ILLINOIS GENERAL ASSEMBLY

LEGISLATIVE RESEARCH UNIT

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MORTGAGE SERVICING ABUSE

asked whether Illinois has a law prohibiting some practices of mortgage servicers that were listed in a letter from a constituent, such as crediting payments to fees instead of principal and interest; putting payments into suspense accounts; charging unwarranted fees; and requiring insurance on property that is already insured.

Illinois law puts many restrictions on practices of mortgage lenders, but says little about mortgage servicers. Two laws (one pertaining to all mortgages, and one pertaining to high-risk mortgages) put some restrictions on fees charged to borrowers. Another law regulates the practice of requiring insurance. We found no laws on applying loan payments or suspense accounts. We describe these laws below, including provisions related to both lenders and servicers since their functions are often similar.

We used information from the National Conference of State Legislatures[1] to check whether other states have taken action to prohibit some practices of mortgage servicers. We describe two recent laws of Kentucky and North Carolina that do so; North Carolina's law is among the strictest in the nation.[2]

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Illinois

Residential Mortgage License Act of 1987[3]

This Act requires that entities in the business of brokering, funding, originating, servicing, or buying residential mortgage loans (except several kinds of entities, including banks and other financial institutions) be licensed by the Commissioner of Banks and Real Estate.[4]

A law that amended the Act effective June 1, 2008[5] requires a residential mortgage licensee, before making a loan, to verify each borrower's ability to pay a proposed residential mortgage loan's principal and interest, real estate taxes, homeowner's insurance, assessments, and mortgage insurance (if any).[6]

A licensee cannot make a mortgage loan having a prepayment penalty without offering the borrower a loan with no such penalty, in writing, and having the borrower initial a form declining it. The licensee must also disclose the reduction in interest rate that the borrower gets for allowing a prepayment penalty. A prepayment penalty cannot exceed 3% of the amount lent 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.[7]

A licensee must give a borrower "timely" notice of any material change in the terms of a residential mortgage loan. Such notice is "timely" if it is provided by the earlier of 3 days after the licensee learns of the change or 24 hours before the closing. (If the licensee discloses a change more than 3 days after learning of it but at least 24 hours before closing, and "cures in time for the borrower to avoid any damage," the licensee is not liable for penalties or forfeitures. The Act does not specify what kinds of actions by a licensee qualify as "cures" of a material change in terms.) Material changes include changes in the type of loan being offered (such as fixed or variable rate); its term; 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 monthly payments; or a requirement to put money into escrow for taxes or insurance, or to pay for private mortgage insurance. A licensee must also give timely notice to a borrower if any fees payable by the borrower to the licensee increase by more than 10% or $100, whichever is greater.[8]

The 2007 law also prohibited practices by licensees that are often referred to as "equity stripping" and "loan flipping."[9] Equity stripping means helping a borrower get a loan 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 required payments.[10] Loan flipping means 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.[11]

The Attorney General can enforce any of those provisions.[12] Borrowers injured by violations also have a private right of action against licensees.[13]

High Risk Home Loan Act[14]

This 2004 Act is intended to protect borrowers who take out 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.[15]

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

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 the loan is consummated 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).[16]

The Act prohibits lenders from using fraudulent or deceptive acts in making high-risk home loans and marketing such loans, and requires lenders to act in good faith in all relations with a borrower when making high-risk home loans.[17] Before making a high-risk home loan, a lender must give written notice to the borrower that the loan is deemed a high-risk loan and have the borrower sign the notice.[18]

The Act limits the amounts a lender can charge in prepayment penalties to 3% of the principal and interest 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 made payments for 3 years.[19] The fees a lender can charge for late payments are limited to 5% of the amount of past-due payment, and a late-payment fee may not be imposed more than once for a single late payment.[20]

Lenders making high-risk home loans are prohibited from doing any of the following on the next page:

(1) Financing a single-premium credit life, credit disability, credit unemployment, or other life or health insurance policy using such a loan.[21]

(2) Refinancing any high-risk home loan if the refinancing would add points and fees within 1 year after the original loan, unless the refinancing would bring a "tangible net benefit to the borrower."[22]

(3) Financing points and fees exceeding 6% of the total loan.[23]

(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.[24]

(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).[25]

(6) Making a loan in an amount higher than the value of the property securing it.[26]

(7) Making a loan under which more than two required periodic payments are consolidated and paid in advance from loan proceeds.[27]

(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.[28]

If a high-risk home loan becomes delinquent more than 30 days, the loan servicer must send notice to the borrower advising that the borrower may want to seek approved credit counseling.[29] 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.[30] 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.[31]

