# MORTGAGE FORECLOSURE

November 23, 2008

Daniel A. Edelman

## I. EXTENT OF PROBLEM

In Illinois, there were over 70,000 foreclosure filings for 2006, up from about 40,000 filings in 2005. ("ForeclosureS.com: Foreclosures Swamp the Midwest," Business Wire, January 8, 2007; News release issued by Attorney General Madigan on March 26, 2007) Cook County had 22,000 foreclosure filings in 2006, and is anticipating 33,000 in 2007. (News release issued by Attorney General Madigan on March 26, 2007) The six-county Chicago metropolitan area had 28,997 filings in 2006. (B. Yerak, "Foreclosures at Highest in Past 8 Years," Chicago Tribune, March 29, 2007, sec. 3, p. 1) Nationally, there were 970,948 foreclosures filed in 2006, up more than 51% from 640,000 in 2005. ("ForeclosureS.com: Foreclosures Swamp the Midwest," Business Wire, January 8, 2007) Most of the increase is in subprime mortgage loans. In Illinois, there were 218,504 subprime loans outstanding on December 31, 2006. More than 15% were at least 30 days past due, nearly 10% more than 90 days past due, and 6.2% in foreclosure. R. Trivedi, "Missouri, Illinois won't escape subprime mortgage meltdown," St. Louis Post-Dispatch, March 23, 2007.

Much of the problem is caused by subprime loans with low teaser rates that adjust upwards after one or two years, resulting in unaffordable payments. These are the so-called 2/28 or 3/27 adjustable rate mortgages (ARMS), meaning that the rate for the first 2 or 3 years is a low "teaser" rate, after which the loan adjusts upwards to the higher, fully indexed rate. The delinquency rate during the last quarter of 2006 was 2.6% on prime loans, 13.3% on subprime loans generally, and 14.4% on subprime adjustable-rate loans. R. Trivedi, "Missouri, Illinois won't escape subprime mortgage meltdown," St. Louis Post-Dispatch, March 23, 2007.

Nationally, the proportion of mortgages entering foreclosure has climbed steadily since 1980. In 2006, lenders reported 318,000 new foreclosure filings for the third quarter alone, 43 percent higher than the third quarter of 2005. M. Eakes, "Point of View: Lending Abuses Threaten To Spark More Defaults," Mortgage Line, March 13, 2007, p. 4.

According to the Mortgage Bankers Association, foreclosure filings on subprime mortgages now account for over 60% of new conventional foreclosure filings, even though only 23% of recent originations are subprime, and subprime mortgages account for only 13% of all outstanding mortgages. M. Eakes, "Point of View: Lending Abuses Threaten To Spark More Defaults," Mortgage Line, March 13, 2007, p. 4.

Lack of underwriting is a substantial part of the problem – 43% of subprime loans

made in 2006 didn't require the borrowers to fully document their income or assets. R. Trivedi, "Missouri, Illinois won't escape subprime mortgage meltdown," St. Louis Post-Dispatch, March 23, 2007. Such "liar loans" are an open invitation to making unaffordable loans. Another is securitization, the process whereby loans are originated and then packaged for sale to investors on Wall Street. A mortgage company which does not have to hold the loans it originates is likely to be less careful about the quality of loans originated. In addition, securitization makes it more difficult for anyone to renegotiate loans or work with borrowers. "Lenders asked to help 'subprime' buyers," International Herald Tribune, March 22, 2007, p. 20.

During the first seven months of 2007, foreclosure filings in Illinois totalled 52,696. "ForeclosureS.com July 2007 Report: Houses Lost up 27% Over June", Business Wire, August 6, 2007.

## II. THE ILLINOIS MORTGAGE FORECLOSURE LAW

### A. Transactions to Which the IMFL Is Applicable

Section 15-1106(a) of the Illinois Mortgage Foreclosure Law (IMFL), 735 ILCS 5/15-1101, *et seq.,* provides that the Law applies to certain security instruments in addition to those openly labeled as a "mortgage," including

> **any real estate installment contract for residential real estate . . . under which (i) the purchase price is to be paid in installments over a period in excess of five years and (ii) the amount unpaid under the terms of the contract at the time of the filing of the foreclosure complaint, including principal and due and unpaid interest, at the rate prior to default, is less than 80% of the original purchase price of the real estate as stated in the contract; [**and**]**
>
> **any collateral assignment of beneficial interest . . . (i) which is made with respect to a land trust which was created contemporaneously with the collateral assignment of beneficial interest, (ii) which is made pursuant to a requirement of the holder of the obligation to secure the payment of money or performance of other obligations and (iii) as to which the security agreement or other writing creating the collateral assignment permits the real estate which is the subject of the land trust to be sold to satisfy the obligations.**

The IMFL may, but need not, be used to enforce "(i) a collateral assignment of beneficial interest in a land trust or (ii) an assignment for security of a buyer's interest in a real estate installment contract," or "any real estate installment contract entered into on or after the effective date of this Amendatory Act of 1986 and not required to be foreclosed under this Article." 735 ILCS 5/15-1106(b), 5/15-1106(c).

"Mortgage" is defined to include a "deed conveying real estate, although an absolute conveyance in its terms, which shall have been intended only as a security in the nature of a

mortgage" and "equitable mortgages." 735 ILCS 5/15-1207(c), 5/15-1207(d).

### B. Constructive Mortgages

A deed that is absolute on its face, but intended as security, will be construed as a mortgage. Facts relevant to the determination include (1) the existence of an indebtedness, (2) a fiduciary or other close relationship between the parties, (3) prior unsuccessful attempts to obtain loans, (4) whether the consideration is sufficiently large to be consistent with a bona fide sale of the property, (5) lack of legal advice, (6) an agreement or option to repurchase, and (7) the continued exercise of ownership privileges and responsibilities by the purported seller (*e.g.,* occupancy of the premises and payment of real estate taxes). *Robinson v. Builders Supply & Lumber Co.,* 223 Ill.App.3d 1007, 586 N.E.2d 316, 320, 166 Ill.Dec. 358 (1st Dist. 1991); *McGill v. Biggs,* 105 Ill.App.3d 706, 434 N.E.2d 772, 774, 61 Ill.Dec. 417 (3d Dist. 1982). The amount of consideration is perhaps the most important factor. *Robinson, supra.* Any question should be resolved in favor of holding that the deed is intended as security.

Persons facing foreclosure are often contacted by helpful individuals who will "refinance" them by paying off the defaulted loan, taking title to the property, giving an option to repurchase to the homeowner, and leasing the property to the homeowner. These deeds should probably be held to constitute mortgages. Furthermore, if obtained by someone who is in the business of "refinancing" real estate in this manner, they will often be subject to attack for noncompliance with the Truth in Lending Act and other consumer protection laws. *See Redic v. Gary H. Watts Realty Co.,* 762 F.2d 1181 (4th Cir. 1985).

Also seen is the "deed as security" device used by auto title lenders that occasionally lend on the security of real estate.

### C. Reinstatement

The Illinois Mortgage Foreclosure Law provides a statutory right to cure a default and reinstate a loan. 735 ILCS 5/15-1602 provides, in part, the following:

> **Reinstatement is effected by curing all defaults then existing, other than payment of such portion of the principal which would not have been due had no acceleration occurred, and by paying all costs and expenses required by the mortgage to be paid in the event of such defaults, provided that such cure and payment are made prior to the expiration of 90 days from the date the mortgagor or, if more than one, all the mortgagors (i) have been served with summons or by publication or (ii) have otherwise submitted to the jurisdiction of the court. . . . Upon such reinstatement of the mortgage, the foreclosure and any other proceedings for the collection or enforcement of the obligation secured by the mortgage shall be dismissed and the mortgage documents shall remain in full force and effect as if no acceleration or default had occurred.**

735 ILCS 5/15-1601 prohibits the waiver of reinstatement and redemption rights in

the case of residential real estate, except for a waiver after a foreclosure action is filed, which is permitted by means of a document filed with the clerk of the court if the mortgagee waives a deficiency.

Entry of a judgment of foreclosure does not terminate the right to reinstatement. Under prior law, reinstatement rights expire at the earlier of (1) 90 days from the date the court obtained jurisdiction over the mortgagor or (2) the date of judgment.

The IMFL provides that a five-year limitation on a subsequent right of reinstatement will exist "if the court has made an express written finding that the mortgagor has exercised its right to reinstate." 735 ILCS 5/15-1602. If a lender does not put the express written finding in the order, it cannot receive the five-year limitation. Under prior law, once the cure provision was invoked, it could not be exercised for five years. Also, the express written finding pursuant to §15-1602 is discretionary.

It often is very difficult to obtain reinstatement figures from a lender. In order to reinstate the mortgage, the mortgagor should make a demand on the lender for the reinstatement figures and, if necessary, should file a motion within the reinstatement period asking the court to order the lender to provide a reinstatement figure and an explanation of how it was determined. The mortgagor must be prepared to tender the necessary amount within the reinstatement period. However, the mortgagor also may want to contest the reasonableness of any attorneys' fees claimed by the mortgagee or of other charges.

If the reinstatement amount is disputed, the 90 days will not begin running until the dispute is resolved. *Lomas & Nettleton Co. v. Humphries,* 703 F.Supp. 757 (N.D.Ill. 1989); *Invex Finance, B.V. v. LaSalle National Bank,* No. 90 C 1066, 1992 U.S.Dist. LEXIS 5668 (N.D.Ill. Apr. 6, 1992).

Finally, most of the standard notes and mortgages, including the Federal National Mortgage Association (FNMA or "Fannie Mae"), Federal Home Loan Mortgage Corporation (FHLMC or "Freddie Mac"), and Federal Housing Administration (FHA) forms, provide for an independent right to reinstate. This right lasts up to sale and is thus more useful than the statutory right.

Any tender of funds to reinstate or redeem should be accompanied by a letter specifying that the funds are to be used only to reinstate or redeem. Otherwise, they can be applied to other debts or to the deficiency. *Citicorp Mortgage, Inc. v. Leonard,* 166 B.R. 645 (N.D.Ill. 1994); *Farm Credit Bank of St. Louis v. Biethman,* 262 Ill.App.3d 614, 634 N.E.2d 1312, 199 Ill.Dec. 958 (5th Dist. 1994).

