

MAY 2001

### Illinois Adopts “High Risk Home Loan” Regulations

In an effort to curtail predatory lending, the Illinois Office of Banks and Real Estate (“OBRE”) and the Department of Financial Institutions (“DFI”) adopted high risk home loan regulations that restrict licensed lenders from engaging in certain predatory lending practices.

Specifically, the new high risk home loan provisions are contained in amendments made to existing regulations promulgated under the Illinois Banking Act, Savings and Loan Act, Savings Bank Act, Residential Mortgage License Act of 1987 (the “Mortgage Act”), Credit Union Act, Consumer Installment Loan Act and Sales Finance Agency Act. These amendments take effect on May 17, 2001.

Although the regulations promulgated under each of these laws contain their own unique set of high risk home loan provisions, each is intended to mirror one another and, thus, all institutions appear subject to the same restrictions. This summary, however, reviews only the amendments to the regulations promulgated pursuant to the Mortgage Act (the “Illinois regulation” or “high risk home loan provisions”).

The high risk home loan provisions banning predatory lending activities in the state of Illinois are in addition to an ordinance passed last November expressly restricting predatory lenders from doing business within the city of Chicago. Thus, licensed lenders making loans within the city of Chicago must comply with the high risk home loan provisions and the Chicago ordinance. Compliance with the Illinois regulation does not preempt the Chicago ordinance.

#### WHO MUST COMPLY WITH THE ILLINOIS REGULATION

The Mortgage Act applies to entities engaged in the business of brokering, funding, originating, servicing or purchasing residential mortgage loans. The high risk home loan provisions, however, apply only to licensees under the Mortgage Act who are deemed a “lender” or “servicer.” A “lender” is any person, partnership, association, corporation, or any other entity who either lends or invests money in residential mortgage loans. A lender would not appear to include the purchasers of high risk home loans. A “servicer” includes one who services debt for the licensee’s own account or for others, and includes loan payment follow-up, delinquency loan follow-up, loan analysis and any notifications to the borrower that are necessary to enable the borrower to keep the loan current and in good standing.

#### Triggers

The high risk home loan provisions are triggered for loans that meet the definition of a “high risk home loan.” Specifically, a “high risk home loan” is a loan that meets all of the following criteria:

- Consumer purpose,
- Secured by borrower’s principal dwelling located in Illinois,
- Proceeds are not used as purchase money for the residence, and
- Loan is not an open-end credit plan subject to subchapter b of 12 CFR 226 (2000), no subsequent dates or editions are included.

A loan is an Illinois High Risk Home Loan if it meets these four criteria and it “flunks” either of the Illinois High Risk Home Loan Tests, i.e., the APR Test or the Points and Fees Test.

**APR Test.** A loan “flunks” the APR Test and therefore triggers the high risk home loan provisions if, at the time of origination, the APR exceeds by more than 6 percentage points in the case of a first-lien mortgage, or by more than 8 percentage points in the case of a junior mortgage, the yield on U.S. Treasury securities having comparable periods of maturity to the loan maturity as of the fifteenth day of the month immediately preceding the month in which the application for the loan is received by the lender.

**Points and Fees Test.** A loan “flunks” the Points and Fees Test and therefore triggers the high risk home loan provisions if the total points and fees payable by the consumer at or before closing will exceed the greater of 5% of the total loan amount, or \$800 (adjusted annually based on the Consumer Price Index).

The term “points and fees” is defined more broadly than the definition contained in federal Regulation Z. Specifically, under the Illinois regulation, “points and fees” mean: (a) all items required to be disclosed as points and fees under 12 CFR 226.32 (2000), no subsequent amendments or editions included; (b) the premium of any single premium credit life, credit disability, credit unemployment, or any other life or health insurance that is financed directly or indirectly into the loan; (c) all compensation paid directly or indirectly to a mortgage broker, including a broker that originates a loan in its own name in a table funded transaction, not included in subsection (a) of this section.

We understand, based on informal discussions with regulators at the OBRE, that yield spread premiums must be included in the points and fees calculation.

#### **PROHIBITED PRACTICES**

Entities subject to the Illinois regulation are prohibited from engaging in certain practices in connection with the making of a high risk home loan. These are as follows:

**Repayment Ability.** A lender cannot make a high risk home loan if the lender does not believe at the time the loan is consummated that the borrower(s) will be able to make the scheduled payments to repay the obligation based upon a consideration of their current and expected income, current obligations, employment status and other financial resources (other than the borrower’s equity in the dwelling that secures repayment of the loan). A borrower is presumed to be able to repay the loan if, at the time the loan is made (or at the time of the first rate adjustment in the case of a lower introductory interest rate), the borrower’s scheduled monthly payments on the loan (PITI), combined with the scheduled payments for all other disclosed debts, do not exceed 50% of the borrower’s monthly gross income.

**Prepayment Penalties.** A prepayment penalty is prohibited on a high risk home loan: (i) after the expiration of the 36 month period following the date the loan was made; or (ii) that is more than 3% of the total loan amount if the prepayment is made within the first 12 month period following the date the loan was made, or more than 2% of the total loan amount if the prepayment is made within the second 12 month period after the date the loan was made, or more than 1% of the total loan amount if the prepayment is made within the third 12 month period following the date the loan was made.

