act also provides the servicer an opportunity to cure the violation or to rebut the evidence of the suspected violation. According to the Mortgage Lending Act, it appears the COB may suspend the foreclosure proceeding when "the putative violation would be sufficient in law or equity to base a claim or affirmative defense which would affect the validity or enforceability of the underlying contract or the right to foreclose." Since the legislature did not create a threshold level of evidence that is necessary prior to the COB suspending foreclosure proceedings, the COB is authorized to directly oversee and interject itself into virtually any foreclosure action filed in the state. Not only will this likely extend the timeline for many foreclosures, it may create a substantial burden on all servicers in North Carolina to rebut claims of wrongdoing by other entities such as mortgage brokers and mortgage lenders in a narrow timeframe. The delay in foreclosures would ultimately increase costs for servicers, causing additional losses to note holders.

New York

Unlike North Carolina law, which provides an extensive list of prohibited practices, New York's new mortgage servicing law gives New York banking regulators broad authority to regulate servicing practices without an explicit legislative framework of prohibited practices. Senate Bill 8143-A was signed by Governor Paterson on August 5, 2008.

The New York law requires an entity engaged in the business of servicing mortgage loans with respect to any property located in New York to register with the New York Department of Banking. Entities exempt from registration (including mortgage bankers and mortgage brokers) will still be subject to a notification requirement. The Senate Bill's servicing-related provisions become effective on July 1, 2009.

The Senate Bill gives the New York banking regulators broad authority to issue rules, regulations, and policies "as may be necessary and appropriate to define improper or fraudulent business practices in connection with the activities of mortgage loan servicers" and to "effectuate the purpose of the [Regulation of Mortgage Loan Servicers] Article." Specifically, the banking regulators are authorized to prescribe regulations that relate to: (a) disclosure of interest rate resets; (b) providing pay off statements; and (c) timely crediting of borrower payments. Further, the banking regulators must promulgate regulations and policies to establish grounds to impose a fine or penalty on mortgage loan servicers. Unlike the North Carolina legislature, which articulated applicable restrictions in almost all facets related to the servicing of loans, the New York legislature provides regulators (and the public) little guidance, except as noted above, as to what type of servicing restrictions are necessary. Similar to North Carolina, the New York law authorizes the banking regulators to examine and investigate mortgage loan servicers to discover violations of New York law, and allows the regulators to impose civil penalties for a violation. In addition, the New York banking regulators may require registered loan servicers to file annual reports, and may subject them to other special reporting duties with respect to mortgage delinquencies and foreclosures.

Illinois

With little prior notice, the Illinois Division of Banking (within its Department of Financial and Professional Regulation) swiftly announced new biannual reporting obligations on loan servicers under the Residential Mortgage License Act, the Illinois Banking Act, the Savings Bank Act, the Illinois Savings and Loan Act, the Consumer Installment Loan Act, and the Illinois Credit Union Act. In addition to asking for statistical information about modifications, similar to other states mentioned below, the reporting form asks servicers to provide narrative descriptions of such things as the “proactive loss mitigation steps” they have taken, “including calls and mailings to borrowers (excluding collection calls, bills, and other collection mailings) and participation at community outreach events, such as Governor Blagojevich’s Homeowner Outreach Days.” The Division of Banking relies on its authority under the statutes above to examine the licensed entities and to require reports as the Division deems necessary.

The Division asserts that the reports are necessary “[i]n order to better enable the State to develop solutions to the mortgage crisis.” The Division is currently requiring two reports – one covering the last half of 2007 and the other covering the first half of 2008 – both of which are due on September 30, 2008. Future reports will be due one month after each biannual period ends.

The report questionnaires require that an officer of the reporting institution certify and attest that the information reported is true and correct to the best of his or her knowledge and belief. A licensee or other entity subject to the reporting obligation that fails to file the report may be subject to disciplinary action. The Division’s announcement and its reporting questionnaires do not indicate what the Division will do with the information in the reports.

Specifically, the servicer must answer the following questions regarding home loans secured by Illinois property:

1. The number and dollar amount of home loans the servicer is servicing (both first- and subordinate-lien, closed- and open-end) broken down by type (fixed vs. adjustable);
2. The number and dollar amount of home loans that the servicer is servicing that are delinquent (30 days past due), broken down by type;
3. The total number and dollar amount of these loans where the servicer has made workout arrangements or loan modifications with borrowers and within those totals, the number and dollar amount by categories of reduced rates, extended loan maturity, grace periods, lower principal amount, or other;
4. A description of the servicer’s loss mitigation process;
5. An explanation of the servicer’s proactive loss mitigation steps;
6. The number of serviced loans restructured; and
7. The number of subordinate-lien loans granted and denied resubordination to a potential first-lien mortgage holder since the last reporting period.

