



**North Carolina  
Mortgage Lending  
Legislative Update  
2008**

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## North Carolina Mortgage Lending Legislative Update 2008

The North Carolina General Assembly's recently-completed 2008 "short session" included an ambitious agenda to address the "mortgage crisis." National foreclosure and home valuation statistics show North Carolina in the "middle of the pack" at worst, with nowhere near the incidence of residential mortgage defaults and foreclosures as in states such as California, Florida, Ohio, Michigan, Arizona and Nevada. But this did not deter consumer advocates and policymakers here from pursuing a comprehensive home preservation agenda in the 2008 short session. Moreover, the work of the House Select Committee on Rising Foreclosures energized the legislative debates. This Committee held hearings and conducted deliberations over the past eighteen months, leading to the introduction of bills supported by the Commissioner of Banks, the Attorney General and various consumer and community advocacy groups.

The General Assembly ultimately enrolled and sent three mortgage servicing, default and foreclosure bills to the Governor for signature and, significantly, provided \$14 million in appropriations aimed at foreclosure prevention and low-income housing finance.\* These bills bear close attention by mortgage lenders and servicers throughout the nation, given North Carolina's leading role in enacting "model" consumer protection legislation that other states adopt and that the U.S. Congress considers for federal action. In fact, consumer advocates here already are touting our newly-enacted laws as desirable go-bys for other states. For example, the Center for Responsible Lending applauded one of the new North Carolina enactments as the "first law in the nation" to ban yield spread premiums outright.

The three new bills are outlined below. HB 2463 is a comprehensive mortgage servicing law, containing licensing requirements on "mortgage servicers" and unprecedented default and foreclosure-related conduct requirements and prohibitions. HB 2188 amends North Carolina's recent enactment on "rate spread home loans," in part making yield spread premiums unlawful for such loans, and redefines the threshold for "points and fees" under the North Carolina high-cost home loan law. HB 2623 imposes additional duties on "subprime" mortgage loan holders and servicers and grants additional emergency foreclosure relief powers to the Commissioner of Banks intended to impel loan holders to negotiate workouts and other alternatives to foreclosures with subprime borrowers. Taken together with existing North Carolina consumer protection laws, these new laws arguably create the strongest state law regulatory framework in the country for residential mortgage loan solicitation, origination, securitization and servicing.

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## **I. HB 2463, Comprehensive Mortgage Servicer Licensing Requirements and Conduct - Prohibitions**

**Effective Date: January 1, 2009**

### **New Mortgage Lending Act Licensing Requirements for “Mortgage Servicers”**

“Mortgage servicers” are required to be licensed under the Mortgage Lending Act, Part 19A of Chapter 53 of the North Carolina General Statutes (“MLA”).

- “Mortgage servicer” is defined as a person who directly or indirectly “acts as a mortgage servicer” or who otherwise meets the definition of “servicer” under RESPA (12 U.S.C. § 2605(i)).
- To “act as a mortgage servicer” means to engage, whether for another or on one’s own behalf, “in the business of receiving any scheduled periodic payments from a borrower pursuant to a mortgage loan,” including escrow amounts, and making the payments of principal and interest and other payments received from the borrower as may be required pursuant to the terms of the mortgage loan, the mortgage servicing loan documents or the servicing contract.
- The existing MLA definition of “mortgage loan” is a loan made to a natural person or persons primarily for personal, family or household use, primarily secured by residential real property located in North Carolina, while “residential real property” is defined as real property located in North Carolina upon which there is located or to be located one or more single-family dwellings or dwelling units. There are no high or low dollar limits in these definitions nor are loan types covered by the definitions otherwise limited.

The application, background check, fees, and financial and bonding requirements will be the same for “mortgage servicers” as for mortgage bankers and mortgage brokers under existing law (the MLA). It is anticipated that the Office of the Commissioner of Banks (“OCOB”) will issue additional guidance and revised application forms in advance of the January 1, 2009 effective date.

Note that the definition of “mortgage servicer” under the bill is broader than the RESPA definition. This is not consistent with the last year’s Mortgage Debt Collection and Servicing Act, Part 10 of Chapter 45 of the North Carolina General Statutes, which covers only RESPA-defined “servicers.”

