

# LEGISLATIVE RESEARCH UNIT

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January 2, 2008

## PROTECTIONS AGAINST PREDATORY MORTGAGE LENDING

You asked for information on laws and recent bills of Illinois and other states to protect consumers against predatory mortgage lending. We describe below the major Illinois laws on this topic, followed by laws and bills of other states.

### Illinois

#### 1987 Act and 2007 Changes

The Residential Mortgage License Act of 1987<sup>1</sup> requires entities in the business of brokering, funding, originating, servicing, or buying residential mortgage loans (with exceptions for several kinds of entities, including banks and other financial institutions) to be licensed by the Commissioner of Banks and Real Estate.<sup>2</sup>

A 2007 law<sup>3</sup> taking effect June 1, 2008 will make many additions and other changes to the Act to protect borrowers against predatory mortgage lending. After it takes effect, residential mortgage licensees must verify each borrower's ability to pay a proposed residential mortgage loan's principal and interest, along with real estate taxes, homeowner's insurance, assessments, and mortgage insurance (if any) before making the loan.<sup>4</sup> A licensee is to use tax returns, payroll receipts, bank records, or "other reasonably reliable methods" to verify a borrower's ability to repay.<sup>5</sup>

A licensee cannot make a mortgage loan containing a prepayment penalty unless the licensee also offers the borrower a loan without a prepayment penalty; the offer with no penalty is in

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writing; and the borrower initials a form declining it. The licensee must also disclose the reduction in interest rate that the borrower receives in return for allowing a prepayment penalty.<sup>6</sup> Prepayment penalties cannot exceed 3% of the total amount lent if prepayment occurs within 1 year, 2% if prepayment is between 1 and 2 years, and 1% if prepayment is between 2 and 3 years after the loan is made.<sup>7</sup>

A licensee must give a borrower timely notice of any material changes in the terms of a residential mortgage loan before the closing date. Material changes include changes in the type of loan being offered (such as fixed or variable rate); the term of the loan; an increase of more than 0.15% in the interest rate or an equivalent increase in the amount of discount points charged; an increase of more than 5% in the monthly payment; or a requirement to put money into escrow for taxes or insurance, or to pay for private mortgage insurance.<sup>8</sup>

A licensee must give the borrower copies of all appraisals.<sup>9</sup> The parties can discuss refinancing options, but a licensee may not promise that it will make a new loan at a future time.<sup>10</sup> Nor may a licensee make a residential mortgage loan whose proceeds are used to finance any credit life, credit disability, or credit unemployment insurance.<sup>11</sup> A licensee cannot encourage or recommend that a borrower default or fail to make payments on an existing residential mortgage loan before and in connection with closing on a new loan that refinances the debt.<sup>12</sup>

The 2007 law will also prohibit practices by licensees that are referred to as "equity stripping" and "loan flipping."<sup>13</sup> Equity stripping means helping a borrower get a loan that is secured by the borrower's principal residence, for the primary purpose of getting fees related to the financing, if (1) the loan reduces the person's equity in the principal residence and (2) at the time of the loan, the financial institution does not reasonably believe that the borrower will be able to make the payments required by the loan.<sup>14</sup> Loan flipping is helping a borrower refinance a home for the primary purpose of getting fees related to the refinancing, if the refinancing will give the borrower no "tangible benefit" and the lender does not reasonably believe that it will provide such a benefit.<sup>15</sup>

The 2007 law will require a mortgage broker to act in the borrower's best interest;<sup>16</sup> and will prohibit any undisclosed compensation that inures to the benefit of the broker based on an expenditure made for the borrower.<sup>17</sup> The law will not bar brokers from contracting for or collecting a fee for services that have been disclosed to the borrower.<sup>18</sup>

Anyone will be allowed under the 2007 law to request a written interpretation of the Act from the Department of Financial and Professional Regulation, but the Department can decide whether

a reply is necessary.<sup>19</sup> The Attorney General can enforce new provisions under the Act.<sup>20</sup> Borrowers injured by violation of the new provisions are also granted a private right of action against licensees.<sup>21</sup>

#### High Risk Home Loan Act

This 2004 Act<sup>22</sup> is intended to protect borrowers taking home loans that have either of these characteristics:

- (1) An annual percentage rate that exceeds by more than 6 percentage points (if a first-lien mortgage) or 8 percentage points (if a junior mortgage) the yield on U.S. Treasury securities having comparable periods of maturity on the 15th day of the month preceding the month in which the application for the loan is received.
- (2) Total points and fees, payable at or before closing, that will exceed the greater of 5% of the total loan principal or \$800. The \$800 limit is indexed to changes in the Consumer Price Index for All Urban Consumers.<sup>23</sup>

Such loans are considered high-risk home loans under the Act.

