REPORT TO THE HOUSE COMMITTEE ON BANKING LAW AMENDMENTS




North Carolina Office of the
Commissioner of Banks

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North Carolina

OFFICE OF THE COMMISSIONER OF BANKS

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Commissioner of Banks

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PURPOSE

This report has been prepared by the N.C. Office of the Commissioner of Banks ("NCCOB") for the House Committee on Banking Law Amendments ("Study Committee") as it considers whether changes need to be made to current banking and mortgage laws as detailed in the Legislative Research Commission's 2013 Authorization Letter.[1]

BACKGROUND

Joint Legislative Study Commission on the Modernization of North Carolina Banking Laws

The 2011 North Carolina General Assembly ("NCGA") authorized the creation of the Joint Legislative Study Commission on the Modernization of North Carolina Banking Laws ("Commission").[2] The purpose of the Commission was to determine whether and to what extent the North Carolina Banking Laws need to be updated.

The Commission, co-chaired by Senator Harry Brown and Representative Harold Brubaker, held a series of public meetings from November 2011 to April 2012, to consider feedback from all stakeholders. A report was issued to the 2012 Regular Session of the General Assembly on April 26, 2012.[3] The Commission's recommended changes were incorporated in Senate Bill 816, which passed the Senate and the House and was signed into law by the Governor in 2012.

In addition to modernizing the banking laws, the new law also:

- Altered the funding structure for mortgage oversight, by changing it from a fee-based structure to an assessment-based structure, similar to the process for bank assessments. This change was made because mortgage fees had never fully covered the cost of mortgage regulation, which was subsidized by bank assessments. The current assessment structure was recommended by the Mortgage Bankers Association. The mortgage assessment statute is NCGS 53-244.100A.
- Reduced the number of State Banking Commission members from 22 to 15, with 8 public members, 5 practical bankers, 1 consumer finance representative, and the State

[1] http://www.ncleg.net/documentsites/committees/BCCI-6612/LRC%202013%20Authorization%20Letter.pdf, pp. 8-9.

[2] http://ncleg.net/gascripts/Committees/Committees.asp?sAction=ViewCommittee&sActionDetails=Non-Standing_6523

[3] http://www.ncleg.net/DocumentSites/Committees/JLSCMNCBL/Meeting,%202012-04-26/Study%20Commission%20on%20the%20Modernization%20of%20NC%20Banking%20Laws%20Report%20(2).pdf

Treasurer as an *ex officio* member. Until that time, the last change to the State Banking Commission occurred in 2001 when the NCGA merged NCCOB with the Savings Institution Division, and combined the Savings Institution Commission into the State Banking Commission. The Commission believed the State Banking Commission was too large in 2012; therefore, the new law reduced the number of members to 15 and also redefined the makeup of the State Banking Commission. Membership requirements were promulgated in NCGS 53C-2-1.

House Committee on Banking Law Amendments

In 2013, the NCGA authorized a study of the banking laws, by the House Committee on Banking Law Amendments, to revisit the legislative changes made in Senate Bill 816.

The Study Committee also is reviewing prior legislation as a result of the implementation of the North Carolina Secure and Fair Enforcement Mortgage Licensing Act ("NC SAFE Act") in 2009.[4]

By way of background, in 2008, the Secure and Fair Enforcement for Mortgage Licensing Act ("Federal SAFE Act") was signed into law at the federal level. It mandated that all states implement a state version of the SAFE Act in an effort to more consistently regulate mortgage originators and brokers nationwide. If a state failed to implement its own version, the Federal SAFE Act gave the Secretary of Housing and Urban Development ("HUD") authority to establish a loan originator licensing system for the licensing and registration of loan originators operating in the state. Given this federal mandate, NCCOB met with stakeholders in 2009 to discuss potential legislative changes. As a result of that discussion, bond requirements were recommended to the NCGA. The NCGA introduced the NC SAFE Act in 2009, promulgating the current bond requirements in NCGS 53-244.103.

The NC SAFE Act also included an audited financial statement requirement to verify minimum net worth requirements, which was discussed at the above mentioned stakeholder meeting in 2009. The audited financial statement requirement was incorporated in the NC SAFE Act and promulgated in NCGS 53-244.104.

The Study Committee held its first meeting on January 22, 2014, and Commissioner of Banks Ray Grace presented an overview of NCCOB. Representatives of the mortgage industry also spoke in support of changing current laws regarding bond requirements, audited financial statements, membership on the State Banking Commission, and assessments.

[4] http://ncleg.net/EnactedLegislation/Statutes/HTML/ByArticle/Chapter_53/Article_19B.html

NCCOB Stakeholder Meeting

On March 13, 2014, NCCOB held a stakeholder meeting in response to a request from the mortgage industry for a forum to discuss possible amendments to current mortgage regulation in relation to the study. (See Attachments A and B for the agenda and list of attendees.)

The following summaries provide background and include key points from the stakeholder meeting and are intended to inform the Study Committee as it considers all views with regard to the study on banking and mortgage laws.

SURETY BONDS

After introductory remarks by Commissioner of Banks Ray Grace and Katie Bosken, attorney at NCCOB, the discussion on March 13 began with the agenda item on bonds.

Mr. Charlie Fields, Financial Program Manager in the Non-Depository Entities Division at NCCOB, provided an overview of surety bonds as follows:

- Surety bonds were first required in 2002 under the N.C. Mortgage Lending Act. Mortgage lenders were required to have a $150,000 bond, and brokers were required to have a $50,000 bond.
- In 2008, the Federal SAFE Act was passed to establish minimum standards for licensing of mortgage loan originators, and HUD subsequently provided commentary on the model state law, which was prepared by the Conference of State Bank Supervisors ("CSBS") and the American Association of Residential Mortgage Regulators ("AARMR"), permitting states to have bonding requirements at the company level as opposed to individually requiring mortgage loan originators to have a separate bond.[5]
- In response to the Federal SAFE Act requirements, the NC SAFE Act became effective July 31, 2009, requiring surety bonds at the company level, based on loan dollar volume as follows:
  - Lenders - $150,000 to $500,000 (58% of current licensed lenders fall into the $150,000 category)
  - Brokers - $75,000 to $250,000 (85% of current licensed brokers fall into the $75,000 and $125,000 categories)
  - Servicers - $150,000
- The purpose of the bonds is to take care of any claims against the licensee to secure the faithful performance of the obligations of the licensee under the NC SAFE Act. These obligations include borrower restitution, third party claims such as records storage fees or unpaid appraisals, and payment of fines or civil money penalties.
- There have been a couple of occasions where the bond amounts were not adequate to provide coverage for the amount of claims filed. In one case, a total of $92,000 was

[5] http://mortgage.nationwidelicensingsystem.org/SAFE/NMLS%20Document%20Library/MSL-Final.pdf, page 6.

claimed against a bond of $50,000, which left a $42,000 shortfall. Another example involved $865,000 claimed against a $150,000 bond, leaving a $715,000 shortfall.

