



**N C B A N K E R S**  
NORTH CAROLINA BANKERS ASSOCIATION

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## Legal Memorandum

September 12, 2007

Vol. 39, No. 6

TO: *LEGAL MEMORANDUM MAILING LIST*

RE: North Carolina's New Anti-Predatory Lending Law: Chaptered House Bill 1817

The 2007 Session of the General Assembly witnessed the introduction of numerous bills seeking to address problems in the subprime mortgage arena and the foreclosures resulting from those problems. Quite a few of those bills passed. Quick summaries of those and all other enacted legislation from the Session may be found in the NCBA's [Legislative Profile Wrap-Up Edition](#). We will address the most significant of those new laws with dedicated issues of *Legal Memorandum*. The subject of this *Legal Memorandum* is Chaptered House Bill 1817 dealing with a new category of mortgage loans: Rate-Spread Loans. Below is a section-by-section review of the contents of the bill.

House Bill 1817 is entitled: "AN ACT TO PROTECT CONSUMERS REGARDING COVERED LOANS AND TO INCREASE THE COMMISSIONER'S DISCIPLINARY AUTHORITY OVER LICENSEES UNDER THE MORTGAGE LENDING ACT."

The first three sections of the bill amend the High Cost Home Loan section, G.S. 24-1.1E.

### **Section 1**

In subdivision G.S. 24-1.1E(a)(5), Section 1 of the bill adds all broker compensation, no matter the source, to the existing definition of "Points and Fees." Specifically, this language was intended to bring in yield spread premiums. Fees related to bona fide secondary mortgage market transactions are clearly excluded from the definition.

## **Section 2**

Section 2 provides definitions of “mortgage broker” (by cross-reference to G.S. 53-243.01(14)) and “table funded transactions” in G.S. 24-1.1E.

## **Section 3**

Section 3 amends G.S. 24-1.1E by establishing that mortgage brokers are jointly and severally liable with lenders for violations of the High Cost Home Loan statute. Through many versions of this legislation, a comparable provision, making lenders jointly and several with brokers for certain actions of the broker, was included. It was deleted, however, before the legislation was enacted.

## **Section 4**

This section is the heart of H-1817. It creates a new statute, G.S. 24-1.1F, defining “Rate Spread Home Loans” and establishing a number of consumer protections and lending rules.

- Subsection (a) contains the definitions:
  - The most important part of this subsection is a new definition for a “Rate Spread Home Loan.” It is defined as a loan in which the APR exceeds both the existing HMDA rate spread trigger (3% over comparable Treasuries for first liens and 5% over comparable Treasuries for second liens) and a new mortgage-based rate trigger (1.75% over conforming prime rate for first liens and 3.75% over conforming prime rate for junior liens). The HMDA trigger would be tracked in accordance with existing HMDA rules; the mortgage rate trigger would be tracked based on the Freddie Mac mortgage commitment data published every Friday by the Fed in its Statistical Release H.15. Agreeing upon alternative triggers was an important part of the negotiations on this legislation. The HMDA rate is familiar, but because it is not a mortgage-based rate, it can pull in prime loans during certain interest rate environments. The second trigger is meant to provide leeway to the lending community in such environments. Both limits must be exceeded for the loan to be classified as a “Rate Spread Home Loan.”
- Subsection (b) provides that prepayment penalties are prohibited for Rate Spread Home Loans.
- Subsection (c) deals with the capacity of the borrower to repay the loan. First, the general proposition is stated that no lender may make a Rate Spread Home Loan unless the lender “reasonably and in good faith believes at the time the loan is consummated that one or more of the obligors, when considered individually or collectively, has the ability to repay the loan according to its terms and to pay applicable real estate taxes and hazard insurance premiums.” Consumer advocates sought to require actual escrow of taxes and insurance premiums, but that requirement was stripped shortly before enactment. The lender must consider all liens in

analyzing the capacity to repay, including loans it knows about that are being simultaneously originated by other lenders.