Before filing suit to foreclose or 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; the date by which the borrower must do so to avoid court action; 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; and contact information of a person the borrower may contact if the borrower does not agree that a default has occurred or disagrees with the amount demanded to cure a default.[32] A borrower cannot be charged a fee or penalty to cure a default within 30 days after such notice. A borrower may not be liable for more than $100 of a lender's attorney's fees relating to a default that are incurred more than 30 days after such notice but before the lender forecloses or takes action to seize the property. After the foreclosure or seizure action, the borrower is liable for only attorney's fees that are reasonable and actually incurred by the lender.[33]

The Department of Financial and Professional Regulation must report to the Attorney General all violations of the Act of which it becomes aware.[34]

Collateral Protection Act[35]

This Act allows a creditor to place "collateral protection insurance" on a debtor's property if the credit agreement requires the debtor to maintain insurance on the collateral and the debtor does not do so, or fails to provide evidence of insurance.[36] A creditor must send the debtor notice when buying such insurance.[37] If the debtor sends the creditor proof that the debtor has obtained insurance, the creditor must cancel the collateral protection insurance. If the debtor provides proof within 30 days after the notice is sent that the debtor already had and continues to have insurance, the creditor must cancel the collateral protection insurance and may not charge the debtor any costs, interest, or other charges in connection with that insurance.[38] After cancellation or expiration of collateral protection insurance, any unearned premiums must be refunded to the debtor.[39]

Kentucky

A 2008 law[40] requires servicers collecting or processing payments on a high-cost home loan (similar to a "high-risk home loan" as defined in Illinois) to do all of the following:

(1) Apply payments by 1 business day after receipt.

(2) Apply payments first to interest and principal currently due, then to late fees currently due, then to other fees and charges currently due, and then to additional principal.

(3) Assess any fee within 30 days after it accrues, and clearly and conspicuously disclose any fee assessed in the next periodic statement to the borrower.

(4) Charge no late fee if a payment is otherwise a full payment for the applicable period and is paid on its due date or within an applicable grace period, and the only delinquency or insufficiency of payment is attributable to a late fee or delinquency charge assessed on an earlier payment.

(5) Make all payments from an escrow account held for the borrower in a timely manner to ensure that no late penalties are assessed or other negative consequences result, regardless of whether the loan is delinquent (unless the account has insufficient funds to make payments), and clearly and conspicuously disclose any payments from the escrow account in the next periodic statement to the borrower.

This law does not state the consequences of a lender's failure to comply with it.

North Carolina

A 2008 law[41] that took effect January 1, 2009 requires that mortgage servicers be licensed by the state Commissioner of Banks.[42] It requires servicers to safeguard and account for any money they handle for a borrower; follow reasonable and lawful instructions from a borrower; and act with reasonable skill, care, and diligence.[43]

At license application and renewal, and supplementally at other times, each servicer must file with the Commissioner of Banks a complete and current schedule of the ranges of costs and fees charged to borrowers for activities related to servicing. At the Commissioner's request, a servicer must file a report detailing its activities in the state, including number of mortgage loans serviced; their types and characteristics; number of serviced loans in default and categorization of loans delinquent for 30, 60, and 90 days; information on loss mitigation activities (including details on workout arrangements undertaken); and information on foreclosures begun in the state.[44]

Upon accepting assignment of servicing rights for a mortgage loan, a servicer must disclose to the borrower any notice required by the federal Real Estate Settlement Procedures Act or by regulations under it; a schedule of the ranges and categories of its costs and fees for servicing-related activities (which must comply with state law and not exceed those reported to the Commissioner); notice that the servicer is licensed by the Commissioner and that complaints about the servicer may be submitted to the Commission; and any other notice required by law.[45]

A mortgage servicer must give written notice to a borrower when the servicer takes action to place hazard, homeowner's, or flood insurance on the mortgaged property, and may not place such insurance if the servicer knows or has reason to know that such insurance is in effect. A servicer may not place such insurance on mortgaged property for an amount that exceeds either the value of the insurable improvements or the last known coverage amount of insurance. A servicer must give the borrower a refund of unearned premiums paid by or charged to the borrower for such insurance placed by a lender if the borrower provides reasonable proof that the borrower has obtained coverage such that the insurance is no longer needed and the property is insured. If the borrower provides reasonable proof within 12 months after the placement that no lapse in coverage occurred, such that the insurance was not necessary, the servicer must refund the entire premium.[46]

