

MEMORANDUM

TO: Hal D. Lingerfelt
Commissioner of Banks

FROM: L. McNeil Chestnut
Assistant Attorney General

DATE: August 25, 1999

RE: Senate Bill 1149 Summary -- Prohibit Predatory Lending

I. Background

S. 1149, given the short title "Prohibit Predatory Lending" (referred to as the "Act") was, as its name implies, designed to prevent predatory lending practices -- a practice in which mortgage lenders sell the borrower on a loan with the highest interest rates and fees possible. These mortgage lenders frequently solicit customers through telemarketing, direct mail and/or home visits, promising lower monthly payments. However, they typically do not effectively disclose that in the long run the borrower's costs will be significantly higher. Predatory lending practices include excessive points and loan origination fees; additional and excessive "junk" fees for questionable services such as document preparation, underwriting and processing; balloon payments (payments in the near term only cover debt service with almost the entire original principal due at the end of the term); equity stripping; flipping i.e., frequently refinancing the loan transaction with more fees at each closing resulting in added debt to the consumer; and packing, i.e. adding and financing overpriced extras, particularly single premium credit life insurance.

II. Structure and Summary of the Legislation

S. 1149 was enacted as Chapter 332 of the 1999 Session Laws, cited as 1999-332. It was ratified on July 15, 1999, and approved by the Governor on July 22, 1999. Sections 1 through 5 revise current provisions of law and add three new sections, (G.S. §§ 24-1.1E, 24-2.5 and 24-10.2). Section 6, an appropriation to the Department of Justice for public awareness and consumer counseling, was deleted by the Technical Corrections Act, 1999-0456, s. 40. Section 7 authorizes certain studies by the General Assembly, and Section 8, provides various effective dates.

This bill did not change the current provisions of G.S. § 24-1.1A(a) regarding rates of interest on first mortgage (deed of trust) home loans. Interest rates and points on most home loans remain deregulated. However, residential mortgage loans which have points and fees which exceed more than 5% of the loan principal, or which have a rate of more than ten percentage points above the treasury index will be considered a "high-cost home loan" and subject to strict limitations.

Section 1.

G.S. § 24-1.1A(b) was reorganized into two subparts. The principal change was to raise the prohibition on prepayment penalties from loans of \$100,000 to loans of \$150,000.

Subpart (b)(1) provides that no prepayment penalty or fee may be imposed on any home loan in which:

- (i) the principal amount borrowed is \$150,000 or less;
- (ii) the borrower is a natural person;
- (iii) the debt is incurred primarily for personal, family, or household use; and
- (iv) the loan is secured by a first deed of trust on residential real estate.

Subpart (b)(2) provides that the limitation on prepayment penalties and fees do not apply to the extent that they are preempted by federal law or regulation. No exception is made for opinions issued by federal bank regulatory agencies which purport to preempt state law.

G.S. § 24-1.1A(c) was reorganized into two subparts. It clarified the authority to impose certain loan fees and replaced the former ambiguous language which provided for unregulated "...points, commitment fees, finance charges, and other similar charges."

Subpart (c)(1) provides that except for the restrictions imposed on "high cost mortgage loans," the lender and borrower may agree to the following fees:

- (a) loan application, origination and commitment fees
- (b) bona fide discount points
- (c) assumption fees (permitted by G.S. § 24-10(d))
- (d) appraisal fees (permitted by G.S. § 24-10(h))
- (e) third party fees paid for bona fide loan related goods, products and services and sums paid for taxes, filing fees, recording fees, and other charges paid to public officials, and
- (f) miscellaneous fees and charges, however denominated, which do not, in the aggregate, exceed the greater of 1/4 of 1% of the principal amount of the loan, or \$150.

Subpart (c)(2) limits and specifies the fees that may be charged for modification, renewal, extension, or amendment to any of the terms of a home loan. The fees include:

- (a) bona fide discount points
- (b) assumption fees (to the extent permitted by G.S. § 24-10(d))
- (c) appraisal fees (to the extent permitted by G.S. § 24-10(h))

- (d) to the extent permitted by G.S. § 24-8(d) third party fees paid for bona fide loan related goods, products, and services, and sums paid for taxes, filing fees, recording fees, and other charges paid to public officials
- (e) miscellaneous fees and charges, however denominated, not to exceed the greater of 1/4 of 1% of the principal amount of the loan, or \$150.

The fees and charges permitted by Subpart (c)(2) may only be imposed pursuant to a written agreement which states the amount of fee charged and is made at the time of the specific modification, renewal, extension, or amendment or at the time the same is requested.