Maryland

Similar to Illinois above, Maryland regulators issued final servicing reporting regulations effective August 25, 2008. These reporting obligations, which are nearly identical to the emergency reporting obligations previously in place, require that licensed servicers under the Maryland Mortgage Lender Law submit information on their servicing portfolios to the Department of Labor, Licensing and Regulation (“DLLR”) on a monthly basis. Like above, the report must include the number of the mortgage loans the licensee is servicing, how many of them are in foreclosure, and how many of them are in default (although Maryland requires that the licensee categorize loans by length of payment deficiency, i.e., 30-, 60-, 90- days late). Further, the licensee must provide information on loss mitigation activities, including the number of workout arrangements entered into, a description of the types of workout arrangements, including loan modifications and the percentage of each type of workout arrangement. Also, like loan servicers in Illinois, the Maryland licensee must describe the proactive steps it has taken to identify borrowers at a heightened risk of default, including contacts with borrowers to assess their ability to repay. The DLLR also requires that the licensee provide information regarding adjustable rate loans and other information the regulator deems necessary. That information, other than a borrower’s personal identifying information, may be made publicly available, although the regulations do not indicate how the DLLR will use this information.

New Jersey

The New Jersey Senate proposed Bill 1419 in March 2008, which would require registration of “servicing organizations.”²² The Bill is pending in the New Jersey legislature, which is in recess until September. Under the Bill, a servicing organization would be required to register with the Department of Banking and Insurance within 30 days of becoming the servicing organization under a mortgage loan agreement. An entity acting as a servicing organization that is already registered with and regulated by the Department under another law would not need to register again, but would be subject to all other new servicing restrictions. As a result of registration, the Department would oversee the loan servicer, which would be required to make any accounts, books, and records concerning its servicing activities available to the regulators for inspection. Unlike the other state actions discussed in this client alert, the New Jersey Bill would not impose reporting duties specific to mortgage delinquencies and foreclosures.

Aside from registration, the Bill would impose certain substantive requirements related to the crediting of payments, responding to consumer complaints, and complying with other state and federal laws concerning loan servicing. For example, the Bill would provide that a servicing organization would be required to post any payment received on the same business day, or if the servicing organization is accepting a payment on behalf of a non-depository institution that it received after business hours, the servicing organization must post the payment on the next business day following the business day of its receipt. Further, the Bill would require that a loan servicer respond to a mortgagor regarding any complaint or inquiry about his or her loan, and initiate any appropriate responsive action, within 10 business days of receipt of the complaint or inquiry. In addition, the Bill would require a servicing organization to comply with any other state and federal law concerning mortgage servicing, including, but not limited to, provisions regarding the recording of mortgage loan instruments, loan satisfaction and discharge, the New Jersey Fair Foreclosure Act, the New Jersey Mortgage Guaranty Insurance Act, RESPA, and the federal Homeowners Protection Act of 1998.

According to the Bill, a servicing organization that violates any of the servicing provisions would be liable for a civil penalty of not more than \$500 for each

offense, and each violation would constitute a separate offense. Further, if the violation is of a continuing nature, each day during which it continues constitutes a separate offense.

California

The California legislators have proposed Bill 69, which would amend the Finance Lenders Law²³ (“FLL”) and the Residential Mortgage Lending Act²⁴ (“RMLA”), authorizing the Department of Financial Institutions to require licensees under those laws to provide reports concerning their residential mortgage loan servicing activities. The Bill would also authorize the Department to seek and accept voluntary information from loan servicers not subject to either the FLL or RMLA. The Department may post the aggregated survey results on its website, noting the number of loan servicers submitting data included in the aggregated totals and the estimated percentage of outstanding mortgage loans to Californians that are serviced by these loan servicers. As of August 18, 2008 the Senate passed this bill and it is currently pending in the Assembly.