Subsection (c) contains four subdivisions further defining the responsibility of the lender to determine capacity to repay the loan:

- Subdivision (1) requires the lender, in analyzing the borrowers' capacity to repay, to take into account "consideration of the obligor's credit history, current and expected income, current obligations, employment status, and other financial resources other than the obligor's equity in the real property that secures repayment of the Rate Spread Home Loan."
- Subdivision (2) requires that reasonable steps be taken to verify information contained in the loan application. In so doing, the lender may make reference to "tax returns, payroll receipts, bank records, reasonable alternative methods, or reasonable third-party verification." This provision addresses a belief that "stated income" and other non-verified information on loan applications have contributed to abuses in the subprime mortgage market.
- Subdivision (3) further defines the responsibilities of the lender in determining the borrower's capacity to repay an adjustable rate loan. Foremost among these requirements is the stipulation that the "fully indexed rate" be used in calculating the borrower's capacity to repay.
- Subdivision (4) permits a lender to "utilize reasonable commercially recognized underwriting standards and methodologies, including automated underwriting systems, provided the standards and methodologies comply with the provisions of this section."
- Subsection (d) deals with damages. It stipulates that making a Rate Spread Home Loan that violates Subsections (b) or (c) is usurious under North Carolina law and that any prepayment penalty on a Rate Spread Home Loan is unenforceable. However, it also states specifically that borrowers cannot recover twice for the same wrong. The provisions are enforceable by the Attorney General and the Commissioner of Banks, in addition to the borrower. Finally, "a mortgage broker who brokers a Rate Spread Home Loan that violates the provisions of this section shall be jointly and severally liable with the lender."
- Subsection (e) provides that lenders may not subdivide loans or otherwise create subterfuges in order to avoid compliance.
- Subsection (f) grants to lenders a right to cure loans in two sets of circumstances, similar to the cure provisions in the High Cost Home Loan statute. Even though

making a Rate Spread Home Loan in violation of the section, a lender will not be deemed in violation if it meets the requirements of either of the two subdivisions:

- Subdivision (1): “Within 90 days of the loan closing and prior to the institution of any action against the lender under this section, the borrower was notified of the compliance failure, the lender tendered appropriate restitution, the lender offered, at the borrower's option, either to (i) make the Rate Spread Home Loan comply with subsection (b) or (c), or (ii) change the terms of the loan in a manner beneficial to the borrower so that the loan will no longer be considered a Rate Spread Home Loan subject to the provisions of this section, and within a reasonable period of time following the borrower's election of remedies, the lender took appropriate action based on the borrower's choice; or”
- Subdivision (2): “The compliance failure was not intentional and resulted from a bona fide error notwithstanding the maintenance of procedures reasonably adopted to avoid such errors, and within 120 days after the discovery of the compliance failure and prior to the institution of any action against the lender under this section or the lender's receipt of written notice of the compliance failure, the borrower was notified of the compliance failure, the lender tendered appropriate restitution, the lender offered, at the borrower's option, either to (i) make the Rate Spread Home Loan comply with subsection (b) or (c) of this section, or (ii) change the terms of the loan in a manner beneficial to the borrower so that the loan will no longer be considered a Rate Spread Home Loan subject to the provisions of this section, and within a reasonable period of time following the borrower's election of remedies, the lender took appropriate action based on the borrower's choice. Examples of a bona fide error include clerical, calculation, computer malfunction and programming, and printing errors. An error of legal judgment with respect to a person's obligations under this section is not a bona fide error.”
- Subsection (g) provides only that the various sections of the Rate Spread Home Loan statute are severable and a court's determination that one section is invalid or unenforceable will not affect any other section.

### **Section 5**

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

**Section 6**

Section 6 amends G.S. 53-243.04 to authorize the Commissioner of Banks to implement and interpret the provisions of G.S. 24-1.1E, 24-1.1F and 24-10.2 as they “apply to licensees under this Article.” “This Article” refers to Article 19A of Chapter 53, the Mortgage Lending Act. Banks are exempt from the licensure requirements of that article so the Commissioner’s authority under this Section does not extend to banks.

**Section 7**

Section 7 amends G.S. 53-243.10 (in the Mortgage Lending Act) to add six new mortgage broker duties ranging from full and timely disclosure of all material information to allowing an applicant who has been denied credit an opportunity to explain a poor credit history or provide additional information. This provision does not apply to banks.

**Section 8**

This Section amends G.S. 53-243.11 (of the Mortgage Lending Act) to add several new prohibited activities, including brokering an ARM without disclosing to the borrower the best fixed rate loan offered by the same lender, failing to comply with any law or regulation related to mortgage lending, and engaging in unfair, misleading or deceptive advertising. As the prohibited activities section of the Mortgage Lending Act **do** apply to banks, bankers should be aware of these provisions.

**Section 9**

This section amends G.S. 53-243.12 (of the Mortgage Lending Act) to authorize the Commissioner of Banks to prohibit by order acts and practices of licensees he finds to be unfair, deceptive, or designed to evade North Carolina statutes or that are not in the best interest of borrowers.

**Section 10**

The effective date of the new law is January 1, 2008.

Please feel free to contact us if you have any questions concerning the legislation discussed in this *Legal Memorandum*.

Sincerely,



Paul H. Stock  
Executive Vice President & Counsel