G.S. § 24-1.1A(c1). This is a new section of law which expressly limits fees and charges on loans under \$10,000 made by lenders who are not banks, approved mortgagees, or a state or federal agency. The fees and charges are limited to:

- (i) third party charges for bona fide loan-related goods, products and services
- (ii) interest permitted pursuant to G.S. § 24-1.1A(a)(3), a maximum of 16% and,
- (iii) late payment charges permitted by G.S. § 24-10.1.

G.S. § 24-1.1A(c2). This is also a new section which expressly limits interest and fees that may be charged by mortgage lenders operating in the same location as a consumer finance licensee. Interest, fees and charges are limited to:

- (i) the fees described in G.S. § 24-10
- (ii) third party charges for bona fide loan-related goods, products and services permitted under G.S. § 24-8(d)
- (iii) interest as permitted in G.S. § 24-1.1A(a)(4), i.e., the Commissioner's rate up to a maximum of 15%, and
- (iv) late payment charges permitted by G.S. § 24-10.1.

G.S. § 24-1.1A(e) was amended to exclude open end credit plans from the definition of a "home loan." Home equity loans are governed by G.S. § 24-1.2A.

G.S. § 24-1.1A(g). The provisions regarding deferral of payment were reorganized into two new subparts. Except for loans past due more than 15 days, the requirement that the agreement be in writing was eliminated.

Except for the "high-cost mortgage loan" limitations, the parties may agree on a deferral fee. Subparts (1) and (2) impose specific provisions and/or limitations.

Subpart (g)(1) provides that if the borrower is a natural person, the debt is incurred primarily for personal, family, or household

purposes, and is secured by a first mortgage or first deed of trust on residential real property which will or is to be occupied by the borrower as the borrower's principal dwelling, then the subpart (g)(2) fee limitations apply.

Subpart (g)(2) limits deferral fees for home loans as follows:

- (a) the fee may be charged only pursuant to an agreement which states the amount of the fee and is made at the time of the deferral or when it was requested; provided, however, when the agreement relates to an installment which is then past due for fifteen days or more, the agreement must be in writing and signed by at least one of the borrowers. An agreement will be considered a signed writing if a lender receives from at least one of the borrowers a facsimile or computer-generated (i.e., e-mail) message confirming or otherwise accepting the agreement.
- (b) the fee may not exceed the greater of 5% of each installment deferred or \$50, multiplied by the number of complete months in a deferral period. "Months" and "deferral" period are defined.
- (c) once a deferral fee has been imposed with respect to a particular installment, it may not be imposed again with respect to any future payment which would have been timely and sufficient but for the prior deferral.
- (d) if a deferral fee is charged, a late payment charge may be imposed on the deferred payment only if the amount deferred is not paid when due and no new deferral agreement is made.
- (e) lenders may not charge a deferral fee for modifying or extending the maturity date of a loan or the date of a balloon payment. An extension or modification fee would be governed by the applicable section of law (G.S. § 24-1.1A(c)(2)).

GS § 24-1.1A(i). This is a new section of law. It provides in principle that nothing is to be construed to authorize or prohibit a lender, borrower, or other party to pay compensation to a mortgage broker or a mortgage banker for services provided by these individuals or entities in connection with a home loan.

Section 2.

This section adds a new provision of law, **G.S. § 24-1.1E** entitled “Restrictions and Limitations on High-Cost Home Loans.” This section contains most of the predatory lending provisions that were the focal point of the legislation.

Subsection (a) defines seven terms:

- (1) affiliate
- (2) annual percentage rate
- (3) bona fide loan discount points
- (4) high-cost home loans
- (5) points and fees
- (6) thresholds, and,
- (7) total loan amount.

While each of these definitions is important for an interpretation of the Act, particular attention should be paid to the following:

(3) Bona fide loan discount points. These are actual discount points knowingly paid by the borrower for the purpose of reducing, and which result in a bona fide reduction of, the interest rate. The interest rate reduction must be reasonably consistent with established industry norms and practices for secondary mortgage market transactions.

(4) High-cost home loan. A loan, other than an open-end credit plan or reverse mortgage transaction, in which (i) the principal amount does not exceed the lesser of the conforming loan size limit for a single-family dwelling established by FNMA or \$300,000; (ii) the borrower is a natural person and the debt is incurred primarily for personal, family, or household purposes; (iii) the loan is secured by either a security interest in a manufactured home which is or will be occupied by the borrower for his/her principal dwelling, or a mortgage or deed of trust on residential real estate which is or will be occupied by the borrower as his/her principal dwelling; and, (iv) the terms of the loan meet any one of the three thresholds in subsection (a)(6).

