

North Carolina's Mortgage Debt Collection And Servicing Act

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June 1, 2008

1. Introduction.

On April 1, 2008, North Carolina's "Mortgage Debt Collection and Servicing Act" (the "Act") became fully effective. The Act came as a response to the increasing mortgage defaults and the legacy of subprime mortgages. Its intent is to make servicing and foreclosure of a mortgage fairer through limiting fees, dictating application of payments, and providing a borrower greater disclosure of and access to loan information.¹

2. The Act covers every "home loan," which is construed broadly.

The Act applies to "every home loan." N.C. Gen. Stat. § 45-91(a). N.C. Gen. Stat. § 45-90 defines a "home loan" as "[a] loan secured by real property located in this State used, or intended to be used, by an individual borrower or individual borrowers in this State as a dwelling." The loan's purpose does not matter. The Act covers purchase money mortgages, refinance mortgages, and equity lines, regardless of the priority. It also applies to loans on first, second, or third homes. No requirements exist for the home to be the borrower's primary residence or for the loan to have a consumer purpose. The only requirement is that the loan is secured by real property that is used or intended to be used as a "dwelling."

Determination of "dwelling" could be problematic where the real property's use changes. For example, a loan may be secured by a rental property, where the house is not the borrower's dwelling at the creation of the loan. If the rental property later becomes the borrower's dwelling, then the Act could apply.² Also, a loan could be secured by real property that is not then a dwelling but is "intended to be used" as a dwelling sometime in the future. This intent may not be clear from the surrounding circumstances. It may be best for a lender to assume any property with a dwelling structure may be subject to the Act and proceed accordingly. Also, a lender could secure a representation or warranty from the borrower, or otherwise develop a disclosure form to show, that no "dwelling" is located on the property and that there is no intent to use the property as a dwelling.

3. The Act applies to any party that services a loan, including the lender, and the Act can have negative effects upon lenders that use third-party servicers.

The Act creates obligations for "servicers." The definition of servicer is cross-referenced from the Real Estate Settlement Procedures Act ("RESPA"). RESPA defines "servicer" as "the person responsible for servicing of a loan (including the person who makes or holds a loan if such person also services the loan)." 12 U.S.C. § 2605(i)(2).³ "Servicing" means "receiving any

scheduled periodic payments from a borrower pursuant to the terms of any loan, including amounts for escrow accounts . . . , and making the payments of principal and interest and such other payments with respect to the amounts received from the borrower as may be required pursuant to the terms of the loan.” 12 U.S.C. § 2605(i) (3). Thus, the servicer is the entity that receives the required payments under a mortgage or deed of trust. *This means that the Act applies to third-party servicers and applies to lenders that service their own home loans.*

Although the Act applies to servicers, if a lender uses a third-party servicer for a loan, the lender must scrutinize its contract with the servicer carefully. The servicer must comply with the Act, otherwise certain loan provisions may be unenforceable. This would directly affect the note-holding lender, as discussed below.

4. New requirements regarding assessment of loan fees will limit unilateral service fees and will require certain mechanisms in billing systems.

The Act limits fees charged for a loan. Any fee must be permitted under all applicable law and the parties’ contract. N.C. Gen. Stat. § 45-91(a)(4). This effectively eliminates any “unilateral” fees. It also highlights that any loan agreement should clearly delineate all possible fees. In light of the Act’s consumer-protection nature, it is likely that any ambiguous language regarding fees in a loan agreement will be construed against the lender. Thus, lenders should review and revise fee explanations to ensure they are clear and unambiguous.

The Act creates assessment and notification procedures for home loan-related fees. Any fee “incurred by a servicer” must be “[a]ssessed within 45 days of the date on which the fee was incurred.” N.C. Gen. Stat. § 45-91(a)(1)(a). In the case of attorney and trustee fees and costs incurred under a foreclosure, such fees must “be assessed within 45 days of the date they are charged by either the attorney or trustee to the servicer.” N.C. Gen. Stat. § 45-91(a)(1)(a). These assessment obligations apply to any borrower “regardless of whether the loan is considered in default or the borrower is in bankruptcy or the borrower has been in bankruptcy.” N.C. Gen. Stat. § 45-91(a). Thus, within the 45-day period, the servicer must make a notation on the account indicating assessment of the fee.