### D. Redemption

Redemption rights are conferred by 735 ILCS 5/15-1603. In the case of residential real estate, the redemption period shall end on the later of seven months from the date all of the

mortgagors have been served with summons or by publication or have otherwise submitted to the jurisdiction of the court or three months from the date of entry of a judgment of foreclosure. 735 ILCS 5/15-1603(b)(1). The period may be shortened if a personal deficiency is waived. 735 ILCS 5/15-1603(b)(3). The redemption amount is

> **(1) The amount specified in the judgment of foreclosure, which shall consist of (i) all principal and accrued interest secured by the mortgage and due as of the date of the judgment, (ii) all costs allowed by law, (iii) costs and expenses approved by the court, (iv) to the extent provided for in the mortgage and approved by the court, additional costs, expenses and reasonable attorneys' fees incurred by the mortgagee, (v) all amounts paid pursuant to** [735 ILCS 5/15-1505] **and (vi) per diem interest from the date of judgment to the date of redemption calculated at the mortgage rate of interest applicable as if no default had occurred; and**
>
> **(2) The amount of other expenses authorized by the court which the mortgagee reasonably incurs between the date of judgment and the date of redemption, which shall be the amount certified by the mortgagee in accordance with [**735 ILCS 5/15-1603(e)**].** 735 ILCS 5/15-1603(d).

Prior notice of intent to redeem is required. 735 ILCS 5/15-1603(e).

A special right to redeem exists with respect to residential real estate if "(i) the purchaser at the sale was a mortgagee who was a party to the foreclosure or its nominee and (ii) the sale price was less than the amount specified in [735 ILCS 5/15-1603(d)]." 735 ILCS 5/15-1604(a). In that event, the mortgagor or other person entitled to redeem may do so for a period ending 30 days after the date the sale is confirmed by tendering the sale price, all additional costs reported by the mortgagee and confirmed by the court, and interest at the statutory judgment rate. *Id.*

### E. Deed in Lieu of Foreclosure and Consent Foreclosure

The Illinois Mortgage Foreclosure Law also provides for acquisition of the borrower's interest through a deed in lieu of foreclosure and consent foreclosure. A deed in lieu of foreclosure normally "shall relieve from personal liability all persons who may owe payment or the performance of other obligations secured by the mortgage, including guarantors of such indebtedness or obligations, except to the extent a person agrees not to be relieved in an instrument executed contemporaneously." 735 ILCS 5/15-1401. Often, when the borrower has some defense, it is possible to obtain cash as part of a settlement in which the borrower gives a deed in lieu of foreclosure.

Consent foreclosure is authorized by 735 ILCS 5/15-1402 and also extinguishes the borrower's personal liability if

> **(1) the mortgagee offers, in connection with such a judgment, to**

**waive any and all rights to a personal judgment for deficiency against the mortgagor and against all other persons liable for the indebtedness or other obligations secured by the mortgage;**

**(2) such offer is made either in the foreclosure complaint or by motion upon notice to all parties not in default;**

**(3) all mortgagors who then have an interest in the mortgaged real estate, by answer to the complaint, response to the motion or stipulation filed with the court expressly consent to the entry of such judgment;**

**(4) no other party, by answer or by response to the motion or stipulation, within the time allowed for such answer or response, objects to the entry of such judgment; and**

**(5) upon notice to all parties who have not previously been found in default for failure to appear, answer or otherwise plead.** 735 ILCS 5/15-1402(a).

If a party other than the mortgager with an interest in the property objects to the judgment, the court, following a hearing on the issue, may disallow or allow the judgment or order that title be vested in the objecting party, provided the party agrees to pay all costs as determined by 735 ILCS 5/15-1603(d) and any additional interest. 735 ILCS 5/15-1402(b).

Care is required when drafting agreements relating to deeds in lieu of foreclosure and consent foreclosures. In *Flora Bank & Trust v. Czyzewski,* 222 Ill.App.3d 382, 583 N.E.2d 720, 164 Ill.Dec. 804 (5th Dist. 1991), the mortgagee and the mortgagors entered into a stipulation by which the mortgagors would deed the property to the mortgagee, who then would sell the property at auction. The auction resulted in a deficiency, for which the mortgagee sought judgment. The mortgagors sought to bar the deficiency judgment arguing that the mortgagors had executed a deed in lieu of foreclosure and that the agreement did not clearly impose liability for a deficiency. The appellate court found that the agreement did impose this liability, rejecting the trial court's finding that there would have been no reason for the mortgagors to execute quitclaim deeds except to be relieved from a deficiency.

Finally, 735 ILCS 5/15-1403 preserves common law strict foreclosure to the extent that it still exists. A common law strict foreclosure is available when the mortgagor is insolvent, the value of the property is less than the debt and outstanding property taxes, and the mortgagee gives up the right to a deficiency. *Great Lakes Mortgage Corp. v. Collymore,* 14 Ill.App.3d 68, 302 N.E.2d 248 (1st Dist. 1973).

### F. Nonjudicial Foreclosures

All other foreclosures in Illinois must be through judicial proceedings. Illinois, unlike

some other states, does not allow nonjudicial foreclosures. However, federal law authorizes nonjudicial foreclosure of government-guaranteed loans under the Single Family Mortgage Foreclosure Act of 1994, 12 U.S.C. §3751, *et seq.,* and 24 C.F.R. Part 27, although, in fact, this procedure is not frequently used.

### G. Allegations Deemed Included in Complaint

A mortgage foreclosure complaint is deemed to include certain allegations, set forth in 735 ILCS 5/15-1504(c). When responding to such a complaint, the attorney representing the defendant must admit or deny the deemed allegations.

### H. Sale

Upon entry of a judgment of foreclosure and expiration of the reinstatement period and the redemption period in accordance with 735 ILCS 5/15-1603(b) and 5/15-1603(c), the real estate shall be sold at a sale after public notice published at least once per week for three consecutive calendar weeks. 735 ILCS 5/15-1507. The first notice is to be published not more than 45 days prior to the sale, the last notice is to be published not less than seven days prior to the sale. 735 ILCS 5/15-1507(c)(2).

Under 735 ILCS 5/15-1508(b), the court has discretion not to confirm a sale if its terms were unconscionable, it was fraudulently conducted, or justice was not otherwise done. *Cragin Federal Bank for Savings v. American National Bank & Trust Company of Chicago,* 262 Ill.App.3d 115, 633 N.E.2d 1011, 199 Ill.Dec. 215 (2d Dist. 1994); *Lyons Savings & Loan Ass'n v. Gash Associates,* 189 Ill.App.3d 684, 545 N.E.2d 412, 136 Ill.Dec. 888 (1st Dist. 1989); *Illini Federal Savings & Loan Ass'n v. Doering,* 162 Ill.App.3d 768, 516 N.E.2d 609, 114 Ill.Dec. 454 (5th Dist. 1987). Some cases state that trial courts have broad discretion in approving or disapproving sales made at their direction. *Citicorp Savings of Illinois v. First Chicago Trust Company of Illinois,* 269 Ill.App.3d 293, 645 N.E.2d 1038, 206 Ill.Dec. 786 (1st Dist. 1995). For example, a sale at one sixth of the value of the property has been held inappropriate. *Commercial Credit Loans, Inc. v. Espinoza,* 293 Ill.App.3d 923, 689 N.E.2d 282, 228 Ill.Dec. 410 (1st Dist. 1997). Courts have held that the extent of inquiry is less stringent than that imposed by the Uniform Commercial Code, 810 ILCS 5/1-101, *et seq.,* which requires that all sales "must be commercially reasonable" or in the Bankruptcy Code, 11 U.S.C. §101, *et seq.,* which requires aggressive advertising of the proposed sale and a foreclosure sale price of "a reasonably equivalent value" for the property. *Resolution Trust Corp. v. Holtzman,* 248 Ill.App.3d 105, 618 N.E.2d 418, 425, 187 Ill.Dec. 827 (1st Dist. 1993).

If the sale is confirmed and produces a deficiency, a judgment for that amount is entered as part of the same order. 735 ILCS 5/15-1508(e).

The sale is merely an irrevocable offer that is accepted by the court order confirming the sale. *BCGS, L.L.C. v. Jaster,* 299 Ill.App.3d 208, 700 N.E.2d 1075, 1079, 233 Ill.Dec. 367 (2d Dist. 1998); *Citicorp Savings, supra; Commercial Credit Loans, supra; World Savings & Loan Ass'n v. AmerUS Bank,* 317 Ill.App.3d 772, 740 N.E.2d 466, 251 Ill.Dec. 385 (1st Dist. 2000).

The Seventh Circuit has held that a Chapter 13 will not stop a foreclosure sale unless it is filed before the sale is held. *Colon v. Option One Mortgage Corp.,* 319 F.3d 912 (7th Cir. 2003). Filing before it is confirmed is not sufficient.

**I. Attorneys' Fees for Mortgagee**

735 ILCS 5/15-1510 provides that "[A]ttorney' fees and other costs incurred in connection with the preparation, filing or prosecution of the foreclosure suit shall be recoverable in a foreclosure only to the extent specifically set forth in the mortgage or other written agreement between the mortgagor and the mortgagee." Illinois law makes the award of attorneys' fees and expenses under a mortgage a matter within the court's discretion based on satisfactory proof. *Mercado v. Calumet Federal Savings & Loan Ass'n,* 196 Ill.App.3d 483, 554 N.E.2d 305, 143 Ill.Dec. 370 (1st Dist. 1990); *Chicago Title & Trust Co. v. Chicago Title & Trust Co.,* 248 Ill.App.3d 1065, 618 N.E.2d 949, 188 Ill.Dec. 379 (1st Dist. 1993). For example, an Illinois court will not award fees to a creditor who is unsuccessful or makes litigation necessary by claiming an excessive amount regardless of what a note or mortgage purports to allow. *Helland v. Helland,* 214 Ill.App.3d 275, 573 N.E.2d 357, 359, 157 Ill.Dec. 939 (2d Dist. 1991).