Mr. David Tyndall of Mortgage Choice, Inc., provided the following feedback:

- In looking at the NMLS region that includes North Carolina, along with the US Virgin Islands and 10 other states, Mr. Tyndall believes that North Carolina was fairly aggressive and restrictive in how it administers bonds compared to other states in its regions. Specifically, North Carolina has the largest surety bond requirement [for brokers] for the maximum level of $250,000 and the second largest for the minimum surety bond at $75,000 (Arkansas had the highest). North Carolina also is one of only three states in the region that require a tail – and one of only two states that require a tail of five years (Tennessee requires a tail of two years).[6]
- Mr. Tyndall agreed that bonds are necessary in order to protect everyone; however, he believed it was necessary to consider whether over time the state had possibly gotten to a position where the bonding requirements were a little more than would be appropriate.

Mr. George Teague of the Mortgage Bankers Association of the Carolinas inquired about the cost of doing business with regard to bonds and its relationship in North Carolina and surrounding states from a competitive standpoint; specifically, the cost of bonds for premium volume.

- Mr. Robert Duke of the Surety & Fidelity Association of America responded that the premium rate is determined by the company. He said the bonding industry develops a component of the loss cost, which is a component to the premium that is based on loss history, and the surety itself without a multiplier, i.e., the expenses – to determine the premium rate for a mortgage broker. It depends on the particular applicant, but is in the range of approximately 1%-2% of the bond amount, which is consistent across the states. Surety itself is a small line of business that rarely has state-specific rates, but generally, a country-wide rate.
- Mr. Tyndall said the information provided by Mr. Duke correlates with what the mortgage industry is seeing – the range is roughly 1%. Mr. Tyndall researched the number of non-depository mortgage brokers and lenders required to hold surety bonds in NC and the relative amounts of those bonding requirements. From 2004-2007, premiums paid by NC lenders and brokers ranged from $400,000 to $600,000 per year. From 2007-2014, premiums paid by lenders and brokers ranged from $200,000 to $300,000 per year. This reduction was, in part, a result of fewer companies being licensed.
- Mr. Duke added that surety bonds are a unique type of insurance in the sense that one reason it is required is that the surety will provide a bond only to that mortgage broker or bond principal that it has determined through its underwriting can perform, so there

[6] In NC, a surety bond is still in effect for five years after a bond is cancelled. During this five year period, or tail, claims can continue to be filed against the insurance policy.

is a prequalification function as well. Therefore, in the discussion of the ability and the difficulty in getting the bond, particularly surety bonds, in addition to the bond's express function, you should weigh in the benefits of the prequalification and screening, as well as the cost.

- Mr. Duke also stated that it is a balancing act in terms of what is the right amount – one way is to consider the bonding industry's exposure to potential claims as a means of determining the amount; another way is to set the amount such that there is going to be meaningful prequalification.

Mr. Hank Cunningham of Cunningham and Associates, requested a breakdown of the 28 bond claims filed by NCCOB over the past several years, by broker, lender, and servicer. He also requested the units of loans made over the same time period.

- That information is included in this report as Attachments C and D.

Mr. Donald Fader of SMC Home Finance stated that he appreciated the qualifying process mentioned by Mr. Duke, but he was concerned about the aggregate resources applied to bonds – premiums of $400,000 to $500,000 per year, with claims running less than $100,000 per year – leaving $400,000 on the table. He believed that bonds are written to a no loss ratio and asked Mr. Duke whether claims for bonds were anticipated in premiums.

- Mr. Duke said Mr. Fader was correct, but that he has to be careful when he looks at the relationship between claims and premiums, because it is hard to prove a negative. Without prequalification, it is one thing to think about how much the claims would have been, but another thing to think about when evaluating losses is that in many cases, surety is a line of insurance of catastrophe as opposed to frequency. So as opposed to many losses, there is that one big broker or lender that goes out of business that causes a loss of a significant amount, and that is what you are trying to avoid by raising the amount.
- Mr. Fader asked about the loss ratio on bonds and percentage of premiums.
- Mr. Duke said he believed there had been a 16% or 17% loss ratio nationally for five years. Mr. Duke added that you have to take into account the prequalification and in some cases, unlike an insurance property and casualty loss, the surety has a right of recovery, a right of indemnity, so the ratio also takes into account recoveries and in some cases, the surety may be requiring some type of collateral.

Ms. Sara Weed, attorney at NCCOB, stated that the Federal SAFE Act would have required bonds against individual loan originators. However, NCCOB opted to permit the sponsoring entity to assume liability for them through a corporate bond. Ms. Weed asked if the bond had been required of individual loan originators (as was the case under the prior Mortgage Lending Act), rather than only the companies that sponsor loan originators, how that would have affected the calculus of bond amounts.

- Mr. Duke responded that it would have been significant. A bond requirement on the entity basis is much more workable from an underwriting perspective, because part of the prequalification involves review of financial strength. Therefore, it is more likely that

the entity is going to have the financial strength to be able to qualify for a bond versus an individual mortgage loan originator.

- Ms. Weed stated that would change the profile of exposure for the entity because it is assuming liability for the individuals, thereby elevating the necessary bond level for the entity.
- Mr. Duke said the bond amount would be raised to account for the fact that the entity is covering multiple individuals.

Mr. Al Ripley of the NC Justice Center made several points:

- He stated that it is important to take into account that in addition to any enforcement actions involving NC regulators, there are other actions engaged in by the private bar and private attorneys that bring cases against mortgage brokers and then make claims against the bonds as well. He was not certain that the NCCOB had captured these numbers, and he noted that it is another piece that we have to look at when we think about the number of claims made.
- He also said there are a number of claims that can be made in relation to brokered loans that have a very long statute of limitations and therefore, the five-year tail should not be shortened and there are good arguments for making it longer.
    - For example, in the instance where there are fiduciary duties, the statute of limitations in NC is ten years. Therefore, it is possible for borrowers to be bringing cases ten years after the loan is originated. Elimination or shortening of the tail coverage would make it far more difficult for borrowers that have been harmed to recover their losses.
    - In situations involving the Unfair and Deceptive Trade Practices Act, there is a four-year statute of limitations.
    - In instances of fraud, the statute of limitations begins at the point of reasonable discovery by the borrower.
- He also added that bonds serve many functions in protecting consumers, including protecting the marketplace and ensuring that we have a good and strong housing market. He noted that what we saw in 2005 to 2007 involved unhealthy practices in NC, not only putting borrowers in difficult circumstances, but also putting our entire economy in difficult circumstances.
- He also said Mr. Duke's point regarding the screening nature of bonds was good in that it helps to ensure we have good quality players in the marketplace.