(5) Points and fees. Includes all items required to be disclosed by Regulation Z (12 C.F.R. § 226.4(a) and (b)), except interest or the time-price differential; charges for items listed under 12 C.F.R. §226.4(c)(7),

but only if the lender receives direct or indirect compensation in connection with the charge or the charges paid to an affiliate of the lender; all compensation paid directly by the borrower to a mortgage broker not otherwise included in G.S. § 24-1.1E(a)(5) a. or b.; and the maximum prepayment fees and penalties which may be charged or collected under the terms of the loan documents.

Points and fees do not include (i) taxes, filing fees, recording fees and other charges and fees paid or to be paid to public officials to determine the existence of or for perfecting, releasing, or satisfying a security interest; and (ii) fees paid to a person other than a lender or an affiliate of the lender or to the mortgage broker or an affiliate of the mortgage broker for the following -- tax payment service fees, flood certification fees, fees for pest infestation and flood determinations, appraisal fees, fees for inspections performed prior to closing, credit reports, surveys, attorneys' fees, if the borrower has the right to select an attorney from an approved list or otherwise, notary fees, escrow charges, so long as not otherwise included under sub-subdivision 5a. above, title insurance premiums, and fire and flood insurance premiums, provided that the conditions of 12 C.F.R. § 226.4(d)(2) are met.

(6) Thresholds (for determining a high-cost home loan).

G.S. § 24-1.1E(a)(6) provides three “threshold” tests to be applied to rates, points and prepayment penalties. If any one of these three tests are met, a loan will be defined as a “high-cost mortgage loan”. They are as follows:

1. The annual percentage rate (“APR”) exceeds by more than 10 percentage points the yield on current treasury securities which have an equivalent term as the mortgage loan.
2. The total points and fees payable at or before the closing of a mortgage loan exceed (i) 5% of the total loan amount for loans of \$20,000 or more, or (ii) the lesser of 8% of the total loan amount or \$1,000, if the total loan amount is less than \$20,000. The following discount points and prepayment penalties are excluded from the calculation of the total points and fees payable by the borrower:
 - a. Up to two bona fide loan discount points payable by the borrower, but only if the interest rate from which the loan interest

will be discounted does not exceed by more than 1% the required net yield for a 90-day standard mandatory delivery commitment for a reasonably comparable loan from either FNMA or the FHLMA, whichever is greater;

- b. Up to and including one bona fide loan discount point payable by the borrower, but only if the interest rate from which the loan interest rate will be discounted does not exceed by more than 2 percentage points the required net yield for a 90-day standard mandatory delivery commitment for a reasonably comparable loan from either the FNMA or the FHLMA, whichever is greater;
- c. Prepayment penalties which may be charged or collected do not exceed 1% of the amount prepaid, provided the loan documents do not permit the lender to charge or collect any prepayment fees or penalties for more than 30 months after the loan closing.

- 3. A prepayment penalty more than 30 months after the loan closing or which exceeds, in the aggregate, more than 2% of the amount prepaid.

G.S. § 24-1.1E(b). Limitations on high-cost home loans. High-cost home loans (a loan which meets one of the three preceding thresholds) are subject to the following limitations:

- (1) No call provision. The lender cannot accelerate the indebtedness in its sole discretion.
- (2) No balloon payment. No scheduled payment that is in excess of twice the regular payments.
- (3) No negative amortization. The payment schedule cannot cause the

principal to increase.

- (4) No increased interest rate. The interest rate cannot be increased after the borrower defaults.
- (5) No advance payments. The lender cannot require more than two payments to be consolidated and paid in advance.
- (6) No modification or deferral fees. The lender cannot charge any fees to modify, renew, extend, or amend a high-cost loan or to defer any payment that is due.

G.S. § 24-1.1E(c). Prohibited acts and practices. The following are prohibited in making high-cost home loans:

- (1) Lending without home-ownership counseling. The North Carolina Housing Finance Agency will approve counselors who can certify that the borrower has received counseling on the advisability and appropriateness of the loan transaction.
- (2) Lending without due regard to repayment ability. The lender must reasonably believe at the time the loan is consummated that the borrower(s) will be able to make the scheduled payments (based on a consideration of their current and expected income, current obligations, employment status, and other financial resources, other than the borrower's equity in the dwelling which secures repayment of the loan). There is a presumption of repayment ability if, at the time the loan is consummated, the borrower's total monthly debts, including amounts owed under the loan, do not exceed 50% of his or her monthly gross income as verified by any one of a number of listed sources. There is, however, no presumption of inability to make the scheduled payments simply because the borrower's monthly debts, including amounts owed under the loan, exceed 50% of his or her monthly gross income.
- (3) Financing of fees or charges. A lender may not finance any points and fees or any other charges payable to third parties.
- (4) Benefiting from refinancing existing high-cost

home loans with new high-cost home loans. A lender may not charge a borrower points and fees in connection with a high-cost loan if they are used to refinance an existing high-cost home loan held by the same lender as the note holder.