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## New Requirements for Mortgage Servicers

The bill incorporates into the MLA a host of requirements on mortgage servicers, including detailed annual reporting requirements. These requirements are imposed only on persons required to be licensed under the MLA (as amended by the bill). It follows that “exempt persons,” including banks, savings institutions and credit unions (or wholly owned subsidiaries of banks, savings institutions or credit unions), should not be required to comply with these new requirements.

Keeping in mind that these new requirements apply to non-exempt lenders collecting their own loans as well as to third-party servicers, the new bill provides that a mortgage servicer must:

- (1) Monies. Safeguard and account for any money handled for the borrower.
- (2) Borrower Instructions. Follow reasonable and lawful instructions from the borrower.
- (3) Standard of Care. Act with reasonable skill, care, and diligence.
- (4) Schedule of Fees and Charges. With its application and renewal and with its supplemental filings with OCOB, file a complete, current schedule of the ranges of costs and fees it charges borrowers for its servicing-related activities.
- (5) Reporting to OCOB. File with the OCOB, upon request, a report in a form and format acceptable to the OCOB detailing the servicer’s activities in North Carolina, including:
  - a. The number of mortgage loans the servicer is servicing;
  - b. The type and characteristics of such loans in North Carolina;
  - c. The number of loans in default, along with a breakdown of 30-, 60-, and 90-day delinquencies;
  - d. Information on loss mitigation activities, including details on workout arrangements undertaken; and
  - e. Information on foreclosures commenced in North Carolina.
- (6) Notice in Addition to Federal Servicing Rights Disclosure. At the time it accepts assignment of servicing rights for a mortgage loan, disclose to the borrower all of the following:

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- a. Any notice required by RESPA or by regulations promulgated thereunder;
  - b. A schedule of the ranges and categories of its costs and fees for its servicing-related activities, which shall comply with North Carolina law and which shall not exceed those reported to the OCOB;
  - c. A notice in a form and content acceptable to the OCOB that the servicer is licensed by the OCOB and that complaints about the servicer may be submitted to the OCOB; and
  - d. Any notice required by the other North Carolina statutes, including the foreclosure statute, the mortgage satisfaction statute and the Mortgage Debt Collection and Servicing Act.
- (7) Mandatory Notice and Duty to Negotiate. In the event of a delinquency or default by the borrower, act in good faith to inform the borrower of the facts concerning the loan and the nature and extent of the delinquency or default, and, if the borrower replies, negotiate with the borrower, subject to the servicer's duties and obligations under the mortgage servicing contract, if any, to attempt a resolution or workout to the delinquency.

### **New Prohibitions on Mortgage Servicers**

The bill makes existing MLA prohibitions binding on mortgage bankers and mortgage brokers apply to mortgage servicers, including failure to comply with fee restrictions in the usury laws, failing to act in good faith or fair dealing, improperly influencing any appraiser and failing to comply with federal law. The bill adds no fewer than seven (7) new prohibitions on mortgage servicers, likely (with the new requirements discussed above) creating the strictest conduct standards on mortgage servicers in the country.

The prohibited activities provisions (appearing in N.C.G.S. § 243-11, part of the MLA) apply to entities otherwise exempt from the MLA, including banks, credit unions and savings institutions. However, this part of the MLA generally does not create private rights of action. That is, only North Carolina government authorities are permitted, under the MLA, to enforce these prohibitions (as amended by the bill). It follows that financial institutions that enjoy federal preemption, including exclusive visitorial authority of federal banking regulators, should not be subject to OCOB enforcement of these extensive new restrictions.

The new prohibitions and restrictions on "mortgage servicers" include:

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- (1) Notice of Forced Placement. Failure to provide written notice to the borrower of forced placement of insurance or force placing insurance when the servicer knows or has reason to know that insurance is in place.
- (2) Excessive Amount of Forced Place Insurance. Placing insurance on a mortgaged property that exceeds either the value of the insurable improvements or the last known coverage amount.
- (3) Force Place Insurance Rebates. Failure to rebate unearned insurance premiums, if the borrower provides “reasonable proof” that the borrower has obtained coverage such that the lender’s forced place coverage is no longer necessary. If the borrower shows that no lapse in coverage occurred, such that forced placement was not necessary, the servicer shall refund the entire premium.
- (4) Borrower Right to Reinstate. Refusal to reinstate a delinquent loan and restore it to current status upon a timely tender of payment by the borrower of all past due amounts (as shown in last written statement received by the borrower), but only once in any 24-month period.
- (5) Foreclosure Moratorium/Pre-Foreclosure. To fail to mail to the borrower at least 45 days before foreclosure is initiated, a detailed, itemized written notice of past due amounts, options other than foreclosure, contact information of the servicer and contact information of HUD-approved counseling agencies and for consumer complaints at OCOB.
- (6) Escrow Payments. Failure to make all escrow payments timely so as to ensure no late charges nor “other negative consequences,” unless there are insufficient funds in escrow *and* the servicer has reasonable belief that recovery of the funds [from the borrower?] will not be possible.