**J. Attorneys' Fees for Mortgagor**

735 ILCS 5/15-1510 has been amended effective January 1, 2009 to permit attorney's fees to be awarded to a borrower:

**735 ILCS 5/15-1510. (As amended by P.A. 95-961, effective January 1, 2009) Attorney's Fees and Costs**

**Sec. 15-1510. (a) The court may award reasonable attorney's fees and costs to the defendant who prevails in a motion, an affirmative defense or counterclaim, or in the foreclosure action. A defendant who exercises the defendant's right of reinstatement or redemption shall not be considered a prevailing party for purposes of this Section. Nothing in this subsection shall abrogate contractual terms in the mortgage or other written agreement between the mortgagor and the mortgagee or rights as otherwise provided in this Article which allow the mortgagee to recover attorney's fees and costs under subsection (b).**

**(b) Attorneys' fees and other costs incurred in connection with the preparation, filing or prosecution of the foreclosure suit shall be recoverable in a foreclosure only to the extent specifically set forth in the mortgage or other written agreement between the mortgagor and the mortgagee or as otherwise provided in this Article.**

## K. Procedural Points

The attorney who undertakes the defense of a mortgage foreclosure should be mindful of a number of points:

1. It is always desirable to act before default. Although appellate decisions urge liberal vacation of default judgments in mortgage foreclosure actions upon a motion made within 30 days (*Bank & Trust Co. v. Line Pilot Bungee, Inc.,* 323 Ill.App.3d 412, 752 N.E.2d 650, 256 Ill.Dec. 770 (5th Dist. 2001)), it is the author's experience that courts are more reluctant to vacate defaults in foreclosures than in virtually any other type of case.

2. It is usually beneficial to file suit against the lender *before* the lender institutes a foreclosure lawsuit.

3. The borrower will rarely recognize or understand what constitutes a valid defense. The author has seen numerous pro se answers that do nothing more than admit that a default exists. Do *not* have the borrower appear or file *anything* pro se. Also, do not rely on the borrower to identify "what is wrong" with a mortgage transaction. Review the documents yourself.

4. Get a complete set of closing documents, a complete loan history, and all available correspondence from the borrower. Informal requests should be sent to the current and prior servicer and the closing agent. A mortgage servicer is legally obligated under federal law (amendments of the Cranston-Gonzales National Affordable Housing Act, Pub.L. No. 101-625, 104 Stat. 4079 (1990), to the Real Estate Settlement Procedures Act of 1974 (RESPA), 12 U.S.C. §2601, *et seq.*) to respond to certain requests while it is servicing the loan and for one year thereafter. 12 U.S.C. §2605. Requests should be sent out at once. If a lawsuit is already on file, discovery asking for these items should be issued immediately.

5. The most common documents giving rise to defenses and counterclaims are (a) the Truth in Lending disclosures, including the basic financial disclosure statement, any itemization of the amount financed, any advance disclosures under the Home Ownership and Equity Protection Act of 1994 (HOEPA), and any notice of right to cancel; (b) the note and mortgage itself, including all riders and attachments; (c) the HUD-1 Settlement Statement, which is the standard settlement form required by RESPA (12 U.S.C. §2603); and (d) the account history. Also obtain all correspondence with the mortgage company and demand letters. A small delinquency can be offset by a few violations of the Cranston-Gonzales National Affordable Housing Act or the Fair Debt Collection Practices Act, 15 U.S.C. §1692, *et seq.*

6. Ascertain the state of title to the property, either by obtaining a title search or conducting one yourself. The sloppiness of lenders is often just short of incredible. For example, the author has seen multiple instances of lenders obtaining a mortgage from less than all joint tenants. The non-signing joint tenants almost certainly did not receive disclosures pursuant to the Truth in

Lending Act (TILA) or notices of their right to cancel the loan. If they qualify as parties entitled to exercise rescission rights (*i.e.,* if they live in the property), the mortgage is subject to rescission under federal law (although it may be effective as to the joint tenant's interest under state law). In this regard, the title of many inner-city properties is often "messy," as a result of persons who cannot afford lawyers informally determining the ownership of property without compliance with probate and recording laws.

7. If the loan is less than three years old (the TILA rescission period), always get evidence of every disbursement listed on the HUD-1, including such items as governmental fees and charges and credit reports. In Cook County, the charge for recording an instrument is endorsed on the instrument. In other counties, there are standard fee schedules from which the cost can be readily computed. The cost of a credit report is often listed on the report itself.

The importance of doing this cannot be overemphasized. Many predatory lenders cannot resist "marking up" such items as recording fees, credit reports, and the like. The "markup" is a finance charge, invariably not disclosed as such. (Indeed, it can be argued that the entire charge for the "marked up" item is a finance charge, not just the amount of the "markup.") As discussed below, the "tolerance" of error permitted under TILA before a borrower can rescind in response to a mortgage foreclosure is only $35. 15 U.S.C. §1635(i)(2); 12 C.F.R. §226.23(h)(2). Therefore, if you can establish $35.01 worth of "markups," you have a defense to foreclosure.

Many predatory lenders also are in the habit of making loans that bump right up against the "triggers" for special disclosure and other requirements, such as the eight-percent HOEPA "trigger." See below. There is no margin of error in this situation. If as a result of padding recording charges or credit report fees the "points and fees" on a loan are at 8.01 percent instead of 7.99 percent as the lender intended, the mortgage is subject to rescission.

If the HUD-1 shows a disbursement to the borrower, do not assume that the borrower actually got the money. Find out. Have the borrower bring in bank statements for the relevant period if there is any question. The author has had a number of cases in which the money went into the pocket of a broker or lender. All such undisbursed amounts are finance charges, and they are almost never disclosed as such.

8. Ascertain the number of dwelling units in the property and who occupies them. Many applicable statutes, such as TILA and the Real Estate Settlement Procedures Act of 1974, 12 U.S.C. §§2601, *et seq.,* apply only if the "principal" purpose of a transaction was "personal, family or household." The IMFL gives certain rights only if the property is "residential." Finally, the Illinois Credit Agreements Act, 815 ILCS 160/0.01, *et seq.,* creates a special statute of frauds in favor of institutional lenders that bars parol evidence of an agreement to "lend money or extend credit or delay or forbear repayment of money not primarily for personal, family or household purposes." 815 ILCS 160/1.

Financing the acquisition of a one- or two-unit property in which the borrower resides is for "personal, family or household" purposes. Financing the acquisition of a six-flat in which one

unit is occupied by the borrower and the others are rented to unrelated persons may not be. Having an appraisal will confirm the number of dwelling units and usually provide separate valuations for the building and underlying land.

9. Make sure that there is nothing inaccurate on the loan application or, if there is any inaccuracy, that there is a good explanation.

## III. IS THERE A PROPER PLAINTIFF

Many mortgage foreclosure cases appear to be brought by nominal parties who do not qualify as the "real party in interest" in federal court and may not have standing under state law.

735 ILCS 5/15-1504 indicates that a foreclosure can be filed by "the legal holder of the indebtedness, a pledgee, an agent, or the trustee under a trust deed. However, the record must affirmatively show in what capacity the plaintiff is suing. In *Bayview Loan Servicing, LLC v. Nelson*, 382 Ill. App. 3d 1184; 890 N.E.2d 940, 944 (5th Dist. 2008), the court reversed a judgment for a "servicing agent" when the record did not show either a transfer of the note and mortgage to plaintiff or that it was otherwise entitled to sue, concluding that " there was no basis for the entry of a summary judgment in favor of Bayview, a stranger to the mortgage."

Elsewhere, courts have dismissed numerous foreclosure and collection lawsuits to have been filed in the names of entities that do not own the purported debts. *In re Foreclosure Cases*, 1:07CV2282 and 14 others, 2007 U.S. Dist. LEXIS 84011, 2007 WL 3232430 (N.D. Ohio Oct. 31, 2007). In the Ohio cases, foreclosure complaints alleged that the named plaintiffs were the holders and owners of the notes and mortgages, but they were not the original payees and there was nothing showing that the plaintiffs owned the notes and mortgages at the time suit was filed. Dismissing the cases, the court commented (*8-9):

> There is no doubt every decision made by a financial institution in the foreclosure process is driven by money. And the legal work which flows from winning the financial institution's favor is highly lucrative. There is nothing improper or wrong with financial institutions or law firms making a profit -- to the contrary , they should be rewarded for sound business and legal practices. However, unchallenged by underfinanced opponents, the institutions worry less about jurisdictional requirements and more about maximizing returns. Unlike the focus of financial institutions, the federal courts must act as gatekeepers, assuring that only those who meet diversity and standing requirements are allowed to pass through. Counsel for the institutions are not without legal argument to support their position, but their arguments fall woefully short of justifying their premature filings, and utterly fail to satisfy their standing and jurisdictional burdens. The institutions seem to adopt the attitude that since they have been doing this for so long, unchallenged, this practice equates with legal compliance. Finally put to the test, their weak legal arguments compel the Court to stop them at the gate.

Subsequently, dozens of other mortgage cases were thrown out or had show cause orders entered for the same reason. *In re Foreclosure Cases,* 07-cv-166 and 18 others, 2007 U.S. Dist. LEXIS 90812 (S.D. Ohio Nov. 27, 2007); *In re Foreclosure Cases,* 521 F. Supp. 2d 650 (S.D.Ohio. 2007); *In re Foreclosure Cases*, 07-cv-166 and 14 others, 2007 U.S. Dist. LEXIS 95673 (S.D.Ohio, Dec. 27, 2007); *NovaStar Mortgage, Inc. v. Riley*, 3:07-CV-397, 2007 U.S. Dist. LEXIS 86216 (S.D.Ohio, Nov. 21, 2007); *NovaStar Mortgage, Inc. v. Grooms*, 3:07-CV-395, 2007 U.S. Dist. LEXIS 86214 (S.D.Ohio., Nov. 21, 2007); *HSBC Bank USA v. Rayford*, 3:07-CV-428, 2007 U.S. Dist. LEXIS 86215 (S.D.Ohio., Nov. 21, 2007); *Everhome Mtge. Co. v. Rowland,* 2008 Ohio 1282; 2008 Ohio App. LEXIS 1103 (Ohio App. March 20, 2008) (judgment for plaintiff reversed because it failed to introduce assignment or establish that it was the holder of the note and mortgage); *Deutsche Bank National Trust Co. v. Castellanos*, 277/07, 2008 NY Slip Op 50033U; 18 Misc. 3d 1115A; 2008 N.Y. Misc. LEXIS 44; 239 N.Y.L.J. 16 (Kings Co., N.Y., Sup. Ct., Jan. 14, 2008) (Justice Arthur M. Schack); *HSBC Bank USA, N.A. v. Valentin,* 15968/07, 2008 NY Slip Op 50164U; 14 Misc. 3d 1123A; 2008 N.Y. Misc. LEXIS 229 (Kings Co., N.Y., Sup. Ct., January 30, 2008); *HSBC Bank USA, N.A., v. Cherry*, 21335/07, 2007 NY Slip Op 52378U; 18 Misc. 3d 1102A; 2007 N.Y. Misc. LEXIS 8279; 239 N.Y.L.J. 2 (Kings Co., N.Y. Sup. Ct., Dec. 17, 2007); *Deutsche Bank National Trust Co. v. Castellanos*, 15 Misc. 3d 1134A; 841 N.Y.S.2d 819 (Kings. Co., N.Y. Sup. Ct. 2007); see also, *Deutsche Bank National Trust Co. v. Steele*, No. 2:07-cv-886, 2008 U.S. Dist. LEXIS 4937 (S.D.Ohio. January 8, 2008); *DLJ Mortgage Capital, Inc. v. Parsons*, 2008 Ohio 1177 (7th Dist. Ct. App. March 13, 2008); *Washington Mutual Bank, F.A. v. Green*, 156 Ohio App.3d 461, 806 N.E.2d 604 (2004).