**Fraudulent or Deceptive Practices.** Fraudulent or deceptive acts or practices in the making of a high risk home loan, including deceptive marketing and sales efforts, are prohibited.

**Pre-paid Insurance Products and Warranties.** The financing of a single premium credit life, credit disability, credit unemployment, or any other life or health insurance, directly or indirectly, is not allowed in connection with the making of a high risk home loan.

**Refinancing.** Any high risk home loan being refinanced that involves the charging of additional points and fees must be seasoned at least 12 months after the original loan agreement was signed, unless the refinancing results in a financial benefit to the borrower.

**Balloon Payments.** Balloon payments are prohibited in connection with the making of a high risk home loan unless: (i) such balloon payment becomes due and payable at least 15 years after the loan's origination; (ii) the payment schedule is adjusted to account for the seasonal or irregular income of the borrower; or (iii) for a bridge loan connected with the acquisition or construction of a dwelling intended to become the borrower's principal dwelling.

**Financing of Certain Points and Fees.** A lender cannot make a high risk home loan that finances points and fees in excess of 6% of the total loan amount.

**Payments to Contractors.** All home improvement contract disbursements made from loan proceeds of a high risk home loan must be made: (1) by instrument payable to the borrower or jointly to the borrower and the contractor; or (2) at the election of the borrower, by a third party escrow agent in accordance with the terms established by a written agreement signed by the borrower, the lender, and the contractor before the date of payment.

**Negative Amortization.** Negative amortization is prohibited on a high risk home loan unless the negative amortization is the consequence of a temporary forbearance sought by the borrower or in connection with a reverse mortgage.

**Negative Equity.** A lender is prohibited from making a high risk home loan where the loan amount exceeds the value of the property securing the loan plus reasonable closing costs not to exceed 5% of the total loan amount.

## **OBLIGATIONS IMPOSED BY THE ILLINOIS REGULATION**

Entities subject to the Illinois regulation also are *required* to perform certain practices in connection with the making or servicing of a high risk home loan:

**Verification of Ability to Pay Loan.** The lender must verify the borrower's ability to repay the loan in the case of high risk home loans. At a minimum, verification must include submitting to the lender a Uniform Residential Loan Application, obtaining a credit report, and verifying income by means of tax

returns, pay stubs, accounting statements or other prudent means.

**Good Faith Requirements.** Among other good faith requirements previously adopted, the Illinois regulation adds a requirement that a licensee shall not accept a fee or charge for a residential mortgage loan application unless there is a reasonable likelihood that a loan commitment will be issued for such loan for the amount, term, rate, charges and other conditions set forth in the loan application and applicable disclosures and documentation, and that the loan has a reasonable likelihood of being paid by the applicant based on his/her ability to pay. This provision is not limited to high risk home loans and, thus, would apply to all loans made by a licensed mortgage lender in Illinois.

**Counseling Prior to Perfecting Foreclosure Proceedings.** In the event a high risk home loan becomes delinquent by more than 30 days, the servicer must send a notice, in the language set forth in the Illinois regulation, advising the borrower that he/she may wish to seek consumer credit counseling from an "approved Credit Counselor." If the borrower obtains counseling by a credit counselor approved by the Director of the DFI, and the lender is notified in writing within 15 days after mailing the notice of that fact, the borrower is allowed one 30 day forbearance period. If, within the 30 day period, the lender, approved credit counselor and borrower agree to a debt management plan, the lender is prohibited from instituting legal action for as long as the debt management plan is complied with by the borrower.

**Offer of Mortgage Awareness Program.** Any lender, prior to making a high risk home loan, must inform the borrower in writing of the right to participate in the Mortgage Awareness Program, which is a counseling and educational program provided by the Director of the DFI. No specific time frame for making this disclosure is indicated in the Illinois regulation and, thus, it appears that it could be provided anytime prior to closing.

**Report of Default and Foreclosure.** On or before April 1 and October 1 of each year, each Mortgage Act licensee who is a servicer of Illinois residential

mortgage loans shall report to the Commissioner of the OBRE the default and foreclosure data of conventional loans for the six month periods ending June 30 and December 31, respectively. This provision is not limited to high risk home loans and, thus, will apply to all Illinois residential mortgage loans.

**Third Party Review of High Risk Loans.** When and if the Illinois General Assembly appropriates adequate funding for the Third Party Review of the High Risk Loan Program, the borrower must be afforded the opportunity to seek independent review of the high risk home loan. The program is elective at the borrower's option. Under the program, the OBRE will provide worksheets for the borrower to prepare and the OBRE to review. This program, however, still requires the approval of and funding by the Illinois General Assembly before it will take effect.

#### **PENALTIES IMPOSED BY THE ILLINOIS REGULATION**

There are no specific penalty provisions for violating the high risk home loan provisions. Violations of these provisions, however, could trigger the general penalty provisions under the Mortgage Act and the regulations promulgated thereunder that include license revocation or suspension, or fines not to exceed \$10,000 for each separate offense. As the high risk home loan provisions apply only to lenders and servicers, and not to purchasers of closed loans, there does not appear to be any assignee liability.

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Please feel free to contact Nanci Weissgold at 202-778-9314 or [nweissgold@kl.com](mailto:nweissgold@kl.com) should you have any questions. Thank you.

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