If a borrower becomes delinquent or defaults on a loan, the servicer must act in good faith to inform the borrower of the facts about the loan and the nature and extent of the delinquency or default. If the borrower replies, the servicer must negotiate with the borrower, subject to the servicer's duties and obligations under the mortgage servicing contract, to attempt a resolution or workout of the delinquency or default.[47]

A mortgage servicer must reinstate a delinquent loan upon payment timely made under the contract that is enough to pay all past-due amounts and outstanding or overdue charges, and restore the loan to nondelinquent status. Such reinstatement is available to a borrower only twice in any 2 years.[48]

A mortgage servicer must mail, at least 45 days before starting foreclosure, a notice to the borrower with the following information:

(1) An itemization of all past-due amounts causing the loan to be in default.

(2) An itemization of any other charges that must be paid to make the loan current.

(3) A statement that the borrower may have options other than foreclosure, and that the borrower may discuss such options with the mortgage lender, the servicer, or a counselor approved by the U.S. Department Of Housing and Urban Development (HUD).

(4) Contact information for the mortgage lender, the servicer, or an agent for either of them, who is authorized to work with the borrower to avoid foreclosure.

(5) Contact information for at least one HUD-approved counseling agency working to help borrowers avoid foreclosure.

(6) Contact information for the Consumer Complaint section of the Commissioner of Banks.[49]

A mortgage servicer must make all payments from any escrow account held for the borrower for insurance, taxes, and other charges with respect to the property in a timely manner to ensure that no late penalties are assessed or other negative consequences result, whether or not the loan is delinquent—unless there are insufficient funds in the account to cover the payments and the servicer has a reasonable basis to believe that recovery of the funds will not be possible.[50]

The Commissioner may deny, suspend, or revoke the license of a violator of the law.[51] If the Commissioner has evidence that a material violation of the law has occurred in the origination or servicing of a loan that is being foreclosed or is delinquent and in threat of foreclosure, and the claimed violation would be sufficient in law or equity to base a claim or affirmative defense that would affect the validity of enforceability of the underlying contract or the right to foreclose, the Commissioner may notify the clerk of the trial court, and the clerk must suspend foreclosure proceedings for 60 days after the notice. The Commissioner must then also notify the servicer and provide an opportunity to correct, or to rebut the evidence of, the suspected violation. If the violation is corrected or sufficiently rebutted, foreclosure proceedings may resume.[52]

Another law effective April 1, 2008[53] says that any fee by a mortgage servicer must be assessed within 45 days after the fee is incurred, and explained clearly and conspicuously in a statement mailed to the borrower within 30 days after assessing the fee[54] (except a fee for a service that is affirmatively requested by the borrower, is paid for by the borrower when the service is provided, and is not charged to the borrower's loan account[55]).

A servicer must make reasonable efforts to comply with a borrower's request for information on the home loan account and to respond to any dispute initiated by the borrower about the loan account. The servicer must keep written or electronic records of each request for information about a dispute or error involving the borrower's account. The servicer must also do all of the following:

(1) Provide a written statement to the borrower within 10 business days after receiving a written request from the borrower about a possible error involving the account. A borrower is entitled to one such statement in any 6-month period at no charge, and additional statements for charges up to $25. The statement must include, if requested, (a) whether the account is current or, if not current, an explanation of the default and the date it went into default; (b) the current balance due including principal; the amount of funds (if any) held in a suspense account; and the amount of the escrow balance (if any) known to the servicer; and (c) whether there are any escrow deficiencies or shortages known to the servicer.

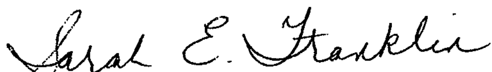
(2) Provide the following information or documents within 25 business days after receiving a written request from a borrower about a possible error involving the account: (a) a copy of the original note or, if unavailable, an affidavit of lost note, and (b) an itemization of all fees and charges assessed under the loan transaction and a full payment history identifying all debits, credits, application and disbursement of all payments received from or for the benefit of the borrower, and other activity on the home loan, including escrow account activity and suspense account activity if any. This history must cover at least the last 2 years before receipt of the request (or the time in which the servicer has serviced the loan, if shorter). If the servicer claims that any delinquent or outstanding sums were owed on the home loan before the 2-year period or period in which the servicer has serviced the loan, the servicer must provide an account history, starting with "the month that the servicer claims any outstanding sums are owed on the loan" (probably meaning the month when, according to the servicer, the "outstanding sums" began to be due). One such statement is free every 6 months, with additional statements costing up to $50.