Conclusion

The immediacy of the foreclosure crisis overshadowed certain other mortgage-related regulatory concerns. State and federal attention has turned to loan servicers, which directly interact with borrowers and are perceived as the last hope for loss mitigation activities and preventing avoidable foreclosures. As a result, there may be an increase in the number of states that license both mortgage lending and servicing activities, thereby closing the “regulatory gap.” State policymakers want regulatory authority over loan servicers to oversee loss mitigation and other servicing practices, and are gaining this supervisory authority to investigate loan servicing activities by requiring licensing and establishing practice requirements, including reporting obligations. As default rates rise, the regulatory gaze shifts from the heavily scrutinized origination of mortgage loans, to the preservation of those loans, and catches loan servicers in its searchlight.

- 1 Effective August 15, 2008, New Hampshire adopted House Bill 759, which requires each mortgage servicing company registered under its provisions to file an annual report with the banking department.

Effective September 5, 2008, Pennsylvania adopted Senate Bill 486, which amends, among other things, certain notice requirements that arise under the Pennsylvania Housing Finance Agency Law, and requires that a mortgagee or other person sending the notice to the mortgagor must simultaneously send a copy of each notice to the Housing Finance Agency, or provide the Agency within 30 days of the end of each calendar quarter a report listing the notices sent during the prior calendar quarter arranged by property address including zip code.

Pennsylvania House Bill 2179 signed by the governor on July 8, 2008, and effective November 5, 2008, combines the state's first-lien and second-lien licensing laws, and the combined law would no longer require licensing of loan servicers, although servicers were previously required to be licensed under the second-lien licensing law.

- 2 Alabama House Bill 643 would have established the "Alabama Mortgage Act," which would have provided for the licensing of mortgage lenders, mortgage brokers, mortgage servicers, mortgage processors, loan originators, and loan processors by the State Banking Department, and would have prohibited certain acts by licensees.
- 3 South Carolina Senate Bill 1090 passed the house of origin and was pending in the House. The Bill would have enacted a new Mortgage Lending Act to require licensure of mortgage lenders (defined to include servicers) and loan officers. Licensure would be required by January 1, 2009 for mortgage lenders and by July 1, 2009 for loan officers. The Bill would have also amended the Mortgage Broker Act.
- 4 See North Carolina Justice Center, [Helping Protect Homeowners from Foreclosure](http://www.ncjustice.org/assets/library/931_ncpbv4no10apr302007.pdf), available at: www.ncjustice.org/assets/library/931_ncpbv4no10apr302007.pdf.
- 5 House Bill 1374 amended the state's usury provisions, providing that the two-year limitation of actions for usury for the financing of usurious points, fees, or other charges accrue with each payment made and accepted on a loan. This expressly overturns [Shepard v. Ocwen Fed. Bank](#), 361 N.C. 137 (N.C. 2006), in which the Court held that the clock on the two-year statute of limitations started the day the loan was closed. Further, House Bill 1374 expressly overturned another North Carolina Supreme Court case,

[Skinner v. Preferred Credit](#), 638 S.E.2d 203 (N.C. 2006), by amending the long-arm statute to provide that North Carolina courts may exercise personal jurisdiction over out-of-state purchasers of loans secured by real property in North Carolina. These two provisions that overturn the state court decisions became effective upon signing.

- 6 Under the North Carolina Mortgage Lending Act, as amended, to "act as a mortgage servicer" means to engage, whether for compensation or gain from another or on its own behalf, in the business of receiving any scheduled periodic payments from a borrower pursuant to the terms of any mortgage loan, including amounts for escrow accounts, and making the payments of principal and interest and such other payments with respect to the amounts received from the borrower as may be required pursuant to the terms of the mortgage loan, the mortgage servicing loan documents, or servicing contract. N.C. Stat. Ann. § 53-243.01(3), as amended by H.B. 2463.
- 7 "Servicers" under the North Carolina Mortgage Lending Act, as amended, has the same meaning as it does in RESPA. Under RESPA, a "servicer" means the person responsible for the servicing of a mortgage loan (including the person who makes or holds a mortgage loan if such person also services the mortgage loan). The term does not include certain government agencies or government-sponsored enterprises. Under RESPA, the term "servicing" means receiving any scheduled periodic payments from a borrower pursuant to the terms of any loan, including amounts for escrow accounts (for taxes, insurance premiums, or other charges described in 12 U.S.C. § 2609), and making the payments of principal and interest and such other payments with respect to the amounts received from the borrower as may be required pursuant to the terms of the loan. 12 U.S.C. § 2605(i)(2), (3).
- 8 Entities exempt from the Mortgage Lending Act include, in relevant part, any agency of the federal government or any state or municipal government servicing mortgage loans, any North Carolina licensed attorney who in the practice of law or in performing as a trustee, accepts payments related to default, foreclosure, loss mitigation, or litigation or settlement of a dispute or legal claim related to a loan, or an entity engaged in the business of a bank, savings institution, credit union (or a wholly owned subsidiary of those entities) established under the laws of the United States, North Carolina, or any other state. Exempt entities must file a notification with the COB. Unlike the Mortgage Lending Act, the Collection and Servicing Act expressly does not apply to the type of licensed attorneys described above. Since the Mortgage