This provision may create new accounting procedures. Servicers must notate on the account all fees within 45 days of incurring the fee. Proper assessment will require a servicer to know all possible fees under the loan agreement and to assess them against the account accordingly. Moreover, the servicer will need to know of any attorney or trustee fees charged in a foreclosure. Given that foreclosure fees must be assessed within 45 days of the date when the attorney or trustees charges them, it may be easier during a foreclosure for the attorney/trustee to advance all costs, including, e.g., the publication of notice, and bill for everything at the end of the foreclosure. This would allow foreclosure fees to be assessed in

one lump sum.

After the fee is assessed, the servicer must “[e]xplain [any fee] clearly and conspicuously in a statement mailed to the borrower at the borrower’s last known address at least 30 days after assessing the fee.” N.C. Gen. Stat. § 45-91(a)(1)(b.). The servicer does not have to take this action if it would violate the bankruptcy code. This notification provision creates another obligation for servicers. Servicers must ensure that mechanisms are in place in order to generate and mail a notice “at least” 30 days after assessment. Mailing notices will be an additional cost as well. These provisions may also cause the end of preprinted “payment books,” which would not notify the borrower of fees assessed. It may be easiest for servicers to begin issuing monthly statements.⁴

If these provisions are not followed, then the fee is waived. N.C. Gen. Stat. § 45-91(a)(3). Thus, the Act requires procedures to ensure all fees are assessed to the account within 45 days of becoming due under the loan agreement and then mandates that the borrower is notified of the fee, in a clear and conspicuous statement, at least 30 days after assessment. Any lender that services its own loans may have to create new billing procedures. When third-party servicers are used, the lender will have to ensure procedures are in place to send these notices. Also, the lender may wish to check periodically to see if its servicer is complying with the procedures because all fees, if not assessed and communicated in a clear and conspicuous notice, are waived and unenforceable.

These assessment and notification provisions may create further issues for those engaged in buying and selling notes. If a buyer purchases a note whose fees have not been properly assessed and communicated, the account for a note may not reflect that certain fees are unenforceable. Thus, those engaged in buying notes may wish to perform due diligence to give them comfort that the seller and its servicers have complied with the Act. Furthermore, buyers may wish to seek representations and warranties that the Act has been complied with, and conversely, sellers may desire to disclaim compliance with the Act.

5. The Act specifies deadlines for processing payments.

The Act requires quick processing times for payments. See N.C. Gen. Stat. § 45-91(a)(2). If the borrower sends the payment to the payment address stated in the controlling agreement, with sufficient information to identify the account, and makes the full contractual payment, the servicer must credit the account, or treat the account as credited, within one business day of receipt. If a servicer uses a “scheduled method of accounting,” any payment made before the due date must be credited by the due date.

If any payment is received and not credited, the servicer must notify the borrower “within ten business days by mail at the borrower’s last known address.” N.C. Gen. Stat. § 45-91(a)(2). The notice must state (1) the payment’s disposition; (2) the reason why the payment was not credited; and (3) actions necessary to make the account current.⁵

6. The Act limits use of escrow balances.

It is common for a lender to collect insurance premiums and property taxes in escrow. Under the Act, servicers must ensure all amounts collected for “insurance, taxes, and other charges” are remitted to the proper entities “so as to ensure that no late penalties are assessed or other negative consequences result.” N.C. Gen. Stat. § 45-92. This applies even if the loan is in default or is delinquent unless two narrow exceptions apply. The servicer does not have to use the escrow funds to pay for the specified insurance, taxes, or other amounts (1) if “the servicer has a reasonable basis to believe that recovery of these funds will not be possible” or (2) if “the loan is more than 90 days in default.” N.C. Gen. Stat. § 45-92. Given the Act’s consumer-protection focus, “reasonable basis” may be narrowly interpreted.

7. The Act imposes duties of care upon servicers.

The Act imposes certain duties of care upon servicers: a general duty to act reasonably, a record-keeping duty, a duty to correct errors, and duties to respond within certain time frames to a borrower’s requests.

General Duty to Act Reasonably. The Act requires “servicer[s] [to] make reasonable attempts to comply with a borrower’s request for information about the home loan account and to respond to any dispute initiated by the borrower about the loan account.” N.C. Gen. Stat. § 45-93.