## IV. EVIDENCE

It is often difficult for mortgage servicers, particular if they are not the original lender, to prove the true status of an account. Affidavits that are conclusory and insufficient are often submitted to prove default. *Manufacturers & Traders Trust Co. v. Medina,* No. 01 C 768, 2001 U.S.Dist. LEXIS 20409 (N.D.Ill. Dec. 5, 2001); *Cole Taylor Bank v. Corrigan,* 230 Ill.App.3d 122, 595 N.E.2d 177, 181, 172 Ill.Dec. 114 (2d Dist. 1992). Computer-generated bank records or testimony based thereon are often offered without proper foundation or are summarized without being introduced. *Medina, supra; Federal Deposit Insurance Corp. v. Carabetta,* 55 Conn.App. 369, 739 A.2d 301 (1999); *Midstates Resources Corp. v. Dobrindt,* 70 Conn.App. 420, 798 A.2d 494 (2002) (lender that had purchased debt from FDIC and could not provide evidence that records of original lender were accurate recovered judgment for $1 rather than $62,800 claimed; counsel for the borrower conceded, perhaps inappropriately, that the records were admissible).

Testimony, whether live or in the form of an affidavit, to the effect that a witness has reviewed a loan file and that the loan file shows that a debtor is in default is hearsay and incompetent; rather, the records must be introduced after a proper foundation is provided. *New England Savings Bank v. Bedford Realty Corp.,* 238 Conn. 745, 680 A.2d 301, 308 – 309 (1996), *later op.,* 246 Conn. 594 (1998); *Cole Taylor Bank, supra.* It is the business records that constitute the evidence, not the testimony of the witness referring to them. *In re A. B.,* 308 Ill.App.3d 227, 719 N.E.2d 348, 241 Ill.Dec. 487 (2d Dist. 1999).

An affidavit is not made sufficient by merely omitting the fact that it is based on a review of loan records if it appears that the affiant did not personally receive or observe the reception of all of the borrower's payments. *Hawaii Community Federal Credit Union v. Keka,* 94 Haw. 213, 11 P.3d 1, 10 (2000). If the underlying records are voluminous, a person who has extracted the necessary information may testify to that fact, but the underlying records must be made available to the court and the opposing party. *In re Marriage of DeLarco,* 313 Ill.App.3d 107, 728 N.E.2d 1278, 245 Ill.Dec. 921 (2d Dist. 2000).

If the records are generated by computer, a person familiar with the computer system who can testify that the output is an accurate reflection of the input must lay a foundation. *In re Vinhnee*, 2005 Bankr. LEXIS 2602, 2005 WL 3609376 (9th Cir. BAP, Dec. 16, 2005). Among pertinent subjects of inquirty are "system control procedures, including control of access to the pertinent databases, controll of access to the pertinent programs, recording and logging of changes to the data, backup practices, and audit procedures utilized to assure the continuing integrity of the records." (Id., *25-26) In that case, "The trial court concluded that the declaration in the post-trial submission was doubly defective. First, the declaration did not establish that the declarant was 'qualified' to provide the requisite testimony. Second, the declaration did not contain information sufficient to warrant a conclusion that the 'American Express computers are sufficiently accurate in the retention and retrieval of the information contained in the documents.'" (*22-23)

Counsel should challenge any such testimony or affidavits. Counsel should not simply assume that the mortgage company must be right in claiming a default; there are reported decisions in which it turned out that the lender's right hand did not know what the left hand was doing and that there was really no basis for a claimed default. *Hart v. GMAC Mortgage Corp. (In re Hart),* 246 B.R. 709 (Bankr. D.Mass. 2000); *Maxwell v. Fairbanks Capital Corp. (In re Maxwell),* 281 B.R. 101 (Bankr. D.Mass. 2002); *Federal Home Loan Mortgage Corp. v. McCormack,* No. 96-81-SD, 1996 U.S.Dist. LEXIS 22663 (D.N.H. Aug. 29, 1996). *See also Federal National Mortgage Ass'n v. Bryant,* 62 Ill.App.3d 25, 378 N.E.2d 333, 18 Ill.Dec. 869 (5th Dist. 1978), in which the court found that the lender had foreclosed too quickly and that the default had been cured. Frequently, mortgage servicers attempt to service loans without consulting the loan documents with the result that they depart from their terms. In other cases, mortgage companies have been unable to prove that they actually own the loan and gave notice of acceleration as required by the loan documents. *In re Kitts,* 274 B.R. 491 (Bankr. E.D.Tenn. 2002).

There is a common assumption that mortgage companies desire performing loans and not to foreclose and acquire real estate. This assumption is no longer well founded. There are an increasing number of "scavengers" that buy bad debts, including mortgages, for a fraction of face value and attempt to enforce them. These entities profit by foreclosure. "Mortgage sources confide that some unscrupulous lenders are purposely allowing certain borrowers to fall deeper into a financial hole from which they can't escape. Why? Because it pushes these consumers into foreclosure, whereupon the lender grabs the house and sells it at a profit." Robert K. Heady, The People's Money: *Foreclosure, You Must Avoid It,* South Florida Sun-Sentinel, Feb. 25, 2002, 2002 WL 2949282. In addition, particularly if the loan is guaranteed (by private mortgage insurance or the government), a mortgage company may find it more profitable to foreclose and make a claim on the

guarantee rather than work with a "difficult" borrower.

Furthermore, production of original records often reveals unauthorized charges and other improprieties that may give rise to a claim against the mortgage company.

### A. Appeal

An order directing a foreclosure sale is an order capable of being made final through a Supreme Court Rule 304(a) finding but not appealable in the absence of such a finding. An order confirming the sale is a final order appealable without a Rule 304(a) finding. "A judgment ordering the foreclosure of a mortgage is not final and appealable until the court enters orders approving the sale and directing the distribution. Unless the court makes a finding pursuant to Supreme Court Rule 304(a) . . . that there is no just reason for delaying enforcement or appeal, the judgment of foreclosure is not appealable." [Citation omitted.] *In re Marriage of Verdung,* 26 Ill.2d 542, 535 N.E.2d 818, 824, 129 Ill.Dec. 53 (1989). *Accord Marion Metal & Roofing Co. v. Mark Twain Marine Industries, Inc.,* 114 Ill.App.3d 33, 448 N.E.2d 219, 69 Ill.Dec. 759 (5th Dist. 1983); *Bell Federal Savings & Loan Ass'n v. Bank of Ravenswood,* 203 Ill.App.3d 219, 560 N.E.2d 1156, 148 Ill.Dec. 559 (1st Dist. 1990).

Most lawyers representing lenders in foreclosures include Rule 304(a) language in the judgment directing the sale.

### B. Trial by Jury

A jury trial on statutory claims (*e.g.,* the Consumer Fraud and Deceptive Business Practices Act, 815 ILCS 505/1, *et seq.*) is available in federal court because of the Seventh Amendment to the United States Constitution (*Inter-Asset Finanz AG v. Refco, Inc.,* No. 92 C 7833, 1993 U.S.Dist. LEXIS 11181, **8–9 (N.D.Ill. Aug. 11, 1993); *Cellular Dynamics, Inc. v. MCI Telecommunications Corp.,* No. 94 C 3126, 1997 U.S.Dist. LEXIS 7466 (N.D.Ill. May 22, 1997)), but not in state court (*Martin v. Heinold Commodities, Inc.,* 163 Ill.2d 33, 643 N.E.2d 734, 205 Ill.Dec. 443 (1994)). This is one reason why counsel may want to sue first.

## V. PREDATORY LENDING PRACTICES

There are a number of practices that are generally regarded as "predatory." Many are legally actionable.

### A. Deceptive Solicitation

One predatory lending tactic consists of touting reduced monthly payments as compared with an existing loan without disclosure of such material facts as (1) that the homeowners' taxes and insurance are included in the payments on the existing loan but not in the payments on the proposed loan, (2) that the number of payments will be greater, and (3) that the total of the payments

will be greater. Allegations of this nature were made by the Illinois Attorney General against First Alliance Mortgage, now bankrupt, and by the Federal Trade Commission against The Associates.

Another common complaint concerns the deceptive use of "teaser" rates on adjustable rate mortgages. A broker or lender quotes a "ten-percent mortgage" to the unsophisticated homeowner. In fact, the ten percent is a "teaser" rate applicable to the first 12 to 24 months. The rate for the rest of the term is indexed on a basis that would produce a 12- to 14-percent rate that the borrower cannot afford.

A particularly offensive practice is the use of "spurious open-end credit." The Truth in Lending Act and other consumer credit disclosure laws distinguish between "closed-end credit," of which the conventional home mortgage is the classic example, and "open-end credit," such as a credit card or home equity line of credit. The disclosure requirements applicable to open-end credit are less onerous because the consumer cannot tell, for example, how much he or she will charge on a credit card over the years.

Certain lenders have taken advantage of the lesser disclosure requirements for open-end credit. They issue open-end credit instruments for wholly inappropriate purposes, such as to finance home improvements and to replace mortgages. The effect of using open-end credit documentation is to evade certain TILA disclosure requirements:

1. the finance charge;

2. whether, if the consumer makes the minimum required payments, the mortgage will fully amortize (*i.e.,* will the consumer have a large balloon payment?); and

3. avoiding inclusion of "points" in the annual percentage rate.