#### *Borrower's ability to repay*

A creditor or broker may not offer or make a high-risk home loan to a borrower if the creditor or broker "does not believe at the time of the loan . . . that the borrower will be able to make the scheduled payments" based on the borrower's employment status, debt, current and expected income, and other financial resources (other than equity in the dwelling to be the security for the loan).

Under the Act, a borrower is presumed to be able to repay a loan if, at the time of the loan (or at the time of the first rate adjustment if the loan has a lower introductory interest rate), the borrower's scheduled monthly payments on the loan, including principal, interest, taxes, insurance, and other assessments, combined with scheduled payments on all other disclosed debts, will not exceed 50% of gross monthly income.<sup>24</sup>

A lender must verify the borrower's ability to repay by requiring the borrower to prepare and submit a personal income and expense statement; verifying the borrower's income by "prudent means" such as from tax returns or pay stubs; and obtaining the borrower's credit report.<sup>25</sup>

*Preventing fraudulent or deceptive acts*

The Act prohibits lenders from using fraudulent or deceptive acts in making high-risk home loans and in marketing for such loans.<sup>26</sup> Before making a high-risk home loan, a lender must give written notice to the borrower that the loan is considered a high-risk loan and have the borrower sign the notice.<sup>27</sup>

Lenders must also inform borrowers that they can participate in a Mortgage Awareness Program, provided by the Commissioner of the Office of Banks and Real Estate or the Director of the Department of Financial Institutions (now part of the Department of Financial and Professional Regulation).<sup>28</sup> The Program includes an explanation of the amount financed and owed, foreclosure procedures, and other loan terms.<sup>29</sup>

A prospective borrower can also seek review of a high-risk loan by the Office of Banks and Real Estate or the Department.<sup>30</sup> If, after such review, the borrower decides against the loan, the "reviewer" (presumably meaning an employee of the Office or the Department) is to notify the lender. The borrower can then withdraw from the loan without penalty.<sup>31</sup>

The Act limits the amounts a lender can charge in prepayment penalties to 3% of the principal if prepayment occurs within 1 year, 2% if between 1 and 2 years, or 1% if between 2 and 3 years after the loan is made. No prepayment penalty can be collected after a borrower has paid for 3 years.<sup>32</sup> The fees a lender can charge for late payments are limited to 5% of the amount of past-due payment.<sup>33</sup> Lenders that make high-risk home loans are prohibited from doing any of the following:

- (1) Financing a single-premium credit life, credit disability, credit unemployment, or any other life or health insurance policy using such a loan.<sup>34</sup>
- (2) Refinancing any high-risk home loan if the refinancing would add points and fees within 1 year after the original loan is made unless the refinancing would bring a "tangible net benefit to the borrower."<sup>35</sup>
- (3) Financing points and fees exceeding 6% of the total loan.<sup>36</sup>
- (4) Making a payment of any proceeds of a high-risk loan directly to a contractor under a home improvement contract, other than by an instrument payable to the borrower or jointly to the borrower and contractor, or (at the election of the borrower) through a third-party escrow agent.<sup>37</sup>
- (5) Making a loan (other than a loan secured by a reverse mortgage) under which the loan balance will rise because the regular payments do not cover interest due (unless

the negative amortization results from temporary forbearance sought by the borrower).<sup>38</sup>

- (6) Making a loan in an amount higher than the value of the property securing it.<sup>39</sup>
- (7) Making a loan under which more than two required periodic payments are consolidated and paid in advance from loan proceeds.<sup>40</sup>
- (8) Making a loan that allows the lender to accelerate the indebtedness unless the acceleration is because the borrower fails to meet the loan terms.<sup>41</sup>

#### *Credit counseling before foreclosure*

If a high-risk home loan becomes delinquent more than 30 days, the loan servicer must send a notice to the borrower advising that the borrower may want to seek approved credit counseling.<sup>42</sup> If a lender, servicer, or lender's agent is notified by an approved credit counselor within 15 days after mailing of the notice that the borrower is seeking counseling, no foreclosure action may be brought for 30 days after the notice. Only one 30-day forbearance is allowed.<sup>43</sup> If the lender or servicer, credit counselor, and borrower agree on a debt management plan, the lender or servicer cannot seek foreclosure for as long as the borrower complies with it.<sup>44</sup>