- (5) Restrictions on home-improvement contracts. Lenders may not pay a contractor under a home-improvement contract from the proceeds of a high-cost home loan other than (i) by an instrument payable to the borrower or jointly to the borrower and the contractor; or (ii) at the election of the borrower, through a third-party escrow agent in accordance with terms established in a written agreement signed by the borrower, the lender, and the contractor prior to the disbursement.

G.S. § 24-1.1E(d). Unfair and deceptive acts or practices. Except for corrections and unintentional violations (described in subsection (e)), making a high-cost home loan which violates any of the foregoing limitations and prohibited acts and practices (subsections (b) and (c)), is subject to penalties for usury (forfeiture of all interest, and return of twice the interest paid), or Chapter 75 of the General Statutes (treble damages). The Attorney General, the Commissioner of Banks, or any party to a high-cost home loan may enforce the provisions of this section.

G.S. § 24-1.1E(e) and (f). Subsection (e) provides that lenders who violate the Act unintentionally or through bona fide error will be given an opportunity to bring the loan into compliance with the law. Subsection (f) is a severability provision; if any part of the Act is declared invalid or preempted by federal law, the remainder shall continue to be effective.

Section 3.

This section adds a new **G.S. § 24-2.5** entitled “Mortgage Bankers and Mortgage Brokers.” It provides that a mortgage broker or a mortgage banker originating loans in a table-funded transaction in which the mortgage broker or banker is identified as the original payor of the note shall be considered a lender for the purposes of Chapter 24. In other words, they are subject to the restrictions and limitations imposed on mortgage lenders.

Section 4.

This section rewrote **G.S. § 24-8** entitled “Loans in excess of \$300,000; what interest, fees and charges permitted.” It was reorganized into six subsections, (a) through (f). Subsections (a) and (d) restate and clarify permissible rates and fees, and third party payments.

- (a) **G.S. § 24-8(a).** This restates the current law that a lender may not, on loans of \$300,000 or less, receive, directly or indirectly, any interest or fee except that provided by statute. In other words, if there is no express authority for an interest rate or fee, it cannot be charged;

- (d) This clarifies that a lender may collect funds from the borrower for the payment of (i) bona fide loan-related goods, products, and services provided or to be provided by third parties, and (ii) taxes, filing fees, recording fees, and other charges and fees paid or to be paid to public officials. It provides further that a third party provider shall not charge or receive (i) any unreasonable compensation for loan-related goods, products, and services, or (ii) any compensation for which no loan-related goods and products are provided or for which no or only nominal loan-related services are performed. Loan-related goods, products and services are defined to include fees for tax payment services, fees for flood certification, fees for pest-infestation determinations, mortgage broker fees, appraisal fees, inspection fees, environmental assessment fees, fees for credit report services, assessments, costs of upkeep, surveys, attorneys fees, notary fees, escrow charges, and insurance premiums.

Section 5.

This adds a new **G.S. § 24-10.2** entitled “Consumer protection in certain home loans”. Lenders are prohibited from:

- (b) Financing, directly or indirectly, any credit life, disability, or unemployment insurance, or any other life or health insurance premiums. However, insurance premiums calculated and paid on a monthly basis are not considered as financed by the lender.

- (c) “Flipping,” the practice of refinancing a loan when the new loan has no reasonable tangible net benefit to the borrower considering all the circumstances.

- (d) Recommending or encouraging default in an existing loan or other debt in connection with a proposed refinance.

Sections (e), (f), and (g) provide that a violation of these prohibited transactions are deemed usurious, in violation of Chapter 24, and unlawful as an unfair or deceptive act or practice in violation of G.S. § 75-1.1. The Attorney General, the Commissioner of Banks or any party to a consumer home loan may enforce the provisions of this section. Also the court may, under described circumstances, award attorneys fees. These consumer protections are in addition to any other protections that may be otherwise available by law.

Section 7.

Requires the LRC to study whether this Act has measurable effect on the availability of credit in North Carolina; whether it is effective in reducing predatory lending; and, the benefits to consumers of financing single premium credit life insurance. The latter must be reported to the 2000 Session of the General Assembly.

Section 8.

The Act has various effective dates as follows:

1. Section 2, Restriction on high-cost home loans (new G.S. § 24-1.1E) and the prohibition against financing single premium credit life insurance (G.S. § 24-10.2(b)) become effective July 1, 2000.
2. Section 7, the LRC study, was effective when the act was approved, July 22, 1999.
3. The remainder is effective October 1, 1999.

This summary has been provided for your information. It is not nor should be construed as an opinion of the Attorney General's Office.