In addition to these subtle origination abuses, the author has seen outright forgery and alteration of loan documents, coercion of elderly homeowners, and loan-making to persons who are clearly mentally incapacitated. Also, falsification or alteration of applications is a common means of making unaffordable loans.

**B. Home Improvement Abuses**

A considerable number of mortgages result from telephone or door-to-door solicitation by home improvement "contractors." In fact, the solicitors are really "brokers" rather than contractors. Once they sign up a homeowner, they "broker" the work to the cheapest subcontractors they can find, often ones without required tradesmen's licenses. They also arrange for financing, either by having the homeowner execute a retail installment contract or by referring the homeowner to a lender or broker. The result is that the homeowner is obligated for large sums of money, secured by his or her home, and receives substandard work or in extreme cases, no work. To facilitate the performance of shoddy or no work, the loan proceeds are often disbursed in an

illegal manner (*e.g.,* directly to the contractor rather than to the homeowner or into an escrow account from which funds can be released upon certification of a competent architect or inspector).

To "lock in" the homeowner, some of these "contractors" will engage in "spiking," or doing part of the work immediately to negate the homeowner's statutory rescission rights. The homeowner may believe that his or her statutory right to cancel the transaction within three days no longer applies after the roof or porch has been removed.

Another tactic is the "two-contract ploy," in which the homeowner's signature is procured on a purportedly binding agreement prior to disclosure of all financial terms. In some cases, the initial agreements represent that the financing terms will be other than the final terms or contain stiff penalties for cancellation. The homeowner who balks at signing onerous financing terms is then told to pay in cash.

The practitioner should not assume that the price of the work listed on the documents actually was paid to the contractor. Often, the contractor may get as little as 75 percent of the purported price or "amount financed." This practice is known as "discounting" or "chopping."

### C. Questionable Mortgage Broker Practices

Some lenders have been paying money to borrowers' mortgage brokers to induce them to sign up borrowers at a higher interest rate than necessary. These payments are known as "yield spread premiums" (YSPs) in the mortgage industry. Their legality is discussed extensively below.

Some mortgage broker agreements require the borrower to pay the broker fee if the borrower decides to cancel or not proceed with the transaction. In a non-purchase money loan (*i.e.,* one subject to the three-day right to cancel under the Truth in Lending Act), such a provision contradicts the rescission notice and is illegal. *Manor Mortgage Corp. v. Giuliano,* 251 N.J.Super. 13, 596 A.2d 763 (App.Div. 1991). This is because all compensation payable by the borrower to mortgage brokers is now defined as a finance charge, and upon exercise of the right to rescind, the borrower is relieved of liability for all finance charges. If the broker made the loan in its name, under the industry practice commonly known as "table funding," the broker is a creditor, and any attempt by the broker to collect a finance charge is a TILA violation. *Manor Mortgage, supra* (mortgage broker sued for fee after borrower rescinded; court not only held that broker could not recover fee, but since broker qualified as "creditor" because loan was issued in its name, found that attempt to collect fee amounted to refusal to rescind and awarded statutory damages and attorneys' fees).

### D. Unnecessarily High Rates

Between 30 and 50 percent of homeowners who receive "subprime" or "B – D" mortgage loans actually qualify for "prime" or "A" loans. John Taylor, *An Anti-Predator's Reader Guide to Tall Tales of Subprime Lending,* American Banker, Apr. 27, 2001, at p. 12, states the following:

**A study by the Research Institute for Housing America, an offshoot of the Mortgage Bankers Association of America, found that minority borrowers are more apt than whites to receive subprime loans, even after controlling for credit risk factors. Freddie Mac estimates that up to 30% of the subprime loans they have purchased were made to borrowers qualified to receive prime loans. Fannie Mae's CEO claims that half of subprime borrowers should be receiving lower interest rates.**

Often, this results from inappropriate payments to mortgage brokers or racial discrimination.

In some cases, the loans are not merely unnecessarily expensive but unaffordable. Some lenders will make loans without any reasonable expectation of repayment for the purpose of acquiring the borrower's equity. In many cases, these loans involve exorbitant "points" and other devices, so the financing entity is getting a mortgage substantially in excess of the amount of cash actually disbursed to unrelated third parties.

Some lenders advertise that they make "no documentation" subprime loans. This is an open invitation to the making of unaffordable loans.

### E. Excessive Points and Fees

The average origination cost on a $100,000 residential mortgage loan is one to two percent. While subprime loans may be somewhat more costly to originate, the Joint Report of the Department of Housing and Urban Development and the Department of the Treasury, *Curbing Predatory Home Mortgage Lending,* p. 2 (June 2000), noted, "While subprime lending involves higher costs to the lender than prime lending, in many instances the Task Force saw evidence of fees that far exceeded what would be expected or justified based on economic grounds, and fees that were 'packed' into the loan amount without the borrower's understanding."

### F. Single-Premium Credit Insurance

Single-premium credit insurance is credit life or disability insurance, the entire premium for which is charged at the outset of the loan, added to the loan balance, and financed. Approximately 50 percent of the premium consists of commission, payable to the lender. By selling this product, the lender can increase the amount of the loan and the amount on which interest is computed without actually disbursing funds.

In many cases, borrowers are told that the credit insurance is mandatory, which is illegal, or it is simply included in the loan papers without any request or agreement, a practice known as "packing."

Most mortgage loans are refinanced prior to the end of their 15- to 30-year terms. If the single-premium credit insurance policy is still outstanding, the borrower is supposed to receive credit for the unearned portion of the premium upon refinancing. Most borrowers don't think of

asking and are unable to tell if the payoff figure includes a credit for the unearned premium. In many cases, it doesn't.

### G. Flipping

The Joint Report of the Department of Housing and Urban Development and the Department of the Treasury, *Curbing Predatory Home Mortgage Lending,* p. 5 (June 2000), describes "loan flipping" as "the practice of repeatedly refinancing a mortgage loan without benefit to the borrower, in order to profit from high origination fees, closing costs, points, prepayment penalties and other charges, steadily eroding the borrower's equity in his or her home."

A particularly egregious and offensive aspect of flipping is requiring the borrower to refinance low-rate first mortgages. Many homeowners who need to borrow for home improvements or other needs are steered to predatory lenders who will not simply make a second mortgage home improvement loan but insist on refinancing the balance on a six- to eight-percent purchase money mortgage with a 10- to 13-percent loan. The author has seen subsidized zero-percent mortgages replaced by 13-percent predatory loans.

Lenders also promote the use of mortgages to consolidate unsecured credit card and personal loan debts.

### H. Bogus and Junk Fees and Charges

Unnecessary charges are used at both the outset of the loan and in servicing loans to increase the lender's income or to increase the amount of the loan without actually disbursing funds. Typical examples of "junk fees" at origination are $75 for transporting documents, $100 for wire transfers, "warehouse fees," "processing fees," and "review fees" as well as many others.

Brokers and lenders seeking to avoid the Illinois restriction on "points and fees" (discussed below) have on occasion created their own title companies and charged borrowers 2-4 times the market rate for title insurance.

Several lenders have been accused of imposing late charges on payments that were not in fact late or of imposing property inspection and preservation charges not authorized by the loan documents or, in the case of FHA mortgages, applicable HUD regulations and handbooks. In one case, a lender charged $10 for accepting an electronic funds transfer without authority in any document.

### I. Prepayment Penalties

Subprime loans will often provide for hefty penalties for prepayment. The homeowner who has been induced to sign an unnecessarily expensive loan is thus precluded from depriving the lender of its ill-gotten gains by going to a competitor.

### J. Balloon Payments and Call Provisions

A common feature of predatory lending is structuring loans so that the borrower still owes most of the amount borrowed at the end of the loan. The homeowner is not able to pay the balloon payment at the end of the loan and either loses the home after making years of high interest payments or is forced to refinance. Some loans provide that they can be accelerated at the sole discretion of the lender.

### K. Negative Amortization

In some cases, the borrower actually owes more at the end of the loan than at the beginning because the loan payments are insufficient to cover the interest.

### L. Loans over 100 Percent Loan-to-Value Ratio

Recently, lenders have been promoting loans in which the amount of the loan exceeds the fair market value of the home, often as much as 125 percent. Often the same result is accomplished by fraudulently overvaluing the home.

These loans are impossible to refinance except by another, similar loan, locking the borrower into high-rate loans.

### M. Mandatory Arbitration

Mandatory arbitration clauses require, as a condition of receiving a loan, that a borrower agree to resolve any and all disputes arising out of the loan through arbitration, rather than litigation. The Joint Report of the Department of Housing and Urban Development and the Department of the Treasury, *Curbing Predatory Home Mortgage Lending,* p. 8 – 9 (June 2000), found that "[m]andatory arbitration may severely disadvantage HOEPA borrowers. Because of the potential for such clauses to restrict unfairly the legal rights of the victims of abusive lending practices, HUD and Treasury believe that Congress should prohibit mandatory arbitration for HOEPA loans."

In many cases, these clauses also contain a waiver of substantive rights under the Truth in Lending Act, such as the right to attorneys' fees.

### N. Misapplication of Payments and Miscomputation of Interest

Most lawyers, much less borrowers, have no idea whether mortgage payments are being properly computed and applied. Often, they are not. It has been estimated that 25 percent of all adjustable rate mortgages are not properly adjusted. In one case, the author found that the note and a rider conflicted as to the frequency of adjustments. In another, the author found such a short interval between the reference date and the change date that the lender could not apply the formula according to its terms.

Another abuse that often escapes attention concerns the use of "daily interest." Traditionally, banks and mortgage companies treat payments received within the grace period as having been received on the due date (generally, the first of the month). If a payment is received after the grace period, a late charge is imposed, but there is no other consequence unless the borrower falls so far behind that the loan is accelerated. This is what most borrowers think will happen when a mortgage provides for a late charge of, for example, ten percent of the payment if it is not made within 15 days of the due date.

Certain "subprime" mortgage companies do not follow this protocol when applying payments received after the due date. Instead, they compute interest on the entire outstanding principal for the additional number of days prior to receipt of the payment. Often, the entire payment will be applied to interest!