#### *Foreclosure of high-risk home loans*

Before filing suit to foreclose or to collect money due on a high-risk home loan, a lender must notify the borrower of the borrower's right to cure the default by paying the amount required;<sup>45</sup> the date by which the borrower must do so to avoid court action;<sup>46</sup> the fact that the lender may file suit for money or take steps to end the borrower's ownership if the borrower does not cure the default;<sup>47</sup> and contact information of a person the borrower may contact if the borrower disagrees that a default has occurred or disagrees with the amount demanded to cure the default.<sup>48</sup> A borrower cannot be charged a fee or penalty to cure a default within 30 days of such notice.<sup>49</sup>

#### *Predatory Lending Database Program*

A predatory lending database pilot program under the Residential Real Property Disclosure Act requires brokers and loan originators to submit information about mortgage applications for residential property in Cook County to a database maintained by the Department of Financial and Professional Regulation within 10 days after taking a mortgage application.<sup>50</sup>

Within 7 days after receiving the information, the Department is to recommend counseling for the borrower if the loan allows interest-only payment; may result in negative amortization; has total points and fees of at least 5% of the loan amount; includes a prepayment penalty; or is an ARM.<sup>51</sup> The borrower cannot waive such counseling.<sup>52</sup>

If the Department recommends counseling, it is to notify the borrower of all participating HUD-certified counseling agencies in the state, and direct the borrower to interview with a counselor. Costs of the counseling, up to \$300, are to be paid by the broker or originator. Counselors may recommend that a borrower get an opinion or quote from another mortgage origination company, but may not recommend a specific company. A counselor or counseling agency that provides counseling in good faith cannot be held liable to a broker, originator, or borrower for civil damages except for willful or wanton misconduct.<sup>53</sup>

The broker or originator and the borrower may not make any mortgage loan contract until either the Department decides counseling is not necessary, or the borrower has undergone recommended counseling and the counselor submits all required information to the database.<sup>54</sup> The counselor or Department cannot prevent borrowers from making their own decisions on whether to take out a loan.<sup>55</sup>

Governor Blagojevich suspended the pilot program in January 2007, saying that it was negatively affecting those it was designed to protect by driving away lenders.<sup>56</sup> The 2007 law described above makes the program permanent after June 1, 2008.<sup>57</sup>

#### Other States' Laws

The National Conference of State Legislatures (NCSL) Web site lists state laws and recent bills on predatory mortgage lending. NCSL says 24 states have laws similar to Illinois' High Risk Home Loan Act:<sup>58</sup>

Arkansas	Maryland	Tennessee
California	Massachusetts	Texas
Colorado	Michigan	Utah
Connecticut	Minnesota	Wisconsin
Florida	Nevada	
Georgia	New Jersey	
Indiana	New Mexico	
Kentucky	North Carolina	
Louisiana	Rhode Island	
Maine	South Carolina	

Of those states, nine require third-party counseling before a lender can make a high-risk home loan:<sup>59</sup>

Arkansas	New Mexico
Maine	North Carolina
Massachusetts	Rhode Island
Minnesota	South Carolina
New Jersey	

Illinois' High Risk Home Loan Act requires only that lenders make potential borrowers aware of such programs.<sup>60</sup> Under the Predatory Lending Database Pilot Program in Cook County, borrowers may be required to have such counseling.<sup>61</sup>

### **Other States' Recent Bills**

A July 2007 NCSL report said 25 states considered bills in 2007 to prevent predatory mortgage lending. We describe the bills below that appear to propose prevention efforts beyond those Illinois has already enacted.

#### **California**

A bill to prohibit a real estate broker from making gifts to a borrower or potential borrower is in the Assembly Committee on Banking and Finance. Prohibited gifts would include money, rebates, trips, gift certificates, and gift cards.<sup>62</sup>

#### **Connecticut**

A bill to prohibit mortgage lenders from requiring borrowers to have homeowner's insurance beyond rebuilding costs and the costs of other reasonably anticipated risks is in the Joint Committee on Banks.<sup>63</sup>

#### **Maryland**

A bill to limit a mortgage broker's ability to charge a finder's fee for obtaining loans passed the House and is in the Senate Committee on Finance.<sup>64</sup>

#### **Massachusetts**

A bill would create a statewide foreclosure database to monitor foreclosure patterns, and require a mortgage lender to file a notice of intent to foreclose with the Division of Banks at least 90 days before beginning foreclosure. It passed the House but was amended in the Senate, and the House did not concur with the Senate amendment.<sup>65</sup>

## Minnesota

Several bills seek to prohibit predatory lending practices. Two of them would prohibit making a "grossly unsuitable" loan. The quoted term would mean a loan in which the borrower lacks the capacity to repay, or one that is made as a result of a loan application containing false information about the borrower's financial status. Violation could bring up to 2 years in jail and/or a fine up to \$75,000.<sup>66</sup> Both bills are in substantive committees in their houses of origin.