### **Foreclosure Suspension/Moratorium Administered by OCOB**

The bill gives the OCOB the authority to suspend any foreclosure proceeding for 60 days (by written notice to the Clerk of the Superior Court) if the OCOB has evidence that a material violation of law occurred in the origination or servicing of the subject defaulted loan and that the violation would be sufficient in law or equity to affect the validity or enforceability of the underlying loan documents or the right to foreclosure. The OCOB is required to provide a copy of the notice to the Clerk and to the servicer and to provide the servicer with an opportunity to cure the violation or rebut the evidence of the suspected violation. If the violation is cured or the

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OCOB is satisfied that no material violation occurred, the OCOB is required to notify the Clerk so that the foreclosure may be resumed.

The scope of the OCOB's authority under this new provision is not clear, but it appears that the OCOB should be able to exercise this extraordinary power only over licensees subject to OCOB jurisdiction under the MLA. As the effective date of the new law approaches, this and other uncertainties under the new law will need to be cleared up. For example, it is not clear how OCOB's power to delay foreclosure under this bill will relate to OCOB's power to impose a one-time 30-day foreclosure extension under the newly-enacted Emergency Program to Reduce Home Foreclosures Act (discussed below).

For mortgage servicers generally subject to the new law, it appears that 3 to 4 month delays in foreclosures in North Carolina could become common. The first period of delay will arise under the 45-day pre-foreclosure notice requirement, and a second 60-day period could be tacked on if the OCOB believes that legal violations as to the origination or servicing of the loan may have occurred. In fact, borrowers who become aware of the new law may use the 45-day notice as a signal to contact OCOB with complaints that very well could lead to the 60-day notice of suspension of foreclosure. Moreover, the 60-day suspension may be available during any phase of the foreclosure process itself, even after a foreclosure sale has taken place. Finally, it may be the case that "subprime loans" are subject to an additional (rather than concurrent) OCOB-directed suspension of foreclosure proceedings under HB 2623 (discussed below).

### **Amendments to Mortgage Lending Act – Mortgage Brokers and Mortgage Bankers**

The bill also contains numerous "technical amendments" to the MLA that will be binding on new applicants for MLA licenses and on existing mortgage broker and mortgage banker licensees, including: (i) change in definition of "managing principal" to "qualifying individual," (ii) prohibition on principal place of business at an individual's home or residence, (iii) amendment to definition of corporate "control," (iv) clarification that an "employee" is a W-2 employee, (v) statement that the MLA also applies to anyone who seeks to avoid the law by "any direct or indirect device, subterfuge, artifice, or pretense whatsoever," (vi) expansion of crime-related disclosures that must be made in applications and renewals and of criminal activity that may form a basis for license suspension or revocation; (vii) increasing fees for late renewals from \$50 to \$100, (viii) express imposition of examination-related expenses on licensees, and (ix) expanded OCOB authority to suspend licenses quickly if a licensee fails to respond to OCOB inquiries related to consumer complaints or if a licensee fails to cooperate with scheduling and conducting examinations or investigations.

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## **II. HB 2188, Amendments to Mortgage Debt Collection and Servicing Act; Amendment to High Cost Home Loan Statute; Amendment to Rate Spread Home Loan Statute**

**Effective Date: October 1, 2008**

### **Amendments to Mortgage Debt Collection and Servicing Act**

In 2007, the General Assembly enacted the Mortgage Debt Collection and Servicing Act (codified in Chapter 45, Article 10, as part of the North Carolina mortgage statute), a complex scheme with no precedent from other law, limiting fees and creating conduct requirements on mortgage servicers. The Act defined “servicer” by reference to the RESPA definition, thus including not only third party servicers but lenders collecting their own residential mortgage loans. There was consensus that the Act (effective April 1, 2008) left open several compliance points and should be amended. Unfortunately, the amendments in HB 2188 do not resolve all identified uncertainties in the Act.