This practice is misleading. If the note and the disclosure under the Truth in Lending Act state that the consequence of paying 16 days late is the addition of a $60 late fee, the borrower does not expect that the consequence will be a $60 late fee plus $600 in extra interest.

One of the most commonly used uniform promissory note forms employed by Fannie Mae and Freddie Mac is Form 3200, Multistate Fixed Rate Note — Single Family — FNMA/FHLMC Uniform Instrument, which contains a clause in Section 2 stating the following:

> **Interest will be charged on unpaid principal until the full amount of Principal has been paid. I will pay interest at a yearly rate of __________%.**

The FANNIE MAE SERVICING GUIDE, Part III, Ch. 1, §101, p. 306 (Sept. 30, 1996), says that the language from Form 3200 means one twelfth of annual interest with each monthly payment (*i.e.,* the manner in which banks and mortgage companies have traditionally calculated interest):

> **The interest portion of the fixed installment must be determined by computing 30 days' interest on the outstanding principal balance as of the last paid installment date. For this calculation, always use the current interest accrual rate for the mortgage. Interest for second mortgages may be determined by a *payment-to-payment calculation method* if the mortgage instrument requires it.** [Emphasis added.]

The FANNIE MAE SERVICING GUIDE, Part VI, Ch. 1, §102.01, p. 605 (Mar. 20, 1996), says much the same thing:

> **Interest charged to the mortgagor should always be calculated on the outstanding principal balance of the mortgage as of the last paid installment date, using the current interest accrual rate. A full month's interest should be calculated on the basis of a 360-day year, while a partial month's interest should be based on a 365-day year.**

### O. Force-Placed Insurance

All mortgages require the homeowner to insure the home against fire and casualty. If the homeowner fails to pay his or her insurance premiums (either directly or through an escrow account), the cheapest thing for the lender to do is to advance the premium and add it to the debt, thereby continuing coverage. Instead, some lenders "force-place" their own insurance that has much higher premiums. Often, a substantial portion of the premiums are paid as commissions to an affiliate of the lender. Sometimes, the insurance is for an amount in excess of that authorized by the note and mortgage. Also, the insurer or an affiliate may provide "free" services (paid from the insurance premiums) to the lender, such as tracking whether borrowers have their own insurance.

Some or all of these practices may be contrary to the note and mortgage and the Collateral Protection Act, 815 ILCS 180/1, *et seq.,* which requires specified notices (1) at the time the loan is entered into (815 ILCS 180/10) and (2) within 30 days after the forced placement of any insurance (815 ILCS 180/15). "Substantial compliance" is required if the loan was made on or after July 1, 1997. 815 ILCS 180/65. The Act provides that "[a] creditor that places collateral protection insurance in substantial compliance with the terms of this Act shall not be directly or indirectly liable in any manner to a debtor, co-signer, guarantor, or any other person, in connection with the placement of the collateral protection insurance." 815 ILCS 180/40. It also provides that the Act "shall not be deemed to create a cause of action for damages on behalf of the debtor or any other person in connection with the placement of collateral protection insurance." 815 ILCS 180/50. The creditor may require that the insurance be paid for at once as a balloon payment at the end of the loan or that it be paid through amortization. 815 ILCS 180/15.

The effect of noncompliance with the Collateral Protection Act has not been determined. One argument is that the debtor may not be charged for insurance except in compliance with the Act.

## VI. IS THERE A DEFAULT?

The first question a lawyer must ask regarding an alleged default is whether the mortgage company's claim is correct. It should be apparent that the effect of some of the predatory practices listed above is to manufacture a default where none exists.

For example, if a lender has used "daily interest" under a mortgage that does not authorize it, it is likely that hundreds or thousands of dollars have been wrongfully allocated to interest instead of principal. Similarly, if rates have not been properly adjusted on an adjustable rate mortgage, the borrower may not be in default. The addition of force-placed insurance premiums and other "junk fees" to the loan balance may also create the appearance of a default where none in fact exists.

Another issue is whether the lender has waived strict compliance with the loan documents by accepting irregular payments. There is a long line of real estate contract cases holding

that forfeiture will be waived unless there has been a notice of intention to require strict compliance. *Allabastro v. Wheaton National Bank,* 77 Ill.App.3d 359, 395 N.E.2d 1212 , 32 Ill.Dec. 831 (2d Dist. 1979); *Lang v. Parks,* 19 Ill.2d 223, 166 N.E.2d 10 (1960); *Kingsley v. Roeder,* 2 Ill.2d 131, 117 N.E.2d 82 (1954); *Clevinger v. Ross,* 109 Ill. 349 (1884); *Heeren v. Smith,* 276 Ill.App. 438 (4th Dist. 1934); *Donovan v. Murphy,* 217 Ill.App. 31 (1st Dist. 1920). *But see Zinser v. Uptown Federal Savings & Loan, F.A.,* 185 Ill.App.3d 979, 542 N.E.2d 87, 134 Ill.Dec. 87 (1st Dist. 1989) (giving effect to contractual anti-waiver provision in context of motor vehicle repossession). Notice requires service of the defaulting party with a definite, written notice of intention to require strict compliance with the contract in the future. *Kingsley, supra; Lang, supra.* Notice is required even when the contract contains a "time is of the essence" provision. *Donovan, supra.*

The existence of credits or setoffs may negate the existence of a default. For example, in *Chicago Title & Trust Co. v. Exchange National Bank of Chicago,* 19 Ill.App.3d 565, 312 N.E.2d 11 (2d Dist. 1974), the $15,000 balance of the purchase price was to be paid in five annual installments to be secured by a second mortgage. The seller agreed inter alia to "remedy condition which permits water to leak into basement." 312 N.E.2d at 14. After attempting to have the seller make the repairs, the purchasers hired an outside plumber who made the repairs, for which they paid $1,190.25, which they then deducted from the first installment. In the seller's foreclosure action, the appellate court held that the purchasers could assert the credit as a defense to the foreclosure suit. The court stated:

> **There is no default which would permit the mortgagor to accelerate the maturity of the debt when there is a setoff available which is equal to or exceeds the amount of the indebtedness due at the time of default. . . . The rule is based on the reasoning that it would be inequitable to permit one by his own act to cause a partial failure of the consideration for the mortgage without requiring him to credit the amount of such failure upon the indebtedness for the purchase price of the property. [Citations omitted.] *Id.***

Further, the court found that the purchaser could assert the credit as a defense rather than file a counterclaim for setoff because the defense, if valid, showed that the purchasers were not in default and prevented acceleration of the entire mortgage indebtedness. *See also Bank Computer Network Corp. v. Continental Illinois National Bank & Trust Company of Chicago,* 110 Ill.App.3d 492, 442 N.E.2d 586, 66 Ill.Dec. 160 (1st Dist. 1982), in which the court stated that there is no default when the borrower is entitled to a setoff that is equal to or exceeds the amount of the delinquency.

On FHA and VA mortgages, there are various notification and counseling requirements, noncompliance with which may constitute a defense. HUD regulations, 24 C.F.R. §§203.604 and 203.606, require the mortgagee to seek a face-to-face interview with the mortgagors before three loan installments have become past due and review its file to determine compliance with servicing requirements before initiating a foreclosure action. In *Bankers Life Co. v. Denton,* 120 Ill.App.3d 576, 458 N.E.2d 203, 76 Ill.Dec. 64 (3d Dist. 1983), the court held that noncompliance with these requirements is an affirmative defense. Similarly, in *Federal National Mortgage Ass'n v. Moore,* 609 F.Supp. 194 (N.D.Ill. 1985), which involved an FHA-insured mortgage, foreclosure

was denied because of the mortgagee's failure to give to the mortgagor written notice of default and intention to foreclose and of the mortgagor's right to apply to HUD for assignment of the mortgage in the form required by HUD regulations. *See also Mellon Mortgage Co. v. Larios,* No. 97 C 2330, 1998 U.S.Dist. LEXIS 7988 (N.D.Ill., May 20, 1998); *Federal Land Bank of St. Paul v. Overboe,* 404 N.W.2d 445 (N.D. 1987); *Union National Bank v. Cobbs,* 389 Pa.Super. 509, 567 A.2d 719 (1989); *GNMA v. Screen*, 379 N.Y.S.2d 327 (1976); *Cross v. FNMA*, 359 So.2d 464 (1978); FNMA v. Ricks, 372 N.Y.S.2d 485 (1975); *Washington Mutual Bank v Mahaffey,* 154 Ohio App.3d 44, 796 N.E. 2d 39 (2003); and *GMAC Mortgage of PA v Gray,* No. 91AP650, 1991 WL 268742 (1991).

Some FHA documents provide that the right to accelerate or initiate foreclosures is subject to the compliance with HUD regulations. The issue that will be raised by the lender is that there is no private cause of action to enforce HUD regulations. There are a number of cases from the 70-80s which make this statement, however, this is a contractual agreement and the earlier authority did not address contractual agreements to comply with the Regulations. There is a good 4th Circuit case that permits contractual enforcement of a regulation that does not provide a private cause of action. *College Loan Corp. v. SLM Corp.*, 396 F.3d 588 (4th Cir., 2005):

> Both expressly agreed to comply with the HEA. In that context, Sallie Mae's argument that enforcement of the Agreement's terms is preempted by the HEA boils down to a contention that it was free to enter into a contract that invoked a federal standard as the indicator of compliance, then to proceed to breach its duties thereunder and to shield its breach by pleading preemption.

The new Illinois predatory mortgage regulations imposed similar counseling requirements. See below. The regulations were invalidated by the Seventh Circuit, *Illinois Association of Mortgage Brokers v. Office of Banks & Real Estate,* 308 F.3d 762 (7th Cir. 2002). They have now been replaced by the High Risk Loan Act, described below. The Act continues a pre-foreclosure counseling requirement.

It is also important to consider whether a default is material. In *Sahadi v. Continental Illinois National Bank & Trust Company of Chicago,* 706 F.2d 193 (7th Cir. 1983), a borrower failed to make payment of accrued interest by a particular date. The court reversed an order of summary judgment in favor of the lender because an issue of fact remained as to whether the alleged breach was material. The court stated that determination of materiality involved an inquiry into such matters as whether the breach worked to defeat the bargained-for objective of the parties and whether the breach was of pecuniary importance.