Record-Keeping Duty. The Act requires servicers to “maintain, until the home loan is paid in full, otherwise satisfied, or sold, written or electronic records of each written request for information regarding a dispute or error involving the borrower’s account.” N.C. Gen. Stat. § 45-93.

Correction of Errors. The Act requires “[p]rompt[] correct[ion of] errors relating to the allocation of payments, the statement of account, or the payoff balance” indicated in a notice from the borrower or “discovered through the due diligence of the servicer or other means.” N.C. Gen. Stat. § 45-93(3). This section not only requires servicers to correct errors found in an account, but also implies that a servicer has a duty to perform “due diligence” to review its accounts. The scope of a servicer’s “due diligence” is unclear.

Document Disclosures. As part of the servicer's general duty to make "reasonable attempts to comply with a borrower's requests," the Act gives a borrower specific rights to request certain information and to contest the account. The Act also delineates short time frames in which the servicer must respond to the request or the contest. The two response time frames discussed below are applicable to any borrower request where the borrower disputes the account and/or requests specific information. To trigger a duty to respond, the statement must also contain sufficient identifying information so that the servicer can identify the account.

Ten-Day Response. If a borrower submits a written request to the servicer that states the account is or may be in error or that provides sufficient detail to the servicer regarding information sought by the borrower, the servicer must respond in writing within ten business days of receipt of the written request. If requested, the written response must include the following information:

- A statement as to whether the account is current or an explanation of the default and the date the account went into default.
- Current loan balance, including principal due, the amount of funds, if any, held in a suspense account, the escrow balance, if any, and whether there are any escrow deficiencies or shortages known to the servicer.
- The identity, address, and other relevant information about the current holder of the note.
- The telephone number and address of the servicer representative with the information and authority to answer questions and resolve disputes.

A borrower is entitled to one such statement in any six-month period, without charge. Thereafter, the servicer may charge up to \$25.00 for the statement.

Compliance with this provision could be difficult. The obligation to send the notice is only triggered by the borrower sending a written communication disputing the account or requesting present account information. The information listed above must be included in the response only if a borrower requests it. Issues could arise with ambiguous communications from a borrower where the borrower could be, but is not clearly, requesting certain information.

Also, the Act is not clear about what the borrower is entitled to if he merely sends a written communication stating, "I dispute the account." Such a communication triggers the servicer's obligation to "[p]rovide a written statement" within ten business days, but the response does not have to include any of the information bulleted above because a borrower has not requested it. The Act states, "[t]he statement shall include the . . . information if requested." N.C. Gen. Stat. § 45-93(1) (emphasis added). The servicer's only obligation in such a situation is to "make reasonable attempts . . . to respond to [the] dispute" within ten business days. N.C. Gen. Stat. § 45-93. What constitutes a "reasonable attempt" is unclear. The best practice may

be to send the ten-day notice with all of the information bulleted above, even if a borrower does not request any specific account information.

25-Day Response. Moreover, within 25 business days of receipt of a written request specifically asking for the following information or merely claiming an account to be in error, the servicer must provide the following historical account information and/or documents:

- A copy of the original note or an affidavit of lost note; and A statement identifying and itemizing all fees and charges assessed under the loan transaction and providing a full payment history, including escrow and suspense activity.
- A borrower is entitled to one 25-day statement in any six-month period, without charge. For additional statements, a servicer may charge an amount not to exceed \$50.00.

For the statement itemizing fees, the time period that such a statement must cover can vary. In general, the statement must cover a minimum two-year period prior to the date of receipt of the communication. If the servicer has serviced the loan for a shorter period of time, then the servicer need only provide information commencing when the servicer started servicing the loan. A servicer may claim that an amount is due prior to its servicing of the loan or prior to the two-year period. In either of those cases, the servicer must start the itemized statement no later than the month in which it claims any outstanding sums are due and provide itemization up to the present.

An important distinction exists between the ten-day and 25-day notices. For the 25-day notice, the Act does not state that a copy of the note and the itemized statement need be sent only if requested. The Act states that the servicer must provide those items within 25 business days if the borrower merely sends written communication contesting the account. For the ten-day notice, it appears the borrower must expressly request those documents or information bulleted above in order to receive them. The safest practice may be to send the documents and bulleted information whenever the borrower disputes the account.