## Missouri

A bill would prohibit a lender from influencing an appraiser's judgment about the value of real estate covered by a home loan or being offered as security for a home loan. The bill would also prohibit a lender from leaving blanks in any loan document to be filled in after the borrower signs. It would require the lender to provide a copy of all disclosure information in the language in which the lender and borrower held discussions about the loan. The bill is in the Senate Committee on Financial and Governmental Organizations and Elections.<sup>67</sup>

## New York

Several 2007 bills seek to prevent predatory lending practices. One would completely prohibit prepayment penalties, and prohibit lenders from offering subprime mortgage loans to anyone with a Fair Isaac Corporation credit score up to 660.<sup>68</sup> It is in the Banks Committee.

Another bill would require lenders to make the most favorable loan (with the most favorable rates, points, fees, and other costs) for which each borrower qualifies. It would also prohibit a mortgage broker from making gifts to borrowers.<sup>69</sup> It was reported favorably from the Banks Committee and referred to the Codes Committee.

A bill to require that a depiction, chart, or table be given to each potential borrower showing the borrower's pre-ARM reset and post-ARM reset monthly payments, and annual property tax and insurance payments, is in the Banks Committee.<sup>70</sup>

## Oregon

A bill would require lenders making nontraditional mortgage loans to adopt risk-management practices set forth in the bill. It also would require that their advertisements disclose the risks of nontraditional mortgage loans in "nontechnical language."<sup>71</sup> It passed the Senate, was recommended "do



pass" by the House Consumer Protection Committee, and is now in the House Elections, Ethics and Rules Committee.

#### Rhode Island

Two bills would prohibit prepayment penalties on mortgage loans.<sup>72</sup> Both are in substantive committees in their houses of origin.

We hope this information is helpful. Please let us know if we can be of further assistance.

Sincerely,

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#### Notes

1. 205 ILCS 635/1-1 ff.
2. 205 ILCS 635/1-3(a) and 635/1-4(d).
3. P.A. 95-691, enacted by S.B. 1167 (J.Collins-Meeks-Raoul-Hunter—Yarbrough-Ford-Lang-M.Davis-A.Collins et al.), amending 205 ILCS 635/4-10 and adding 205 ILCS 635/4-15, 635/4-16, and 635/5-6 to 635/5-17.
4. P.A. 95-691, adding 205 ILCS 635/5-6(a).
5. P.A. 95-691, adding 205 ILCS 635/5-6(b).
6. P.A. 95-691, adding 205 ILCS 635/5-8(a).
7. P.A. 95-691, adding 205 ILCS 635/5-8(b).
8. P.A. 95-691, adding 205 ILCS 635/5-9(a).
9. P.A. 95-691, adding 205 ILCS 635/5-11.
10. P.A. 95-691, adding 205 ILCS 635/5-12.
11. P.A. 95-691, adding 205 ILCS 635/5-15.
12. P.A. 95-691, adding 205/635/5-16.
13. P.A. 95-691, adding 205 ILCS 635/5-14.
14. 815 ILCS 120/2(d).
15. 815 ILCS 120/2(e).
16. P.A. 95-691, adding 205 ILCS 635/5-7(a).
17. P.A. 95-691, adding 205 ILCS 635/5-7(a)(1).
18. P.A. 95-691, adding 205 ILCS 635/5-7(b).
19. P.A. 95-691, adding 205 ILCS 635/4-10(c).
20. P.A. 95-691, adding 205 ILCS 635/4-15.
21. P.A. 95-691, adding 205 ILCS 635/4-16.