Mr. Tyndall made the following points:

- He said, in speaking with Governor McCrory and his office, one of the things that became a theme was that NC needs to be careful that its laws are not more restrictive than at the federal level. He added that he took it a step further and was very clear that he did not feel like North Carolina should be at a disadvantage with surrounding states with respect to job creation.
- Mr. Tyndall reiterated his view on NC's tail compared to other states. He agrees that a tail is a great idea, but is not certain that a five-year tail is appropriate. He said there is a

cost associated with it that is borne by the consumer. Therefore, the question is what is appropriate for NC consumers, and are they going to be adequately protected.

Rep. John Szoka referred to Mr. Ripley's statement regarding his concerns from 2005 to 2007. He said that he did not believe we will return to those days, due to current state and federal laws. He said that he believed all of the bad actors have been driven out of the industry. He also asked if Mr. Ripley had the number of civil actions that have been put against bonds.

- Mr. Ripley said he has no way to track the activity of all attorneys in NC, but is aware of cases of private rights of action where the process involves a suit that is brought against the broker and a separate suit is brought against the bonding company, and then a motion is made to consolidate the two actions.
- Rep. Szoka asked for the magnitude, saying if we are only talking about 24 to 28 cases over the last 8 or 10 years, it is not a large magnitude, but if there are thousands of these cases, that is a different issue.
- Mr. Ripley said he did not know the magnitude because he was not aware of any entity tracking that information. However, he pointed out that if 28 cases is considered to be a few, to them it is a significant number. When people have a problem where they lose their home or are put in a bad mortgage it is incredibly disruptive to their lives, and is a tremendous burden. Also, he noted that 1% on a $75,000 bond, $750 a year, for a company that is well-operated and professional is not a very large burden versus the potential loss to a homeowner.
- Mr. Fields added that for the 28 claims filed, there were 3 or 4 that resulted from outside claimants of which NCCOB was aware. However, there could be others of which NCCOB is unaware – despite the fact that there is a requirement for the surety bond company and the licensee to notify NCCOB.

Mr. Nathan Batts of the North Carolina Bankers Association reviewed some history regarding bonds.

- He remembered the time frame from 2008 to 2009 and a meeting that occurred at NCCOB to talk about bond requirements and the development of the NC SAFE Act. He said that there were many stakeholders involved and the mortgage origination industry was represented. He added that the state had to come up with a framework in NC or the federal government was going to put its own version in place, so the stakeholders tried to take a measured approach.
- He noted that in NCGS 53-244.103, the Commissioner has the discretion to waive surety bonds. He said that the statute sets out various criteria, such as the licensee having been licensed for at least 3 years and having a net worth of at least 4 times the required bond amount. He added that if there is a $750 cost on a $75,000 bond, if that is a source of strength and that is something that can be utilized in the event that there is malfeasance, then that seems like there is a rationale behind a surety bond requirement.
- Mr. Chris Kukla of the Center for Responsible Lending added that he had been in meetings at the NCCOB and recalled the discussion about the bond amounts. There was

recognition that the $50,000 bond was not really screening out anybody. The previous Commissioner had noted that basically anybody who wanted to get a $50,000 bond seemed to be able to, and the inability to do so supported that secondary screening function Mr. Duke mentioned.

Mr. Kukla provided comment regarding the total cost of bonds.

- Ne said nobody is saying we should get rid of the bonds entirely, so in terms of the overall cost in North Carolina versus other states, we are not talking about a reduction of $400,000 or $600,000 or $200,000 or $300,000 a year. He added that if you are considering lowering to something approaching those in a neighboring state, the difference in cost is going to be marginal. If looking at $100,000 or $50,000, extrapolating that over the entire mortgage market, you might be talking about a dollar a loan, which is not an extreme cost to ensure that we have reputable actors in the marketplace and that consumers are adequately protected from any harm that might occur.

Mr. Fader asked Mr. Tyndall about the bond levels for certain states.

- Mr. Tyndall replied that Virginia starts at $25,000. Virginia tiers to $50,000, $75,000, $100,000, and $150,000. Tennessee is at $45,000, $90,000, and $135,000. South Carolina is $25,000, $50,000, and $55,000. Mr. Tyndall added that he wanted to have a dialogue about bonds and does not want to do away with bond requirements and said they have a value as long as they are appropriately placed.
- Commissioner Grace said he thinks there is a certain peril in overreliance on comparison with other states, within the region or without, because some of those states have complementary laws that may present an offset. For example, with respect to the tails, we have a five-year tail in North Carolina, and obviously that creates agitation with some, but some states that have no tail have a fund that is designed to compensate for the absence of one. (Mr. Tyndall interjected and said Florida has no bond.) So things are not always as they seem, so it is one of the reasons that he appreciates this opportunity to get together because there is a lot we can all learn from one another, and it is important that we do that.
- Representative Szoka agreed this is a very good conversation. He also referenced Mr. Kukla's previous comment that a dollar per loan does not seem like an extravagant amount. Rep. Szoka said regulatory agencies and legislatures have to be very careful about taking that approach to an extreme in looking at things a slice at a time, because when you add a dollar per loan from this and a dollar per loan for whatever the business is, what small business owners are struggling with right now is not a dollar added to the cost. It is multiples of dollars from many different sources. He would just caution the legislature or regulatory agencies and whoever has comments to be careful of taking that approach in looking at this or any other regulatory action.

Ms. Harnick referenced an earlier comment made by Rep. Szoka, where he mentioned the idea that the Dodd-Frank Act and NC law changes hopefully have made the market safer. It made her think that does suggest that maybe we could reduce the bond requirement. However, she

said one thing we need to remember is the bond is here for people who violate the law, so the market will be safer for those who comply with the law.

Mr. Tyndall said another deterrent is if you as a professional have a bond and there is a claim placed on that bond, the likelihood is diminished greatly that you will ever get another bond.

Mr. Batts noted that with regard to surety bonds, he thinks part of the intent is to address the actions by the broker, individual, or the entity that is conducting the malfeasance, and to look at things holistically and try to determine whether there should be some adjustments. There are other entities further down the line that can inherit some of these loans. He noted that in a situation described earlier, there is $800,000 or so worth of additional loss that is not really covered, and he would hazard in that circumstance that some claims may be made against some of the other entities that may have acquired some of those loans. He said that reality has to be factored in as part of these broader discussions.

AUDITED FINANCIAL STATEMENTS

The second agenda item involved a discussion of audited financial statements, and Deputy Commissioner of Banks Molly Sheehan provided the following overview.