- Lending Act and the Collection and Servicing Act cross-reference each other and require compliance with both Acts, the value of the attorney exemption under the Collection and Servicing Act is unclear. N.C. Stat. Ann. § 53-243.01(12), as amended by H.B. 2463; see also N.C. Stat. Ann. § 45-85(2).
- 9 An audited financial statement from a qualified servicer (approved by the Department of Housing and Urban Development (“HUD”) to service FHA loans or approved by Fannie Mae or by Freddie Mac) that shows a net worth of \$250,000 or more will be accepted in lieu of the bond requirement. N.C. Stat. Ann. § 53-243.05(f).
 - 10 The licensing and practice restrictions of the North Carolina Mortgage Lending Act, as amended, applies to “mortgage loans,” which means those loans made to a natural person primarily for personal, family, or household use, secured by a mortgage or deed of trust on residential real property in North Carolina. N.C. Stat. Ann. § 53-243.01(19). Under the Mortgage Lending Act, certain entities are exempt from the Act’s licensing obligations, but all mortgage loan servicers are subject to the Act’s listed “prohibited activities.” The Collection and Servicing Act, while similarly applying to “servicers” as defined under RESPA, more broadly applies to “home loans,” defined as loans secured by real property in North Carolina used or intended to be used as a dwelling, regardless of whether the proceeds of the loan are for personal, family or business purposes. See id.; see also id. § 45-85(1).
 - 11 See generally, Laurence E. Platt, Nanci L. Weissgold, and David L. Beam, Hurricane Subprime: Will Congress Provide Disaster Relief from Home Foreclosure?, BNA’s Banking Report, April 2, 2007.
 - 12 According to the North Carolina Mortgage Lending Act, a loan servicer must disclose to the borrower: (1) any notice required by RESPA; (2) a schedule of the ranges and categories of its costs and fees for its servicing-related activities, which must comply with North Carolina law and must not exceed those reported to the COB; (3) a notice that the servicer is licensed by the COB and that complaints about the servicer may be submitted to the COB; (4) any notice required by provisions regulating foreclosures, satisfaction of mortgages, or the Collection and Servicing Act. N.C. Stat. Ann. § 53-243.10(a)(6).
 - 13 With regard to the force-placement of insurance, under the new provisions of the North Carolina Mortgage Lending Act, a loan servicer must provide written notice to a borrower upon taking action to place insurance on the mortgaged property or to place that insurance when the person acting as a mortgage servicer knows or has reason to know that such insurance is in effect. A servicer may not place insurance on a mortgaged property for an amount that exceeds either the value of the insurable improvements or the last known coverage amount of insurance. Lastly, a servicer must provide to the borrower a refund of unearned premiums paid or charged to the borrower for insurance the lender placed if the borrower provides reasonable proof that the borrower has obtained coverage such that the forced-placement is no longer necessary and the property is insured. If the borrower provides reasonable proof within 12 months of the placement that no lapse in coverage occurred, the servicer must refund the entire premium. N.C. Stat. Ann. § 53-243.11(17-19).
 - 14 The Mortgage Lending Act also prohibits a loan servicer from failing to make all payments from any escrow account held for the borrower for insurance, taxes, and other charges with respect to the property in a timely manner so as to ensure that no late penalties are assessed or other negative consequences result regardless of whether the loan is delinquent unless there are not sufficient funds in the account to cover the payments, and the servicer has a reasonable basis to believe that recovery of the funds will not be possible. N.C. Stat. Ann. § 53-243.11(22). The Collection and Servicing Act contains an identical restriction.
 - 15 The Mortgage Lending Act prohibits a loan servicer from refusing to reinstate a delinquent loan upon a tender of payment made timely under the contract that is sufficient in amount, based upon the last written statement received by borrower, to pay all past due amounts, outstanding or overdue charges, and restore the loan to a non-delinquent status. The reinstatement right is only available to a borrower twice in any 24-month period. N.C. Stat. Ann. § 53-243.11(20).
 - 16 The Mortgage Lending Act provides that a loan servicer must mail, at least 45 days before foreclosure is initiated, a notice addressed to the borrower at his or her last known address with the following information: (1) an itemization of all past due amounts causing the loan to be in default and any other charges that must be paid in order to bring the loan current; (2) a statement that the borrower may have options available other than foreclosure, and that he or she may discuss those options with the mortgage lender, the servicer, or a HUD-approved counselor; (3) the contact information for the entity authorized to attempt to work with the borrower to avoid foreclosure; (4) the contact information for one or more HUD-approved counseling agencies operating to assist borrowers in