The bill amends the Act in the following respects:

- (1) Timing of Notice. Clarifies that required notices regarding fees incurred and assessed must be provided within thirty (30) days of assessment.
- (2) Fees and Impositions not Triggering Notice. Servicer notices are not required if the fee (i) results from a service “affirmatively requested by the borrower,”(ii) is paid by the borrower at the time the service is provided, and (iii) is not charged to the borrower’s loan account. What it means for a borrower to “affirmatively request” a “service” is not described.
- (3) Notice of Application of Payment. Under the Act, if the servicer does not credit any payment received from the borrower within 10 days, the servicer must notify the borrower within 10 business days of the circumstances and reasons why the payment was not credited. The bill provides a limited list of circumstances, involving agreed-upon forbearance, modification or loss mitigation arrangements or bankruptcy, as to any of which this 10-day notice is not required.

### **Amendment to High Cost Home Loan Law**

The bill amends the description of the “threshold” for “points and fees” in North Carolina’s high-cost home loan statute. Under the bill, this “threshold” of 5% is by reference to all “points and

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fees” as defined in the statute and not to points and fees “payable by the borrower at or before loan closing.” The intent of the amendment appears to make it even clearer that yield spread premiums are counted in “points and fees,” but the amendment also appears to negate the line of cases under HOEPA suggesting that fees not payable by the borrower are not “points and fees.” Presumably, this will mean that certain non-borrower paid items that could be excluded from the points and fees threshold under existing North Carolina law must be included in the threshold.

### **Amendment to Rate Spread Home Loan Law**

The General Assembly last year enacted the “rate spread home loan” usury law (codified at Section 24-1.1F of the North Carolina General Statutes), in order to discourage lenders from making residential mortgage loans carrying an APR at or above the HMDA rate spread APR (whether reportable or not). Now, as per the bill, in “rate spread home loan” transactions, “lenders shall not pay and brokers shall not accept compensation that changes based on the terms of the loan” (i.e., yield spread premiums). The bill says that this prohibition does not prohibit “compensation based on the principal balance of the loan.”

## **III. HB 2623, Emergency Program to Reduce Home Foreclosures Act**

**Effective Date: November 1, 2008, expiring on October 31, 2010**

### **New Requirements on Mortgage Servicers and Lenders – “Subprime Loans”**

The bill imposes additional requirements on “mortgage servicers” who enforce “subprime loans.” The bill defines “mortgage servicer” in the same way as HB 2463 (see above), but does not limit the definition to mortgage servicers who are required to be licensed as such under North Carolina’s new mortgage servicer licensing law. It appears that the legislature intends anyone who collects residential mortgage loans in North Carolina, whether for his/her/its own account or for others, to be covered by this bill.

The bill defines “subprime loan” as a loan originated on or after January 1, 2005 but before December 31, 2007 that would have been a “rate spread home loan” as defined in N.C.G.S. §24-1.1F (HMDA rate spread home loan, whether reportable or not). As to these loans, “mortgage servicers” of “subprime loans” must send a detailed written notice to the borrower at least 45 days prior to the filing of a notice of hearing in a foreclosure proceeding on the borrower’s primary residence. The content of the notice is substantially the same as the “general” 45-day pre-foreclosure notice required of mortgage servicers under the amended MLA (see above). The

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mortgage servicer also must submit this information to an electronic database to be established by the North Carolina Administrative Office of the Courts.

### **New Electronic Database of AOC and OCOB**

The Administrative Office of the Courts (AOC) is directed to establish by October 1, 2008 an electronic foreclosure information database, which the OCOB is to design and develop. Mortgage servicers must submit information required in the subprime pre-foreclosure notices mandated by the bill (see above) to this database in electronic format, PLUS “optional information” [sic] that OCOB may request as per its design of the database. All of this information is to be used by OCOB in connection with its “State Home Foreclosure Prevention Project.”