- The NC SAFE Act requires a minimum net worth of $100,000, for mortgage lenders and servicers as well as audited financial statements. As noted above, the purpose for these requirements is to assess net worth and financial responsibility.
- Mortgage brokers are required to have a certified statement of financial condition and a net worth requirement of $25,000.
- Ms. Sheehan also noted that most investors, including FHA, VA, Fannie Mae and Freddie Mac, require audited financial statements and a net worth of $2 million to $2 ½ million. She said that NCCOB looks at and assesses lenders' responsibilities and the stability of their finances. This becomes relevant in the case of a lender that either must make refunds to consumers or repurchase loans from investors.
- She added that NCCOB examiners have discovered that brokers sometimes have inflated their assets, which is concerning.
- She noted that 58 percent of NC licensees are FHA-approved. Most lenders fall under Title II, which are nonsupervised lenders and correspondents for FHA, and are required to have audited financial statements.

Ms. Lisa Glenn with Stonegate Mortgage gave a breakdown of how lenders seek to purchase loans from correspondent lenders.

- She said there is another tier of lenders known as mini-correspondents. They are not Title II lenders and have to apply for warehouse lines because they do not have their own funds. Larger lenders have warehouse funds as well, but they are a different level of lender. It is the next step after the broker level.
- Warehouse lenders, as well as correspondent accounts such as a Stonegate, do not require audited financials from them. She said Stonegate underwrites their loans and

takes the credit underwriting risk for those transactions, so there is a tremendous difference in the level of financial risk that the mini-correspondents assume.

- She said the reason you do not see a lot of lenders like that in NC is because NC requires $100,000 audited financials. She went on to say NC has fewer mini-correspondents because of the greater standards required. Whether intentional or not, there is a whole other delivery channel out there in the country that North Carolina discourages.

NCCOB staff provided additional information regarding mini-correspondents in Attachment E.

Mr. Fader commented:

- The Federal SAFE Act indicated that applicants must either meet a net worth requirement, a surety bond requirement, or pay into a state fund. He also said CSBS-AARMR's model state statute reflects that choice. The model state statute was roughly 7,500 words, but became a 15,000-word document in NC and required two of the three – an audited financial and net worth.
- The bond provides a certain level of comfort for NCCOB because it fulfills part of the screening process. An audited financial does the same thing. Mr. Fader suggested that NCCOB is outsourcing licensing approvals by getting third party documentation.
- The audit to prove that a small lender has $100,000 in net worth is going to cost him $5,000 to $8,000. He said that was an expensive proposition for a small lender. He is not required to have a financial audit for anything else that he does. He has $42 million in credit lines that do not require a financial audit. He said BB&T visited his office two weeks ago and expressed surprise, asking why he had to have a certified financial audit. Mr. Fader replied that his regulator requires it. He said BB&T does not require an audit until they get to $10,000,000 or $15,000,000.
- He said the cost of the audited financial statement is a cost that is borne by the small independent professional that ultimately is going to be passed on to the consumer.
- With regard to licensees inflating their net worth, NCCOB has statutory authority to request any financial document at any time, and if they find that a licensee is inflating their financial statement, require them to have an audit. Beyond that, he suggested that the cost is disproportionate because he is paying 8% a year to prove that he has $100,000. He said in five years, he is probably not going to have $100,000 as a result of paying for the audit, and that deserves consideration.

Ms. Weed responded to Mr. Fader's comments.

- Addressing Mr. Fader's reference to the Federal SAFE Act and the model state law regarding one of the three requirements, she said that the SAFE Act in that context refers only to mortgage loan originators, not to lenders or brokers. It is not an act that is related to the licensing of entities but is instead focused on the licensing of individuals who might be employed by entities. The Federal SAFE Act does not speak at all to the requirements of net worth or surety bonds as being mutually exclusive but is instead referring to something entirely different.

- As to the second issue raised in terms of requiring an audit, she said it was fair to say that to the extent that there is exposure to NCCOB in issuing licenses to entities who may or may not be financially responsible relative to the requirements of the act, the more exposure those entities have, then NCCOB needs even more assurance that the basis for its determination of licensure is a sound one. Therefore, having a certified financial statement does not give NCCOB nearly the same confidence that having an audit does.
- She cautioned against the impression that NCCOB could simply just do more diligence to get at whether a licensee is or is not adequately capitalized. NCCOB wants to be able to get down to the business of actually supervising the operations of mortgage lenders and brokers, not evaluating on the front end whether they should be market participants.

Ms. Victoria Starace with Liberty Mutual Surety said that she wanted to speak on behalf of most surety companies. She noted that to receive an audited statement when insuring a broker or a lender is the cream of the crop. She said companies would all love to look at audited statements. She said that when you have small lenders, small brokers, and small companies, the cost associated with an audited statement is astronomical sometimes, and if you could narrow it down to a simple CPA statement that would suffice for most surety companies that the due diligence is done in looking at the financials.

Mr. Phil Lamm with BB&T referenced Mr. Fader's earlier comments regarding BB&T's audit requirements.

- He clarified that Mr. Fader's experience had to be in the commercial loan context.
- Mr. Fader agreed that it was.
- Mr. Lamm noted the bank has different standards on the consumer side as an aggregator. BB&T requires $22 million net worth and above, plus audited statements. He said that is common in the aggregator industry.

There was continued discussion regarding SAFE Act requirements. Ms. Weed provided additional information contained in Attachment F.

Mr. Cunningham made the following comments:

- Historically, HUD required audited financial statements. One of the ways to qualify was as a correspondent, and that required audited financial statements and certain net worth requirements. However, HUD has done away with that requirement, because the lender bears the risk of purchasing and underwriting the loan. He thinks North Carolina began requiring audited financial statements because of those requirements.
- He also referenced Mr. Fader's earlier comment about the cost of audited financial statements. Mr. Cunningham said his accountant told him costs could range from $8,000 to $13,000 for audited financial statements, depending on the size of the entity.
- He also said he asked a couple of commercial banks if they would require an audited financial statement from a lender that was applying for a $5 million dollar warehouse loan or would a review be adequate. The response in both cases was that a review

would be adequate, because they are going to underwrite the risk of their counterparty. Therefore, the issue may be that North Carolina has a one-size-fits-all approach. North Carolina requires audited financial statements regardless of the size of the entity or whether it is a lender. A lender can be a servicer or it can only be an originator. There is a difference in risk between somebody servicing loans and somebody originating loans.

- Mr. Cunningham suggested an alternative way to determine net worth could be verification from an accounting firm in lieu of an audit, depending on the risk the lender exhibits. When he said risk, he meant the size of the lender or whether they are a servicer or a lender.
- Ms. Glenn suggested doing as HUD does, by looking at Title II.

Ms. Sheehan commented that before 2011, FHA had a number of ways of qualifying, and an entity could be sponsored at different levels. She said, although the standards of approval changed in January of 2011, HUD still requires audited statements, whether an entity is selling or servicing, and their main correspondents require audited financials as well. She acknowledged that if one of the correspondents or other entities wanted to take on a mini-correspondent, then that does fall under the lender entity.

Mr. Kukla made a few points in response to Ms. Sheehan's comments.