- North Carolina to avoid foreclosure; and (5) the contact information for the consumer complaint section of the Office of the COB. N.C. Stat. Ann. § 53-243.11(21).
- 17 See N.C. Stat. Ann. § 3-243.11(5), as amended by H.B. 2463.
- 18 House Bill 2188, signed by Governor Easley on August 18, 2008, amends the Collection and Servicing Act's fee provisions, effective April 1, 2008. The Bill provides the exception that a servicer is not required to send a statement for a fee that: (1) results from a service that is affirmatively requested by the borrower, (2) is paid for by the borrower at the time the service is provided, and (3) is not charged to the borrower's loan account.
- 19 House Bill 2188 also amends the Collection and Servicing Act's notification requirements, effective April 1, 2008. The Bill provides that the notification requirement explaining why a payment was not credited is not necessary if: (1) the servicer complies with the terms of any agreement or plan made with the borrower and has applied and credited payments received in the manner required, and (2) the servicer is applying and crediting payments to the borrower's account in compliance with all applicable State and federal laws, including bankruptcy laws, and if at least one of the following occurs: (a) The borrower has entered into a written loss mitigation, loan modification, or forbearance agreement with the servicer that itemizes all amounts due and specifies how payments will be applied and credited; (b) The borrower has elected to participate in an alternative payment plan, such as a biweekly payment plan, that specifies as part of a written agreement how payments will be applied and credited; or (c) The borrower is making payments pursuant to a bankruptcy plan.
- 20 Under RESPA, a "qualified written request" is a written correspondence, other than notice on a payment coupon or other payment medium supplied by the servicer, that: (1) includes or otherwise enables the servicer to identify the name and account of the borrower; and (2) includes a statement of the reasons for the borrower's belief, to the extent applicable, that the account is in error or provides sufficient detail to the servicer regarding other information the borrower seeks. See 12 U.S.C. § 2605(e)(1)(B).
- 21 Id. § 2616.
- 22 "Servicing organization" means a person or entity to whom or which a mortgagee or a selling servicing organization sells, assigns, or transfers the servicing of a mortgage loan. See N.J. Stat. Ann. § 17:16F-15. "Servicing" means performing, or possessing the authority to perform, any of the following activities for a fee in connection with a mortgage loan agreement: crediting mortgage payments, crediting escrow account payments, managing escrow accounts, providing escrow statements, providing payoff statements, forwarding discharges of mortgages, canceling mortgage guarantee insurance, and responding to consumer complaints in accordance with applicable law.
- 23 Cal. Fin. Code §§ 22000 et seq.
- 24 Id. §§ 50000 et seq.

K&L Gates' Mortgage Banking & Consumer Finance practice provides a comprehensive range of transactional, regulatory compliance, enforcement and litigation services to the lending and settlement service industry. Our focus includes first- and subordinate-lien, open- and closed-end residential mortgage loans, as well as multi-family and commercial mortgage loans. We also advise clients on direct and indirect automobile, and manufactured housing finance relationships. In addition, we handle unsecured consumer and commercial lending. In all areas, our practice includes traditional and e-commerce applications of current law governing the fields of mortgage banking and consumer finance.

For more information, please contact one of the professionals listed below.