8. The Act gives a borrower remedies for violations.

N.C. Gen. Stat. § 45-94, in addition to any other legal or equitable remedy, allows recovery of actual damages, including reasonable attorneys' fees, for violations of the Act. The Act provides that a borrower wishing to bring a civil action for damages against a servicer for violations of the Act must give the servicer 30 days prior notice. The notice must describe claimed errors or disputes regarding the home loan. A complaint or summons is not considered "notice." The Commissioner of Banks and the Attorney General also have the power to bring actions against servicers. Those actions do not have to be preceded by 30 days' notice.

Notwithstanding that a servicer has otherwise failed to comply with the terms of the Act, it will not be in violation of the Act if it shows two elements. First, it must show that more likely than not any violation was not intentional or in bad faith. Second, within 30 days after discovering or being notified of any error, and prior to a borrower's commencement of any legal action, the servicer corrected the error and compensated the borrower for fees and charges incurred as a result of the violation. A reasonable interpretation of the Act is that compensation for the borrower's fees includes a borrower's legal fees incurred in creating the notice. It is unclear whether a servicer has a corrective period if the Commissioner of Banks or Attorney General commences an action. This provision, in sum, provides lenders some leeway in complying with the Act.

9. Conclusion.

The Act provides new, North Carolina-specific requirements for servicing a "home loan." Lenders will have to reconsider any loan secured by real property that is or is intended to be used by a borrower as a dwelling. Any fees will need to be assessed within 45 days and communicated in a clear and conspicuous communication within 30 days of assessment—otherwise the fee is waived. Servicers must credit payments within one day of receipt unless a scheduled method of payment is used and a payment is received before the due date. Any payments not credited must be explained in writing within ten business days. Servicers must also make reasonable attempts to comply with borrower's written requests and to respond to disputes. Specifically, if a borrower requests information or disputes the account, the servicer has a duty to send specific present account information within ten business days and historical account information within 25 business days. Failure to comply with the Act can result in litigation, with awards of actual damages and reasonable attorney's fees to a borrower. The Act implies that servicers have some due-diligence duty to review and correct their own accounts. Given that the Act is new and contains some ambiguity, and amendments are already pending, lenders and servicers will need to stay current on the Act's evolution.

1 There is other proposed legislation in this area. One bill would require registration, with the Commissioner of Banks, of subprime mortgages that are likely to go into foreclosure within 30 days. The Commissioner could thereafter propose a workout of a subprime mortgage between the borrower and lender. Another pending bill would require licensure of mortgage servicers.

2 A commentator has suggested the property only needs to have a dwelling on it—not just the borrower's dwelling. Thus, the Act could apply to real property with any dwelling on it. The statutory text, however, states that it covers "loan[s] secured by real property . . . used . . . by an individual borrower . . . as a dwelling." N.C. Gen. Stat. § 45-90(1). By requiring a borrower to use the property as a dwelling, the text implies that the dwelling is the borrower's dwelling.

Given that the Act is new, lenders will need to monitor amendments and relevant court cases closely as its meaning is further clarified.

3 Excluded from “servicer” are the FDIC and RTC when either is in the role of “receiver or conservator of an insured depository institution” and Ginnie Mae, Fannie Mae, Freddie Mac, the RTC, or the FDIC where “the assignment, sale, or transfer of the servicing of the mortgage is preceded by” certain enumerated events. See 12 U.S.C. § 2605(i)(2).

4 A proposed amendment to take effect October 1, 2008, would clarify this provision in two respects. First, the amendment changes “at least” to “within.” Thus, the notice of assessment must be mailed within 30 days of assessment. Second, the amendment will not require the notification of assessment for any fee that results from a service requested by the borrower, paid for by the borrower, not collected by the servicer, and not charged to the borrower’s account. This amendment is still being debated, however.

5 A proposed amendment that could take effect October 1, 2008, would slightly alter this provision. Under the amendment, if the borrower enters into a written loan modification or loss mitigation agreement that provides for acceptance and crediting of partial payments, no notification is necessary if the agreed upon payments are applied as provided for in the new agreement. This amendment is still being debated, however.