- He said that part of the reason that HUD is concerned about audited financials is repurchase risk. HUD wants to be sure that if a loan is sold, and that loan is guaranteed by FHA, there is an entity available to repurchase that loan so that they can minimize their losses.
- He said that the audited financial statement may also play a consumer protection role in that it ensures that there is financial viability in case there is a claim against that entity.

- He also noted that there is limited liability in NC under federal and state law. He said there are only certain times when a consumer can make a claim against the purchaser of a loan. He observed that there are two different things going on, and so the discussion about whether HUD requires or does not require audited financial statements is appropriate, but it is a discussion about one particular concern of the repurchase risk, not necessarily risk of harm to the overall market.

Mr. Cunningham stated that his point was really related to smaller lenders, because larger lenders that are approved by HUD, FHA, Fannie, Freddie, etc., or an aggregator, are going to be required to have audited financial statements. He added that audited financial statements are going to be what the industry requires from an investor standpoint. He clarified that when he says investor, he is including the agencies.

Ms. Sheehan said that in bringing up net worth, NC only requires $100,000 for the lenders by statute. She noted that from 2010 through 2013, the amount of refunds that were required to consumers exceeded $18 million. She said that figure was from 85 different examinations that required refunds, with the year 2010 having the highest amount. She attributed reductions in other years to the economy and to the requirements that were put in place. In 2013, she said

there were over $1 million in refunds to consumers, and that supported having some type of confirmed net worth.

Mr. Cunningham, Mr. Teague, Mr. Fader, and Rep. Szoka posed a number of follow-up questions for clarification to Ms. Sheehan. She said that nine entities were ordered to make refunds. She said that she would likely be able to provide the number of borrowers who received refunds, and the size of the entities, but did not have that number available during the meeting.

After the meeting, Ms. Sheehan followed up with the refund information found in Attachment G.

Mr. Fader cautioned that net worth is going to be a slippery number. He suggested that an audited financial is a snapshot of a single day and time, and that when things can go bad in a company the temptation for the owner is to move the net worth somewhere else. He added that NC has the backstop of a bond and also requires evidence of a $1 million plus warehouse line. He continued by saying there are several issues at play and proving the net worth through an 8 percent or an $8,000 certified audit seems to be a poor use of resources. He said a compilation and review would be significantly less expensive and perhaps would provide a comfort level that would be acceptable to the NCCOB.

Mr. Ripley said from a consumer perspective, he liked the idea of having some ability to have a standardized review of the licensees that are going to be licensed under the SAFE Act and operate in NC. He thinks that provides a measure of protection for consumers so there is at least a snapshot in time of the viability of the firms that are operating in NC and that gives NCCOB an easy way to fairly evaluate the health of the various firms.

Mr. Tyndall questioned whether a compilation would also do that.

Commissioner Grace responded that a compilation would give NCCOB a snapshot in time. He added that it is important to note that under generally accepted accounting principles, an audited financial statement is not a snapshot in time. In order to get an unqualified opinion, the accountants are obligated to determine the ongoing nature of the firm. And so it is not just the snapshot with an audited financial statement. He noted that, based on his experience as a bank examiner, there is a significant difference among self-prepared statements, compilations or reviews and audited statements.

MEMBERSHIP ON THE STATE BANKING COMMISSION

The third item on the agenda for the March meeting involved discussion of membership on the State Banking Commission.

Ms. Tina Krasner, attorney at NCCOB, provided an overview of the State Banking Commission including its current makeup and statutory responsibilities.

Mr. Tyndall made the following points:

- A large portion of the revenue generated to fund NCCOB's budget comes from non-depository mortgage brokers and lenders. However, even if it was 1%, that still should not preclude mortgage brokers and lenders from having a seat on the State Banking Commission.
- The mortgage industry does not want to take seats away from any entities that currently have a seat on the State Banking Commission. Mr. Tyndall proposes, as he did with the Governor's office, adding another seat for non-depository mortgage brokers, and perhaps adding an additional seat for public members, so that the public would retain a majority position.

Rep. John Szoka asked if anyone would deny a seat to the mortgage industry.

- Ms. Glenn stated it was a great idea. Because of the competition for small business owners within the mortgage lending business, it is important to keep brokers active and healthy within North Carolina. Also, because of the way mortgage brokers are paid within the lending process, they are the consumers' best advocate for finding a mortgage loan. She said compensation is not driven by where they place their loan. They set compensation, and anything above and beyond that in their pricing goes to consumers. It is a balancing act to keep the market honest. She feels like the industry is discouraged, and they protect consumers in NC. This is why she thinks they should have a seat on the State Banking Commission.
- Ms. Weed asked: To the extent that the State Banking Commission acts as an appellate forum for things such as merger decisions of banks or *de novo* applications and does not have a policy-making function – what is it that the mortgage industry is interested in having access to on the State Banking Commission?
- Mr. Fader stated that to the extent that we have a State Banking Commission or agency that regulates the industry, it may appear that the State Banking Commission only involves itself with banking-related issues. He said the mortgage industry pays for 25% of the budget and needs to discuss issues that relate to non-depositories. He mentioned that NCCOB should generate non-depository reports. He noted the website has consumer finance and bank annual reports, but none for non-depositories, and feels the industry is overlooked by the State Banking Commission. Representation by the mortgage industry would be helpful on the State Banking Commission he said.
- Commissioner Grace asked about the perceived advantages or disadvantages of having a member from a particular industry. He said that this issue was brought up during the banking law revision in 2012. He made the recommendation then that a non-depository representative be included, and the legislature ultimately chose a consumer finance industry representative. He said the reason that the banking industry is represented is because the Commission started out as the Banking Commission. Banking is a specialized industry and important to the state as a major employer and economic

force, so it was important to have people on the State Banking Commission who understood the industry. The NCGA also recognized the need to protect the public, so the law requires that the majority of the State Banking Commission positions be filled by public representatives. He said he does not see how it would hurt to include someone from the mortgage industry, but he cautioned that care had to be taken against constant tinkering with the Commission.

- Rep. Szoka inquired what other industries were regulated by NCCOB.
- NCCOB Staff stated that other regulated industries include check cashers, money transmitters, and refund anticipation lenders.
- Rep. Szoka said that based on his observations for the past 10 to 15 years the majority of regulations and issues have involved mortgages and banks. He asked whether it would be beneficial to have someone experienced on the Commission in those areas.
- The Commissioner said perhaps so.

Mr. Batts noted that from a drafting perspective, if the State Banking Commission were to be reevaluated, the definition of public member within Chapter 53C would need to be examined because currently a public member is defined as a member of the Commission who is not a practical banker. He said the definition does not include a limitation for consumer finance licensees, so that is an omission that needs to be corrected. He further stated that if a member from the mortgage industry were to be added, the definition would also have to be reevaluated to have exclusions for practical bankers, consumer finance licensees, and mortgage representatives.