22. 815 ILCS 137/1 ff. (added by P.A. 93-561 (2004), enacted by S.B. 1784 (Link-Rutherford-J.Collins-Schoenberg-Lightford et al.—Currie-M.Davis-Black-Fritchey-Aguilar et al.)).
23. 815 ILCS 137/10.
24. 815 ILCS 137/15.
25. 815 ILCS 137/20.
26. 815 ILCS 137/25.
27. 815 ILCS 137/95.
28. 815 ILCS 137/110(f).
29. 815 ILCS 137/110(b).
30. 815 ILCS 137/125(a).
31. 815 ILCS 137/125(d).
32. 815 ILCS 137/30.
33. 815 ILCS 137/80.
34. 815 ILCS 137/40.
35. 815 ILCS 137/45.
36. 815 ICLS 137/55.
37. 815 ILCS 137/60.
38. 815 ILCS 137/65.
39. 815 ILCS 137/70.
40. 815 ILCS 137/85.
41. 815 ILCS 137/90.
42. 815 ILCS 137/100(a).
43. 815 ILCS 137/100(c).
44. 815 ILCS 137/100(d).
45. 815 ILCS 137/105(a)(2)
46. 815 ILCS 137/105(a)(3).
47. 815 ILCS 137/105(a)(4).
48. 815 ILCS 137/105(a)(5).
49. 815 ILCS 137/105(c).
50. 765 ILCS 77/70(a-5), (b), and (c).
51. 765 ICLS 77/70(c) and 765 ILCS 77/73.
52. 765 ILCS 77/70(c).
53. 765 ILCS 77/70(d).
54. 765 ILCS 77/70(e).
55. 765 ILCS 77/70(i).
56. Pearson and Long, "Blagojevich shelves predatory-loan program," *Chicago Tribune*, Jan. 20, 2007, p. B1.
57. P.A. 95-691, amending 765 ILCS 77/70(a-5).
58. Ark. Stat., sec. 23-53-101 ff.; Cal. Fin. Code, sec. 4970 ff.; Colo. Rev. Stat., secs. 5-3.1-101 ff. and 38-40-405; Conn. Gen. Stat., secs. 36a-746 ff. and 36a-521; Fla. Stat., sec. 494.0078 ff.; Ga. Code, sec. 7-6A-1 ff.; Ind. Code, sec. 24-9-1 ff.; Ky. Rev. Stat., sec. 360.010 ff.; La. Rev. Stat., sec. 6:1096; Me. Rev. Stat., tit. 9-A, sec. 8-206-A and 2007 Me. Laws, ch. 273, pt. A, adding Me. Rev. Stat. tit. 9-A, sec. A-206-C; Md. Com. Law, sec. 12-311; Mass. Gen. Laws, ch. 183C, sec. 1 ff.; Mich. Comp. Laws,

- sec. 445.1631 ff.; Minn. Stat., sec. 58.16; Nev. Rev. Stat., sec. 598D.100; N.J. Stat., sec. 46:10B-22 ff.; N.M. Stat., sec. 58-21A-1 ff.; N.C. Gen. Stat., sec. 24-1.1E; R.I. Gen. Laws, sec. 34-25.2-1 ff.; S.C. Code, sec. 37-23-10 ff.; Tenn. Code, sec. 45-20-101 ff.; Tex. Fin. Code, sec. 343.001 ff.; Utah Code, sec. 61-2d-101 ff.; and Wis. Stat., sec. 428.202 ff.
59. Ark. Stat., subsec. 23-53-104(k); 2007 Me. Laws, ch. 273, pt. A, adding Me. Rev. Stat. tit. 9-A, sec. A-206-C; Mass. Gen. Laws, ch. 183C, sec. 3; Minn. Stat., sec. 58.13; N.J. Stat., sec. 46:10B-26, subd. g; N.M. Stat., sec. 58-21A-5, subd. G; N.C. Gen. Stat., subsec. 24-1.1E(c)(1); R.I. Gen. Laws, subsec. 34-25.2-6(g); and S.C. Code, subsec. 37-23-40(1).
  60. 815 ILCS 137/110(f).
  61. 765 ILCS 77/70(c).
  62. 2007 Cal. A.B. 628.
  63. 2007 Conn. H.B. 5548.
  64. 2007 Md. H.B. 1107.
  65. 2007 Mass. H.B. 4306.
  66. 2007 Minn. H.F. 387 and S.F. 766.
  67. 2007 Mo. S.B. 74.
  68. 2007 N.Y. A.B. 8357.
  69. 2007 N.Y. A.B. 8972.
  70. 2007 N.Y. A.B. 8973.
  71. 2007 Ore. S.B. 965.
  72. 2007 R.I. H.B. 5545 and S.B. 35.