### **OCOB’s State Home Foreclosure Prevention Project**

The bill authorizes OCOB to establish the “State Home Foreclosure Prevention Project” (the “Project”). The stated purpose of the Project is “to seek solutions to avoid foreclosures for certain subprime loans.” OCOB may seek input from interested constituencies in developing the Project. It appears that the Project is to consist of specially-designated OCOB staff who will be charged with reviewing information from the database and elsewhere and working with borrowers and servicers (or lenders servicing their own loans) to negotiate alternatives to foreclosure for “subprime” borrowers. In this regard, OCOB is required to review information in the database “to determine which loans are appropriate for efforts to avoid foreclosure.” If OCOB “reasonably believes, based on [i] a full review of the loan information, [ii] the mortgage servicer’s loss mitigation efforts, [iii] the borrower’s capacity and interest in staying in the home, and [iv] other appropriate factors, that further efforts by the [Project] offer a reasonable prospect to avoid foreclosure on primary residences,” the OCOB shall have the authority to extend (one time) the foreclosure filing date by up to thirty (30) additional days beyond the date established in the required pre-foreclosure notice. OCOB must provide notice of this extension to the borrower, the mortgage servicer and AOC (and presumably make a note of it in the database).

### **Impact on the Foreclosure Process**

The bill provides that initial foreclosure notices involving “subprime loans” on primary residences filed on or after November 15, 2008 must contain a certification that the mortgage servicer complied with the 45-day notice requirement and submitted information to the electronic database and that the time periods provided for by the bill have elapsed. The Clerk of the Superior Court will have access to the database to confirm this. If this certification is “materially inaccurate,” there will be ground for dismissal of the foreclosure action without prejudice and for

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payment of the borrower's costs in defending the foreclosure up to that time. All foreclosing lenders are required to include in the initial foreclosure notice either a statement of compliance with the subprime pre-foreclosure notification requirement or a statement that the loan being foreclosed is not a "subprime loan" under the bill. It is not clear whether the 60-day extension that OCOB may impose under the MLA (as amended by HB 2463, discussed above) may be tacked on to the 30-day suspension that OCOB may impose for Project-related "subprime loans."

### **Protection of Information in the Database**

The data in the database shall be exclusively for the use and purposes of the Project. The information in the database is not a "public record," and mortgage servicers and mortgage lenders will have access only to information on their own loans. A mortgage servicer is to be held harmless for any alleged breach of privacy rights of the borrower with respect to information that the mortgage servicer submits under the new law. The bill does not appear to exempt financial institutions from Gramm-Leech Bliley Act safeguarding or other information security mandates in other laws.

## **IV. HB 2436 (S.L. 2008-107), Appropriations for Housing-Related Relief**

Finding that "homeownership is the primary means by which families and individuals of low and moderate incomes build wealth" and further that "homeownership and a healthy housing market are essential to the health and economic vitality of North Carolina," the General Assembly appropriated \$14,000,000 in the "short session" to help stabilize the housing market in North Carolina. The specific budget items include funds to the North Carolina Housing Finance Agency for expansion of low income housing and housing for persons with disabilities, as well as \$3,000,000 to the NCHFA to expand the existing Home Protection Program to the entire state (forbearance-related funds for homeowners suffering temporary job losses). The General Assembly also provided:

- \$1,000,000 in nonrecurring funds to OCOB to implement the Emergency Program to Reduce Home Foreclosures (see above) and to provide additional counseling services to at-risk homeowners. The legislature also directed OCOB to use \$600,000 of its funds in the 2008-2009 fiscal year to make grants to non-profit counseling services.
- \$200,000 in recurring funds to the North Carolina State Bar to provide legal assistance to low-income consumers in cases involving predatory mortgage lending, mortgage broker and loan services abuses, foreclosure defense, and

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other legal issues that relate to helping low-income consumers avoid foreclosure and home loss. Of these funds, \$100,000 recurring is provided to the Land Loss Prevention Project and \$100,000 recurring is provided to the Financial Protection Law Center.

- Allocation of additional funds to Legal Services to provide access to legal assistance to homeowners in cases involving predatory mortgage lending, mortgage broker and loan services abuses, foreclosure defense, and other legal issues that relate to helping consumers avoid foreclosure and home loss.

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\* This Update assumes that Governor Mike Easley will sign these bills, an outcome expected at any time.