MORTGAGE ASSESSMENTS

The final agenda item of the March 13 meeting involved mortgage assessments.

Ms. Elizabeth Hammond, Chief Financial Officer at NCCOB, provided a brief overview:

- From the end of 2011 to the beginning of 2012, NCCOB met with the mortgage industry to discuss the funding deficit for supervision of non-depositories. Since regulation of the mortgage industry began in 2002, she said that NCCOB had never been able to meet the full cost of regulation through fees. She said that NCCOB representatives met with Mr. Teague, Mr. Cunningham, Mr. Fader and Mr. Bill Bost over several meetings to discuss ideas on funding. Ms. Hammond presented some 38 different funding proposals. Ultimately, the assessment tier structure selected was similar to the bank assessment structure.
- Another reason for the assessment approach was consolidation of the banking industry. Prior to the mortgage assessment, bank assessments covered the deficit in non-depository regulation. Due to the recession, banks could not be relied on to continue to fund the cost of regulation of the mortgage industry.
- NCCOB examined the funding possibilities, met with stakeholders, and talked to entities that would experience the biggest financial impact from the assessment change before recommending the change.

Mr. Teague noted:

- The industry was faced with the prospect that if the regulation of the industry was not adequately funded, another regulator would step in.
- He also noted that the requirement that mortgage companies reimburse NCCOB for the cost of examination fees was eliminated when the assessment was implemented.
- He stated that he would like to table the conversation on assessments as the industries that are most affected by the assessments are in discussions to come up with an alternate structure.

Mr. Teague asked Ms. Hammond if funding under the assessment was successful and if there was a refund to the industry.

- Ms. Hammond confirmed that 20% of the assessment would be refunded to the industry, because NCCOB's goal was to cover the cost of operating the agency, not to build cash reserves.
- Mr. Teague promised that the banks would not be subsidizing the mortgage industry.
- Mr. Tyndall noted that there could be a real budget issue if NCCOB relies on a singular fee from each entity due to the decreasing numbers in licensure.
- Ms. Hammond confirmed the numbers – mortgage companies have dropped 230% (the high was at 1,696; currently, the number is at 514), loan officers have dropped 112% (the current number of licensed loan officers is 8,121). She also noted that a fee-related revenue stream is not sustainable when there is consolidation in the industry. She added that the volume is still similar, which is why the assessment structure, based on volume, is able to fund the agency.

ADDITIONAL COMMENTS

Ms. Glenn asked the group to be mindful of audited financials because there is a national mini-correspondent channel of business that NC law discourages.

Mr. Teague said that from a global perspective, we know that NC is an importer of capital. He said NC needs to avoid any barriers (such as audited financial statements, bonds, etc.) that make NC look different from other states where investors can put their capital.

Mr. Kukla said:

- NC has always been a leader in creating laws that both protected consumers and ensured that the mortgage market still thrived. In fact, it was the model for the federal law changes in 2009. UNC studies showed NC fared better in the financial crisis than other states that did not have those protections. He added that North Carolinians were still harmed, but their harm was to a lesser extent than other states. North Carolina should be careful when comparing itself to other states, because significant harms occurred in those other states.

- He also said that we hear repeatedly that a lot of the bad guys are gone and the market looks different today. He hopes that our strategy for keeping the market free of bad guys is not that we have to wait for the next financial crisis in order to do that. The financial crisis took care of that, but also a significant amount of family wealth disappeared.
- He noted that as we both look back at history and forecast ahead, we should ensure that we are not opening the door again to some of the kinds of practices that were going on elsewhere.

Mr. Ripley said from the litigation side, he still sees cases mentioned by Mr. Kukla under the current regulatory regime. Going backwards is not a good thing, but we could even look at strengthening some of the rules. He said there are still many cases reported to the Consumer Financial Protection Bureau of abuses involving lending.

Mr. Tyndall said he agrees that we should not go backward but remain strong. He said the caveat is that the drop in numbers was due to disenfranchisement of entities saying they cannot operate here.

Rep. Szoka said to keep in mind that the purpose of the mortgage industry is to provide capital to consumers to purchase houses. To the extent that overregulation diminishes the flow of capital to people who need it, then we are overregulated. His opinion is that there are two extremes – the unlimited flow of capital and then swinging too far on the side of overregulation. The purpose of the mortgage industry is to provide capital to our citizens, and if overregulation is preventing citizens from getting access to the capital to purchase the houses they want to live in, or improve the houses they have been living in, then we need to take a very serious look at that.

Ms. Ellen Harnick of the Center for Responsible Lending said she appreciates the need to make credit available, because that is an issue on the Self Help Credit Union side of their activity. She also noted that with regard to the bonding and audited financial statement requirements, the state should be careful about limiting the protections that are fundamental.

Mr. Fader referenced a 2013 CSBS white paper called an *Incremental Approach to Financial Regulation*. He said that the hearing group focused on issues facing banks and pinpointed excessive regulatory burdens and regulations inappropriately applied to the community banking business model, saying that the one-size-fits-all approach does not work effectively in the industry. He discussed that Kinston is a town with 20,000 people in a county of 50,000. He said it has seven banks, three credit unions, two resident mortgage loan officers (one at Self Help Credit Union and one at State Employees Credit Union), and one non-depository. He said they are working with an access-to-credit issue whereas the smaller lenders, such as Mr. Fader, and brokers are willing to assume risks that other industries or other financial institutions are not. They are able to provide services and products to the borrowing public to enable them to buy and refinance homes. He said the NC economy is not going to turn around absent recovery of the real estate market.

Rep. Stephen Ross said that when the pendulum swings, as has happened every time we have ever had a financial crisis, regulatory burdens seem to increase, causing the flow of capital to come to a halt. The credit standards have become so strict that it makes it impossible to get a loan. However, it appears in his readings that some of the lending institutions are beginning to relax some of the credit score standards. He believes we will probably see a gradual relaxing of some of those standards and scores to the point it will improve capital flow. He said we need to remember that we just went through quite a crisis. Five years out, we are just starting to thaw, but that thawing will continue and the flow of capital will probably pick up. He said that he is not saying some of the regulatory burdens will go away, because federal laws typically are not reversible. However, we can do our part here to make it easier. He hopes to see a recovery in the housing and mortgage markets, because they are critical to the economy – and, he thinks it will happen; it is a slow thaw.

The meeting concluded with remarks by Commissioner Grace. He noted that NCCOB would give careful consideration to all the remarks, compile them, and send them on to the legislature.