## VII. LEGAL REMEDIES FOR MORTGAGE ABUSES

### A. Truth in Lending and Home Ownership and Equity Protection Acts

The single most important remedy for the homeowner facing foreclosure is the Truth in Lending Act (TILA), 15 U.S.C. §1601, *et seq.,* as amended by the Home Ownership and Equity Protection Act of 1994 (HOEPA), Pub.L. No. 103-325, 108 Stat. 2190, adding 15 U.S.C. §§1602(aa)

and 1639, and implementing Federal Reserve Board Regulation Z, 12 C.F.R. Part 226. There are also Official Staff Interpretations of Regulation Z, 12 C.F.R. Part 226, Supp. I, which despite their name are regulations issued under §553 of the Administrative Procedure Act, 5 U.S.C. §551, *et seq.,* and entitled to be treated as such. The portions of Regulation Z and the Interpretations implementing HOEPA were substantially revised in December 2001. 66 Fed.Reg. 65,604 (Dec. 20, 2001).

**1. Applicability**

The Truth in Lending Act applies to any creditor who makes 26 extensions of consumer credit of any type per year, five extensions of consumer credit secured by real estate, or two loans subject to the Home Ownership and Equity Protection Act of 1994.

**2. Purpose**

The Truth in Lending Act was originally enacted in 1967 "to effectively adopt a new national loan vocabulary that means the same in every contract in every state." *Mason v. General Finance Corporation of Virginia,* 542 F.2d 1226, 1233 (4th Cir. 1976). "The legislative history [of TILA] makes crystal clear that lack of uniformity in the disclosure of the cost of credit was one of the major evils to be remedied by the Act." 542 F.2d at 1231.

TILA is remedial legislation designed to eliminate impediments to the informed use of credit. *Mourning v. Family Publications Service, Inc.,* 411 U.S. 356, 36 L.Ed.2d 318, 93 S.Ct. 1652, 1658 – 1659, 1664 – 1665 (1973).

TILA "is intended to balance scales thought to be weighed in favor of lenders and is thus to be liberally construed in favor of borrowers." *Bizier v. Globe Financial Services Inc.,* 654 F.2d 1, 3 (1st Cir. 1981). *Accord Smith v. Fidelity Consumer Discount Co.,* 898 F.2d 896, 898 (3d Cir. 1989).

"The scheme of [TILA] is to create a system of private attorneys general to aid its enforcement, and its language should be construed liberally in light of its remedial purpose." *McGowan v. King, Inc.,* 569 F.2d 845, 848 (5th Cir. 1978).

Creditors must strictly comply with TILA. "[A]ny violation of TILA, regardless of the technical nature of the violation, must result in a finding of liability against the lender." [Citation omitted.] *Steinbrecher v. Mid-Penn Consumer Discount Co. (In re Steinbrecher),* 110 B.R. 155, 161 (Bankr. E.D.Pa. 1990). *Accord Semar v. Platte Valley Federal Savings & Loan Ass'n,* 791 F.2d 699, 703 – 704 (9th Cir. 1986). Harm need not be shown for recovery of statutory damages or rescission under TILA: "An objective standard is used to determine violations of the TILA, based on the representations contained in the relevant disclosure documents; it is unnecessary to inquire as to the subjective deception or misunderstanding of particular consumers." *Zamarippa v. Cy's Car Sales Inc.,* 674 F.2d 877, 879 (11th Cir. 1982). *Accord Rodash v. AIB Mortgage Co.,* 16 F.3d 1142, 1144 – 1145 (11th Cir. 1994) (violation of TILA concerning disclosure of right to rescission); *Brown v. Marquette Savings & Loan Ass'n,* 686 F.2d 608, 614 (7th Cir. 1982); *Wright v. Tower Loan of*

*Mississippi, Inc.,* 679 F.2d 436, 445 (5th Cir. 1982); *Steinbrecher, supra; Shepeard v. Quality Siding & Window Factory, Inc.,* 730 F.Supp. 1295, 1299 (D.Del. 1990); *Russell v. Fidelity Consumer Discount Co. (In re Russell),* 72 B.R. 855 (Bankr. E.D.Pa. 1987).

TILA and Regulation Z accordingly require disclosure of several key credit terms, computed in the precise manner prescribed by the Regulation and using precise terminology:

a. The "amount financed" is "the amount of credit provided to you [the consumer] or on your behalf." 12 C.F.R. §226.18(b).

b. The "finance charge" is "the dollar amount the credit will cost you [the consumer]." 12 C.F.R. §226.18(d). It includes "any charge payable directly or indirectly by the consumer and imposed directly or indirectly by the creditor as an incident to or a condition of the extension of credit." 12 C.F.R. §226.4(a).

c. The "annual percentage rate" is the finance charge expressed as an annual rate. 12 C.F.R. §226.18(e).

Tolerances are specified for these items. Most critically in the context of a foreclosure, the tolerance for an error in the finance charge is an understatement of $35.01. 15 U.S.C. §1635(i)(2); 12 C.F.R. §226.23(h)(2). That is, if counsel can prove that the actual finance charge is $35 or more greater than the disclosed finance charge, the mortgage is subject to attack for three years after closing.

**3. Rescission Rights**

The Truth in Lending Act gives homeowners rescission rights when their principal residence is used to secure an extension of credit, other than one for the initial purchase or construction of the residence. 15 U.S.C. §1635; 12 C.F.R. §226.23. A creditor must furnish *two properly filled-out* copies of a notice of the right to cancel to everyone whose interest in the principal residence is subject to the creditor's security interest. This is *not* limited to the borrower; for example, a spouse or child who is on title has the right to cancel and must be notified of that right. The rescission right is not limited to real property, but also includes mobile homes and an interest in a cooperative apartment.

The right to cancel normally extends for three business days (*i.e.,* excluding federal holidays and Sundays, but not Saturdays). 15 U.S.C. §1635(a). However, if a creditor fails to furnish the "material disclosures" (those listed at 12 C.F.R. §226.23 n. 48) and two properly filled-out notices of the right to cancel to each person entitled thereto, the right continues until (a) the creditor cures the violation by providing new disclosures and a new cancellation period and conforming the loan terms to the disclosures, (b) the property is sold, or (c) three years expire. 12 C.F.R. §226.23(a)(3). The three years is an absolute time limit. *Beach v. Ocwen Federal Bank,* 523 U.S. 410, 140 L.Ed.2d 566, 118 S.Ct. 1408 (1998).

A signed acknowledgment that the required number of copies of the notice of right to cancel have been delivered "does no more than create a rebuttable presumption of delivery." 15 U.S.C. 1635(c). The borrower's testimony is sufficient to rebut the presumption, particularly if the borrower kept all of the documents received at the closing together and the requisite number of copies is not present. *Davison v. Bank One Home Loan Services*, 01-2511, 2003 WL 124542 (D.Kan., Jan. 13, 2003); *In re Jones,* 298 B.R. 451, 459 (Bankr.D.Kan. 2003); *Cooper v. First Government Mortgage and Investors Corp.*, 238 F.Supp.2d 50, 63-65 (D.D.C.2002); *Williams v. Bank One (In re Williams),* 291 B.R. 636, 647-48 (Bankr.E.D.Pa.2003); *Hanlin v. Ohio Builders and Remodelers, Inc.,* 212 F.Supp.2d 752, 760-62 (S.D.Ohio 2002). It is therefore important in cases presenting such issues that counsel segregate (and preferably Bates-number) documents obtained from the borrowers and documents obtained from other sources, so that they may be readily distinguished by source.

Two Northern District of Illinois cases, *Jenkins v. Mercantile Mortgage Co.,* 231 F.Supp.2d 737 (N.D.Ill. 2002), and *Coleman v. Equicredit Corporation of America,* No. 01 C 2130, 2002 U.S.Dist. LEXIS 969 (N.D.Ill. Jan. 22, 2002), state that the refinancing of a loan cuts off the right to rescind. The author believes these to be wrongly decided. There are contrary decisions from other Northern District judges (*Pulphus v. Sullivan,* No. 02 C 5794, 2003 U.S.Dist. LEXIS 7080 (N.D.Ill. Apr. 28, 2003); *Payton v. New Century Mortg. Corp.,* 03 C 333, 03 C 703, 2003 WL 22349118 (N.D.Ill. Oct 14, 2003)) and elsewhere. *Wright v. Mid-Penn Consumer Discount Co. (In re Wright),* 127 B.R. 766 (Bankr.), *aff'd,* 133 B.R. 704 (E.D.Pa. 1991); *McIntosh v. Irwin Union Bank & Trust Co.,* 215 F.R.D. 26 (D.Mass. 2003).

The right to rescind is a statutory remedy and is not to be confused with common law rescission. Its operation is described in 12 C.F.R. §226.23:

> **(a) Consumer's right to rescind. (1) In a credit transaction in which a security interest is or will be retained or acquired in a consumer's principal dwelling, each consumer whose ownership interest is or will be subject to the security interest shall have the right to rescind the transaction, except for transactions described in paragraph (f) of this section.**
>
> **(2) To exercise the right to rescind, the consumer shall notify the creditor of the rescission by mail, telegram or other means of written communication. Notice is considered given when mailed, when filed for telegraphic transmission or, if sent by other means, when delivered to the creditor's designated place of business.**
>
> **(3) The consumer may exercise the right to rescind until midnight of the third business day following consummation, delivery of the notice required by paragraph (b) of this section, or delivery of all material disclosures, whichever occurs last. If the required notice or material disclosures are not delivered, the right to rescind shall expire 3 years**

**after consummation, upon transfer of all of the consumer's interest in the property, or upon sale of the property, whichever occurs first. In the case of certain administrative proceedings, the rescission period shall be extended in accordance with [**15 U.S.C. §1635(f)**].**

**(4) When more than one consumer in a transaction has the right to rescind, the exercise of the right by one consumer shall be effective as to all consumers.**

**(b) (1) Notice of right to rescind. In a transaction subject to rescission, a creditor shall deliver two copies of the notice of the right to rescind to each consumer entitled to rescind . . . The notice shall be on a separate document that identifies the transaction and shall clearly and conspicuously disclose the following:**

**(i) The retention or acquisition of a security interest in the consumer's principal dwelling.**

**(ii) The consumer's right to rescind the transaction.**

**(iii) How to exercise the right to rescind, with a form for that purpose, designating the address of the creditor's place of business.**

**(iv) The effects of rescission, as described in paragraph (d) of this section.**

**(v) The date the rescission period expires.**

*** * ***

**(f) Exempt transactions. The right to rescind does not apply to the following:**

**(1) A residential mortgage transaction [**defined in 15 U.S.C. §1602(w) as one in which a "security interest is created or retained against the consumer's dwelling to finance the acquisition or initial construction of such dwelling"**]. . . .**

**(3) A transaction in which a state agency is a creditor.**

A separate notice of rescission should be sent to the original creditor and each assignee, although the statute and regulations only require notice to the creditor and the overwhelming authority on the matter holds that the filing of a complaint is sufficient notice that the

plaintiff is exercising his or her right to rescind. *See Taylor v. Domestic Remodeling, Inc.,* 97 F.3d 96, 100 (5th Cir. 1996); *Elliott v. ITT Corp.,* 764 F.Supp. 102, 106 (N.D.Ill. 1991); *Eveland v. Star Bank, NA,* 976 F.Supp. 721 (S.D. Ohio 1997); *Payton v. New Century Mortg. Corp.,* 03 C 333, 03 C 703, 2003 WL 22349118 (N.D.Ill. Oct 14, 2003); *Pulphus v. Sullivan,*02 C 5794, 2003 WL 1964333 (N.D.Ill. Apr 28, 2003).