(3) Promptly correct errors relating to the allocation of payments, the statement of account, or the payoff balance that are identified in a notice provided by the borrower or discovered by any other means.[56]

A borrower may sue for actual damages suffered from violation of the law, including reasonable attorney's fees.[57]

We hope this information is helpful. Please let us know if you need anything further.

Sincerely,



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Notes

1. National Conference of State Legislatures, "Mortgage Lending" (May 2008, downloaded from National Conference of State Legislatures Internet site).
2. Dymi, "NC Servicing Law: Unprecedented Requirements," *Mortgage Servicing News*, Sept. 19, 2008, p. 1 (downloaded from LexisNexis Internet site).
3. 205 ILCS 635/1-1 ff.
4. 205 ILCS 635/1-3(a) and 635/1-4(d).

5. P.A. 95-691 (2007), enacted by S.B. 1167 (J.Collins-Meeks-Raoul-Hunter—Yarbrough-Ford-Lang-M.Davis-A.Collins et al.).
6. 205 ILCS 635/5-6(a).
7. 205 ILCS 635/5-8.
8. 205 ILCS 635/5-9(a) and (b).
9. 205 ILCS 635/5-14.
10. 815 ILCS 120/2(d).
11. 815 ILCS 120/2(e).
12. 205 ILCS 635/4-15.
13. 205 ILCS 635/4-16.
14. 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.).
15. 815 ILCS 137/10 (definition of "high risk home loan").
16. 815 ILCS 137/15.
17. 815 ILCS 137/25.
18. 815 ILCS 137/95.
19. 815 ILCS 137/30.
20. 815 ILCS 137/80.
21. 815 ILCS 137/40.
22. 815 ILCS 137/45.
23. 815 ILCS 137/55.
24. 815 ILCS 137/60.
25. 815 ILCS 137/65.
26. 815 ILCS 137/70.
27. 815 ILCS 137/85.
28. 815 ILCS 137/90.
29. 815 ILCS 137/100(a).
30. 815 ILCS 137/100(c).
31. 815 ILCS 137/100(d).
32. 815 ILCS 137/105(a).
33. 815 ILCS 137/105(c).
34. 815 ILCS 137/153.
35. 815 ILCS 180/1 ff.
36. 815 ILCS 180/5 (definition of "collateral protection insurance") and 180/10.
37. 815 ILCS 180/15(a).
38. 815 ILCS 180/25.
39. 815 ILCS 180/30.
40. 2008 Ky. Acts 175, eff. April 24, 2008, adding Ky. Rev. Stat., sec. 367.320.
41. 2008 N.C. Sess. Laws, ch. 228, eff. Jan. 1, 2009.
42. 2008 N.C. Sess. Laws, ch. 228, amending N.C. Gen. Stat., subsec. 53-243.02(a).
43. 2008 N.C. Sess. Laws, ch. 228, adding 2008 N.C. Gen. Stat., subsecs. 53-243.10(b)(1) to (b)(3).
44. 2008 N.C. Sess. Laws, ch. 228, adding 2008 N.C. Gen. Stat., subsec. 53-243.10(b)(5).
45. 2008 N.C. Sess. Laws, ch. 228, adding. 2008 N.C. Gen. Stat., subsec. 53-243.10(b)(6).

46. 2008 N.C. Sess. Laws, ch. 228, adding 2008 N.C. Stat., subsecs. 53-243.11(17) to (19).
47. 2008 N.C. Sess. Laws, ch. 228, adding 2008 N.C. Gen. Stat., subsec. 53-243.10(7).
48. 2008 N.C. Sess. Laws, ch. 228, adding 2008 N.C. Gen. Stat., subsec. 53-243.11(20).
49. 2008 N.C. Sess. Laws, ch. 228, adding 2008 N.C. Gen. Stat., subsec. 53-243.11(21).
50. 2008 N.C. Sess. Laws, ch. 228, adding 2008 N.C. Gen. Stat., subsec. 53-243.11(22).
51. N.C. Gen. Stat., subsec. 53-243.12(a).
52. 2008 N.C. Sess. Laws, ch. 228, adding 2008 N.C. Gen. Stat., subsec. 53-243.12(n).
53. 2007 N.C. Sess. Laws, ch. 351, eff. April 1, 2008.
54. N.C. Gen. Stat., subsec. 45-91(1).
55. 2008 N.C. Sess. Laws, ch. 227, eff. April 1, 2008, amending N.C. Gen. Stat., subsec. 45-91(1)(b).
56. N.C. Gen. Stat., sec. 45-93.
57. N.C. Gen. Stat., sec. 45-94.