

The Case for Surety Bond Reduction in North Carolina

The Federal SAFE Act requires mortgage loan originators (MLO) to meet financial standards necessary to serve the borrowing public. The standard would be met by the MLO providing a bond or paying into a state fund established for borrower making claims for damages or meeting a predetermined net worth requirement. The Act allowed each state to choose the appropriate standard for their jurisdiction. HUD guidance provided that states could choose to apply this standard to a company rather than an individual which is the direction the NCGA chose in crafting the NC SAFE Act.

However, rather than applying a single standard to non-depositories the NCGA was lobbied to implement 2 of the 3 standards described in the Federal SAFE Act plus an additional hurdle for small lenders, a minimum \$1,000,000 credit or warehouse line. These standards were adopted in 2009 making NC one of the most restrictive states for licensing in the nation. NC also requires bond companies to provide 5 year "tails" allowing claims to be brought against the bond 5 years after the licensee ceases business. This 5 year requirement is the longest in the nation and adds to the cost incurred by NC small businesses making NC one of the most expensive states to operate a non-depository in the nation.

Surety bonds serve a useful purpose by providing a backstop for claims made against a licensee who fails to perform their obligations under the NCGS. Borrower restitution, fines, civil penalties and other third party claims can be levied against a bond if the licensee fails to honor the claim. While serving a useful purpose they are not without cost to small business and should be reviewed regularly to determine that are set at appropriate levels for both licensees and consumers.

At the behest of the House Committee on Banking Law Amendments (HCBLA) the North Carolina Office of the Commissioner of Banks (NCCOB) convened a stakeholder meeting to discuss the issues being considered by the HCBLA. This group consisted of NCCOB staff, consumer activists and industry groups.

- 1) **Current company bond levels cover all MLOs who work for a non-depository.** While this may be true documentation has been provided that non-depositories in other states also provide coverage for all MLOs at significantly reduced bond amounts. It is important to note that when a state has significantly different laws and regulations than its neighbors it is difficult to attract industry and businesses. Virginia, Tennessee and South Carolina all have substantially lower bond requirements than NC.
- 2) **Higher bond amounts provide additional screening for the NCCOB when approving new applications and granting renewals.** The NCCOB is one of the premier state regulatory agencies in the nation. They have constructed an effective and elaborate regulatory scheme that serves the people of NC well. They substantially increased regulatory fees paid by the industry in order to properly fund the division that regulates non-depositories to assure that they have the capacity to do the work for which they are charged. Requiring higher bond amounts for screening purposes is not the purpose for bonds.
- 3) **Higher bond amounts are needed for catastrophic claims.** The stakeholders report from the NCCOB provides 8 years of bond claims in which time a total of \$528,911 dollars in claims have been made through the NCCOB including the time frame of the financial meltdown. While the possibility of a catastrophic claim exists current regulatory oversight is far more valuable than dealing with the aftermath of a catastrophe. The NCCOB has testified that additional

regulations, reports and exam procedures have been implemented since the passage of the 2009 SAFE Act in NC. These additional requirements serve to make borrowers safer while making non-depositories more accountable.

- 4) **Bonds provide a backstop for restitution, fees, penalties and other third party claims.** It should be noted that the bulk of all claims made against non-depositories are paid out of the assets of the licensee. Since the NC SAFE Act was enacted in 2009 there have been 12 claims against bonds held by licensees in the state. These claims totaled \$367,557. Loans closed by non-depositories during this period totaled 363,420. Conversely, according to the representative of the Surety & Fidelity Association of America premiums for these bonds cost 1-2% of the face amount. This means the premiums paid by non-depositories during this 4 year period range from \$3,700,000 to \$7,400,000, an average of \$5,500,000. The claims compared to the premiums result in a 10:1 ratio.

Eight years of history show that claims do not rise to level of coverage required by current legislation. Small business is bearing an increasingly heavy regulatory burden and we would ask that the HCBLA recommend to the General Assembly the proposal included with his report. Industry believes that a balance can be achieved without harming the consumer. Ultimately all costs are passed to the consumer. When coupled with assessment fees and financial audits for lenders the annual regulatory cost for a small business originating 100 loans in NC can be as much as \$18,000. While a reduction in bond coverage will not bring the regulatory costs into line with other our neighboring states, it is a start.

Surety Bond Proposal

BROKERS

Current Requirements

| Production | Bond |
|---------------|-----------|
| \$0 - \$10MM | \$75,000 |
| \$50 - \$50MM | \$125,000 |
| \$50MM+ | \$250,000 |

Proposed

| Production | Bond |
|--------------------|-----------|
| \$0 - \$49,999,999 | \$50,000 |
| \$50MM+ | \$100,000 |

LENDERS

Current Requirements

| Production | Bond |
|-----------------|-----------|
| \$0 - \$10MM | \$150,000 |
| \$10MM - \$50MM | \$250,000 |
| \$50MM+ | \$500,000 |

Proposed

| Production | Bond |
|--------------------|-----------|
| \$0 - \$99,999,999 | \$100,000 |
| \$100MM+ | \$150,000 |

All with a 1 yr. tail...