ATTACHMENT A

State of North Carolina

Office of the Commissioner of Banks

Pat McCrory
Governor

Ray Grace
Commissioner of Banks

Meeting to Discuss House Committee on Banking Law Amendments

Agenda

March 13, 2014
1:00 pm – 4:00 pm

N.C. Office of the Commissioner of Banks

1:00 p.m.	Welcome from Commissioner Ray Grace, Commissioner of Banks Moderator Remarks Katie Bosken, Attorney, NC Office of the Commissioner of Banks
1:05 p.m.	Discuss bond requirements under G.S. 53-244.103 Brief Remarks by David Tyndall, President, Mortgage Choice Inc.
1:45 p.m.	Discuss audited financial statement requirements under G.S. 53-244.104
2:25 p.m.	Break
2:40 p.m.	Discuss non-depository industry representation on the State Banking Commission
3:20 p.m.	Discuss assessment fee structure under G.S. 53-244.100A
4:00 p.m.	Adjourn

Location: 316 W. Edenton Street, Raleigh, NC 27603
Mailing Address: 4309 Mail Service Center, Raleigh, NC 27699-4309
(919) 733-3016 Fax (919) 733-6918 Internet: www.nccob.org

A T T E N D E E S OF THE MARCH 13, 2014 STAKEHOLDER MEETING

Hank Cunningham, Cunningham & Company
George Teague, Mortgage Bankers Association of the Carolinas
Ellen Harnick, Center for Responsible Lending
Chris Kukla, Center for Responsible Lending
Al Ripley, North Carolina Justice Center
Phil Woods, North Carolina Department of Justice
Robert Duke, The Surety & Fidelity Association of America
Victoria Starace, Liberty Mutual Surety
David Tyndall, Mortgage Choice, Inc.
Lisa Glenn, Stonegate Mortgage
Don Fader, SMC Home Finance
Nathan Batts, North Carolina Bankers Association
Phil Lamm, Branch Banking and Trust Company
Representative John Szoka, North Carolina General Assembly
Representative Beverly Earle, North Carolina General Assembly
Representative Stephen Ross, North Carolina General Assembly
Rose Vaughn Williams, North Carolina Department of Insurance
Bob Mack, North Carolina Department of Insurance

OFFICE OF THE COMMISSIONER OF BANKS:

Ray Grace, Commissioner
Katherine M.R. Bosken, Bank Supervision Attorney
Molly Sheehan, Deputy Commissioner of Banks
Tina Krasner, Attorney
Sara Weed, Attorney
Charlie Fields, Licensing and Consumer Complaints
Elizabeth Hammond, Chief Financial Officer
Ha Cam Nguyen, NCCP, Public Information Officer
Lonnie E. Christopher, NCCP, Paralegal
Angela B. Maynard, NCCP, Paralegal

Also Present:

Hope Chadwick, Office of Rep. Jordan, NC General Assembly
Karen Cochrane-Brown, North Carolina General Assembly
Brandon Watson, Department of State Treasurer

ATTACHMENT C

Year	Bond Claim Amount	Amount of Surety Bond	License Type
	$ 46,553	$ 250,000	Broker
	$ 50,000	$ 50,000	Broker
	$ 25,000	$ 50,000	Broker
	$ 8,632	$ 75,000	Broker
	$ 17,598	$ 150,000	Lender
2012	$ 147,782		
	$ 150,000	$ 150,000	Lender
	$ 8,632	$ 75,000	Broker
	$ 4,076	$ 75,000	Broker
	$ 1,298	$ 150,000	Lender
	$ 1,894	$ 75,000	Broker
2011	$ 165,900		
	$ 3,875	$ 50,000	Broker
2010	$ 3,875		
	$ 50,000	$ 50,000	Broker
2009	$ 50,000		
	$ 5,587	$ 150,000	Lender
2008	$ 5,587		
	$ 1,140	$ 50,000	Broker
	$ 96,871	$ 150,000	Lender
	$ 2,000	$ 50,000	Broker
	$ 300	$ 50,000	Broker
	$ 1,650	$ 150,000	Lender
	$ 3,844	$ 50,000	Broker
	$ 3,645	$ 50,000	Broker
	$ 5,000	$ 50,000	Broker
	$ 4,000	$ 150,000	Lender
2007	$ 118,450		
	$ 1,330	$ 50,000	Broker
	$ 25,000	$ 25,000	Broker
	$ 2,551	$ 50,000	Broker
	$ 4,075	$ 50,000	Broker
2006	**$ 32,956**		
	$ 2,285	$ 50,000	Broker
	$ 2,075	$ 50,000	Broker
2005	**$ 4,360**		
Grand Total:	**$ 528,911**		

Annual Report Mortgage Loan Volume			
Year	License Type	Loan Number	Loan Dollar Volume
2006	Lender	255,111	$ 40,195,895,143
	Broker	72,168	$ 10,285,415,743
2007	Lender	140,410	$ 22,471,256,871
	Broker	51,376	$ 8,016,445,142
2008	Lender	94,780	$ 16,262,879,551
	Broker	28,650	$ 5,515,941,192
2009	Lender	80,542	$ 14,857,796,388
	Broker	22,903	$ 4,704,478,603
2010	Lender	73,963	$ 14,223,802,925
	Broker	16,452	$ 3,561,723,819
2011	Lender	54,803	$ 9,933,487,873
	Broker	12,426	$ 2,715,910,359
2012	Lender	86,937	$ 16,828,709,651
	Broker	15,394	$ 3,330,775,146

2006 was the first year OCOB collected annual report information.

Mini Correspondents

The Mortgage Professional published an article, dated November 27, 2013, defining "mini-correspondent" as a new kind of correspondent, which is seeing a rise in popularity among brokers. However, it said not all brokers fully consider the complexity of the process. A mini-correspondent is defined as a broker who obtains a lender license and enters into agreements with its investors. The broker will take the application, but the investor will underwrite the loan, and the loan will close in the mini-correspondent's name using the mini-correspondent's warehouse line.

At the March 13, 2014 stakeholder meeting, the opinion expressed by one of the attendees is that North Carolina discourages this type of business in the state by requiring an audited financial statement and a $100,000 net worth. They also said that it was a growing business across the country.

After the March 13 meeting, North Carolina reached out to fellow state regulators to get a better sense of how much growth they are seeing with regard to mini-correspondents, and whether they have separate regulations for mini-correspondents versus lenders.

Seventeen states responded: AK, CT, DC, FL, ID, IL, IN, KY, LA, MA, MN, MO, NY, PA, SC, VA, and VT. Sixteen of the states do not have any separate regulations or licensure requirements for mini-correspondents. Mini-correspondents would fall under the licensure requirements for a lender, which is the case in North Carolina.

Pennsylvania, on the other hand, has a separate license for a mortgage loan correspondent, but not a mini-correspondent. The correspondent is required to have a minimum net worth of $100,000, and if they collect advance fees, the correspondent is also required to have a surety bond of $100,000.