LAWYERS

Boston

R. Bruce Allensworth	bruce.allensworth@klgates.com	+1.617.261.3119
Irene C. Freidel	irene.freidel@klgates.com	+1.617.951.9154
Stephen E. Moore	stephen.moore@klgates.com	+1.617.951.9191
Stanley V. Ragalevsky	stan.ragalevsky@klgates.com	+1.617.951.9203
Nadya N. Fitisenko	nadya.fitisenko@klgates.com	+1.617.261.3173
Brian M. Forbes	brian.forbes@klgates.com	+1.617.261.3152
Andrew Glass	andrew.glass@klgates.com	+1.617.261.3107
Phoebe Winder	phoebe.winder@klgates.com	+1.617.261.3196\

Charlotte

John H. Culver III	john.culver@klgates.com	+1.704.331.7453
--------------------	-------------------------	-----------------

Los Angeles

Thomas J. Poletti	thomas.poletti@klgates.com	+1.310.552.5045
-------------------	----------------------------	-----------------

Miami

Paul F. Hancock	paul.hancock@klgates.com	+1.305.539.3378
-----------------	--------------------------	-----------------

New York

Philip M. Cedar	phil.cedar@klgates.com	+1.212.536.4820
Elwood F. Collins	elwood.collins@klgates.com	+1.212.536.4005
Steve H. Epstein	steve.epstein@klgates.com	+1.212.536.4830
Drew A. Malakoff	drew.malakoff@klgates.com	+1.216.536.4034

San Francisco

Jonathan Jaffe	jonathan.jaffe@klgates.com	+1.415.249.1023
Erin Murphy	erin.murphy@klgates.com	+1.415.249.1038

Seattle

Holly K. Towle	holly.towle@klgates.com	+1.206.370.8334
----------------	-------------------------	-----------------

Washington, D.C.

Costas A. Avrakotos	costas.avrakotos@klgates.com	+1.202.778.9075
Melanie Hibbs Brody	melanie.brody@klgates.com	+1.202.778.9203
Eric J. Edwardson	eric.edwardson@klgates.com	+1.202.778.9387
Anthony C. Green	anthony.green@klgates.com	+1.202.778.9893
Steven M. Kaplan	steven.kaplan@klgates.com	+1.202.778.9204
Phillip John Kardis II	phillip.kardis@klgates.com	+1.202.778.9401
Rebecca H. Laird	rebecca.laird@klgates.com	+1.202.778.9038

Laurence E. Platt	larry.platt@klgates.com	+1.202.778.9034
Phillip L. Schulman	phil.schulman@klgates.com	+1.202.778.9027
H. John Steele	john.steele@klgates.com	+1.202.778.9489
Ira L. Tannenbaum	ira.tannenbaum@klgates.com	+1.202.778.9350
Nanci L. Weissgold	nanci.weissgold@klgates.com	+1.202.778.9314
Kris D. Kully	kris.kully@klgates.com	+1.202.778.9301
Morey E. Barnes	morey.barnes@klgates.com	+1.202.778.9215
David L. Beam	david.beam@klgates.com	+1.202.778.9026
Emily J. Booth	emily.booth@klgates.com	+1.202.778.9112
Holly Spencer Bunting	holly.bunting@klgates.com	+1.202.778.9853
Krista Cooley	krista.cooley@klgates.com	+1.202.778.9257
Elena Grigera	elena.grigera@klgates.com	+1.202.778.9039
David G. McDonough, Jr.	david.mcdonough@klgates.com	+1.202.778.9207
Staci P. Newman	staci.newman@klgates.com	+1.202.778.9452
Stephanie C. Robinson	stephanie.robinson@klgates.com	+1.202.778.9856
Melissa Sanchez	melissa.sanchez@klgates.com	+1.305.539.3373
Kerri M. Smith	kerri.smith@klgates.com	+1.202.778.9445

DIRECTOR OF LICENSING**Washington, D.C.**

Stacey L. Riggan	stacey.riggan@klgates.com	+1.202.778.9202
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REGULATORY COMPLIANCE ANALYSTS**Washington, D.C.**

Dameian L. Buncum	dameian.buncum@klgates.com	+1.202.778.9093
Teresa Diaz	teresa.diaz@klgates.com	+1.202.778.9852
Jennifer Early	jennifer.early@klgates.com	+1.202.778.9291
Robin L. Gieseke	robin.gieseke@klgates.com	+1.202.778.9481
Allison Hamad	allison.hamad@klgates.com	+1.202.778.9894
Joann Kim	joann.kim@klgates.com	+1.202.778.9421
Brenda R. Kittrell	brenda.kittrell@klgates.com	+1.202.778.9049
Dana L. Lopez	dana.lopez@klgates.com	+1.202.778.9383
Patricia E. Mesa	patty.mesa@klgates.com	+1.202.778.9199
Jeffrey Prost	jeffrey.prost@klgates.com	+1.202.778.9364

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