Mini-correspondents need a warehouse line of credit. Therefore, warehouse lenders, who underwrite the loan, also have certain requirements of mini-correspondents to minimize risk. For example, Affiliated Mortgage Company, an

affiliate of Benchmark Bank, requires an audited financial statement from the mini-correspondent. They also require the following:

Minimum Warehouse Line Amount - $1,000,000

Financial requirements:

- **$75,000 minimum audited tangible net worth**
- **Two years Business audited financials (if applicable)**
- **Two years Business Tax Returns (if applicable)**
- **Two years Personal Tax Returns for all Guarantors**

Personal Financial Statements:

- **Required for each Guarantor with at least 20% ownership in Company**

Fidelity Bond: Minimum coverage $300,000 each

Eligible loans: Conventional Conforming and VA with approved investors

Funding Percentage: 100%

Transaction fee: $95.00

Background

The Office of the Commissioner of Banks ("NCCOB") is offering additional information regarding the applicability of the Federal S.A.F.E. Act to licensing requirements imposed by the North Carolina S.A.F.E. Act ("NC SAFE Act") specific to mortgage brokers and mortgage lenders.

The dialogue in question was prompted by the following excerpt from the State Model S.A.F.E. Act[1] provided by Mr. Don Fader of SMC Home Finance at the initial meeting of the House Committee on Banking Law Amendments held January 22, 2014 and again at the stakeholder meeting convened by the NCCOB on March 13, 2014:

> (6) NET WORTH, SURETY BOND OR STATE FUND REQUIREMENT—The applicant has met the [States must choose one: net worth, surety bond requirement, or paid into a State fund] as required pursuant to MSL XX.XXX.140.

The language was used to advance the argument that the requirements of NC SAFE Act exceed the minimum standards set forth under the Federal S.A.F.E. Act by requiring both net worth and surety bonds for licensed mortgage brokers and mortgage lenders.

The Office of the Commissioner of Banks seeks to clarify that the language in question applies only to individuals licensed as mortgage loan originators (MLOs) and not to entities licensed as mortgage brokers and mortgage lenders, but only to mortgage loan originators. To that end, the agency wanted to provide background concerning how the identified requirement specific to individual MLOs relates to the requirements of their sponsoring entities, mortgage brokers and mortgage lenders.

Requirements of the Federal S.A.F.E. Act

The language identified above is a subpart of the provision of the State Model Act, that implements Section 1508(d)(6) of the Federal S.A.F.E. Act, which provides:

"The State loan originator supervisory authority has established minimum net worth or surety bonding requirements that reflect the dollar amount of loans originated by a residential mortgage loan originator, or has established a recovery fund paid into by the loan originators."

Requirement as set forth in the Model State Law

This Federal requirement was incorporated by the Conference of State Bank Supervisors and the American Association of Residential Mortgage Regulators, which includes a portion of the language offered by Mr. Fader:

> MSL XX.XXX.060 ISSUANCE OF LICENSE—The Commissioner shall not issue a *mortgage loan originator license* unless the Commissioner makes at a minimum the following findings:
>
> (6) NET WORTH, SURETY BOND OR STATE FUND REQUIREMENT—The applicant has met the [States must choose one: net worth, surety bond requirement, or paid into a State fund] as required pursuant to MSL XX.XXX.140.

[1] State Model Language for Implementation of Public Law 110-289, Title V – S.A.F.E. Mortgage Licensing Act

While subsection (6) refers to "applicant," the prefacing language clarifies that "applicant" means "mortgage loan originator applicant." As such, the Federal S.A.F.E. Act does not provide that state mortgage regulators must choose from among the options of (a) net worth, (b) surety bond, or (c) a state fund in licensing entities like mortgage brokers and mortgage lenders.

The imposition of both net worth and surety bonds for mortgage lenders and brokers is not in any way addressed or otherwise restricted by the requirements of the Federal S.A.F.E. Act, which only speaks to the minimum requirements for licensure of individual MLOs. It is also worth noting that there is no body of Federal law that dictates the licensing criteria that must be applied by state mortgage regulators to mortgage entities.

HUD Guidance on State Implementation of the Federal S.A.F.E. Act Requirements

HUD Commentary Model State Law[2] provides: "HUD has determined that a state may comply with the SAFE Act requirement [set forth under Section 1508(d)(6)] by providing that, in the case of a company that employs more than one loan originator, the bonding requirement may be met at the company level. Individual loan originators would not have to be bonded separately."

North Carolina's Adoption of the HUD Guidance

In keeping with HUD's interpretation, Section 53-244.103(a) of the North Carolina S.A.F.E. Act states:

> "Each mortgage loan originator shall be covered by a surety bond through employment with a licensee in accordance with this section. The surety bond shall provide coverage for each mortgage loan originator employed by the licensee in an amount as prescribed by section (b) of this section and shall be in a form prescribed by the Commissioner…"

As a result, the NC SAFE Act provides that the mortgage broker or mortgage lender sponsoring the MLO assume the liability for the individual licensee through its bond. Thus, the surety bonds required of mortgage brokers and mortgage lenders not only extend to the entity but also the MLOs sponsored or employed by the entity.

While the North Carolina Mortgage Lending Act, the predecessor to the NC SAFE Act, required surety bonds for mortgage bankers and mortgage brokers, the bond requirements imposed by the Federal S.A.F.E. Act tied to individual MLOs consequently increased the surety bond requirements of the entities that sponsor these licensed individuals.

[2] HUD Commentary Model State Law, available online at: http://www.hud.gov/offices/hsg/ramh/safe/cmsl.cfm

The following charts reflect the amount of refunds required by OCOB by License Type, from 2010-2013.

Year	Licenses Type	# of Exams	# of loans	Refund Amount	Avg. Per Exam
2010	Broker	4	171	$38,449.71	$9,612
2011	Broker	1	34	$6,048.32	$6,048.32
2012	Broker	3	8	$7,364.29	$2,454.76
2013	Broker	10	43	$11,163.25	$1,116.33
Total		**18**	**256**	**$63,025.57**	

Net Worth
$25,000

Year	Licenses Type	# of Exams	# of loans	Refund Amount	Avg. Per Exam
2010	Lender	22	8,804	$9,457,699.07	$429,895
2011	Lender	19	3,627	$2,551,371.87	$134,283
2012	Lender	26	2,495	$871,564.49	$33,522
2013	Lender	29	1,720	$127,779.23	$4,406
Total		**96**	**16,646**	**$13,008,414.66**	

Net Worth
$100,000

Year	License Type	# of Exams	# of loans	Refund Amount	Avg. Per Exam
2010	Servicer	1	652	$60,445.85	$60,445.00
2011	Servicer	2	3,649	$71,214.29	$35,607.00
2012	Servicer	4	41,061	$4,264,651.89	$1,066,162.00
2013	Servicer	6	7,838	$1,214,549.24	$202,424.00
Total		**13**	**53,200**	**$5,610,861.27**	

Net Worth
$100,000