Under 15 U.S.C. §1641(c), the borrower is entitled to assert the right to rescind against any assignee of the loan. In addition, the assignee is liable for damages to the extent that "the violation for which such action or proceeding is brought is apparent on the face of the disclosure statement provided in connection with such transaction pursuant to this title" and "the assignment to the assignee was voluntary." 15 U.S.C. §1641(e)(1). This is further discussed below.

Furthermore, 15 U.S.C. §1635(g) provides the following:

> **In any action in which it is determined that a creditor has violated this section, in addition to rescission the court may award relief under [15 U.S.C. §1640] for violations of this title not relating to the right to rescind.**

Upon exercise of the right to rescind, the creditor is required to remove its security interest from the property. Failure to do so may subject the creditor to additional liability in damages. *Rollins v. Dwyer,* 666 F.2d 141, 145 (5th Cir. 1982); *Williams v. Gelt Financial Corp.,* 237 B.R. 590, 599 (E.D.Pa. 1999); *Aquino v. Public Finance Consumer Discount Co.,* 606 F.Supp. 504, 510 (E.D.Pa. 1985). Note that the one-year statute of limitations for such a claim runs from the date a rescission demand is not complied with. *Reid v. Liberty Consumer Discount Company of Pennsylvania,* 484 F.Supp. 435, 441 (E.D.Pa. 1980); *Tucker v. Mid-Penn Consumer Discount Co. (In re Tucker),* 74 B.R. 923, 932 (Bankr. E.D.Pa. 1987); *Bookhart v. Mid-Penn Consumer Discount Co.,* 559 F.Supp. 208, 212 (Bankr. E.D.Pa. 1983); *Dowdy v. First Metropolitan Mortgage Co.,* No. 01 C 7211, 2002 WL 745851 (N.D.Ill. Jan. 29, 2002).

The creditor can apply to a court to condition the removal of the security interest upon the consumer's tender of the loan proceeds. If the creditor does not rescind, the statute provides for forfeiture of the loan proceeds or goods purchased. 15 U.S.C. §1635(b). Again, courts have held that they have discretion whether to enforce the forfeiture. Cases are divided as to whether a court has this authority, although most acknowledge it. *Williams v. Homestake Mortgage Co.,* 968 F.2d 1137 (11th Cir. 1992); *Regency Savings Bank v. Chavis,* 333 Ill.App.3d 865, 776 N.E.2d 876, 267 Ill.Dec. 504 (2d Dist. 2002); *Lynch v. GMAC Mortgage Corporation of Iowa (In re Lynch),* 170 B.R. 26, 29 (Bankr. D.N.H. 1994) (requiring borrower to repay principal); *Apaydin v. Citibank Federal Savings Bank (In re Apaydin),* 201 B.R. 716, 723 – 724 (Bankr. E.D.Pa. 1996) (same). Among the relevant considerations is the willfulness of the creditor's conduct and the creditor's record of compliance with the Truth in Lending Act. *Apaydin, supra.*

Discretion to modify works both ways in that the court's discretion includes requiring the borrower to repay at a future date or in installments. *Federal Deposit Insurance Corp. v. Hughes Development Co.,* 938 F.2d 889, 890 (8th Cir. 1991) (relying on pre-simplification cases to require

borrower to repay principal within one year).

The tender amount is the principal, minus all closing costs and all payments made. The borrower's payments are applied entirely to principal. *Semar v. Platte Valley Federal Savings & Loan Ass'n,* 791 F.2d 699 (9th Cir. 1986). *Section 226.23 — Right of Recission,* Paragraph 23(d)(2)1, Official Staff Interpretation, 12 C.F.R. Part 226, Supp. I, provides that "[t]he consumer cannot be required to pay any amount in the form of money or property," including "finance charges already accrued, as well as other charges such as broker fees, application and commitment fees, or fees for a title search or appraisal."

### 4. HOEPA

In 1994, Congress added the Home Ownership and Equity Protection Act of 1994 (HOEPA) as an amendment to the Truth in Lending Act. The added sections are 15 U.S.C. §1602(aa), defining loans subject to HOEPA, and 15 U.S.C. §1639, creating special disclosure and substantive requirements. Loans subject to HOEPA are often referred to as "Section 32 loans" because the implementing Regulation Z section was originally 12 C.F.R. §226.32. The December 2001 revision moved certain provisions into 12 C.F.R. §226.34.

Basically, HOEPA applies to a mortgage described in 15 U.S.C. §1602(aa) (Section 1602(aa) mortgage). A "Section 1602(aa) mortgage" is a mortgage loan secured by a consumer's principal dwelling, other than one entered into to finance the original construction or acquisition of the dwelling, in which either (a) "the total points and fees payable by the consumer at or before closing will exceed the greater of — (i) 8 percent of the total loan amount; or (ii) $400" or (b) "the annual percentage rate at consummation of the transaction will exceed by more than 10 percentage points the yield on Treasury securities having comparable periods of maturity on the fifteenth day of the month immediately preceding the month in which the application for the extension of credit is received by the creditor." 15 U.S.C. §1602(aa)(1). "Points and fees" are defined to include "all items included in the finance charge, except interest or the time-price differential" and "all compensation paid to mortgage brokers." 15 U.S.C. §1602(aa)(4). The "total loan amount" is the amount financed, minus any item included in the "points and fees." *Section 226.32 — Requirements for Certain Closed-End Home Mortgages,* Paragraph 32(a)(1)(ii), Official Staff Interpretation, 12 C.F.R. Part 226, Supp. I.

One court holds that a yield spread premium counts toward the "points and fees." *Mourer v. Equicredit Corporation of America (In re Mourer),* 287 B.R. 889 (Bankr. W.D.Mich. 2003). However, this decision was reversed on appeal. *Mourer v. EquiCredit Corp. of Am. (In re Mourer)*, 309 B.R. 502 (W.D. Mich. 2004)

The December 2001 Regulation Z revision changed the "trigger," effective October 1, 2002. The APR trigger was changed to eight percent over the Treasury yield for first mortgages and ten percent for junior mortgages. The Treasury yield was approximately six percent in early April 2002.

The "points and fees" trigger was left at eight percent, but single-premium credit insurance is now included in the "points and fees." This includes premiums for credit life, accident, health, loss-of-income, debt cancellation coverage, or similar products. If they are financed by the creditor, they are counted toward the "points and fees" and deducted from the amount financed in calculating the total loan amount.

If a mortgage loan is covered by HOEPA, 15 U.S.C. §1639 and 12 C.F.R. §226.32(c) require that the borrower must be given a special disclosure at least three business days prior to closing stating the following:

> **You are not required to complete this agreement merely because you have received these disclosures or have signed a loan application. If you obtain this loan, the lender will have a mortgage on your home. You could lose your home, and any money you have put into it, if you do not meet your obligations under the loan.**

The disclosure statement must also provide the following information:

a. the annual percentage rate;

b. each level of monthly payments;

c. any balloon payment;

d. the "amount borrowed," which is the principal amount of the note; and

e. the inclusion of credit insurance, if any. 12 C.F.R. §226.32(c).

In addition, HOEPA imposes certain substantive requirements on high-interest and high-fee loans. Due-on-demand clauses are prohibited. Prepayment penalties are limited. Specifically, any prepayment penalty provision must by its terms exclude refinancing by the same creditor. *Rodrigues v. U.S. Bank (In re Rodrigues),* 278 B.R. 683 (Bankr. D.R.I. 2002). 15 U.S.C. §1639(c)(2) provides exceptions regarding prepayment penalties:

> **Notwithstanding paragraph (1), a mortgage referred to in [15 U.S.C. §1602(aa)] may contain a prepayment penalty (including terms calculating a refund by a method that is not prohibited under [15 U.S.C. §1615(b)] for the transaction in question) if —**
>
> **(A) at the time the mortgage is consummated —**
>
> **(i) the consumer is not liable for an amount of monthly indebtedness payments (including the amount of credit extended or to be extended under the transaction) that is greater than 50 percent of the monthly**

**gross income of the consumer; and**

**(ii) the income and expenses of the consumer are verified by a financial statement signed by the consumer, by a credit report, and in the case of employment income, by payment records or by verification from the employer of the consumer (which verification may be in the form of a copy of a pay stub or other payment record supplied by the consumer);**

**(B) the penalty applies only to a prepayment made with amounts obtained by the consumer by means other than a refinancing by the creditor under the mortgage, or an affiliate of that creditor;**

**(C) the penalty does not apply after the end of the 5-year period beginning on the date on which the mortgage is consummated; and**

**(D) the penalty is not prohibited under other applicable law.**

Home improvement disbursements must be in the form of a check payable to the borrower, to the contractor and borrower jointly, or through an escrow. HOEPA also prohibits a pattern of making loans that cannot be repaid without recourse to the security.

12 C.F.R. §226.34(a)(4) creates a presumption of a violation if the consumer's repayment ability is not verified and documented. Section 226.34(a)(3) prohibits the original creditor, an assignee, or a servicer from refinancing a HOEPA loan for a period of one year following the original extension of credit unless the refinancing is in the borrower's interest. Also, §226.34(b) prohibits the use of open-end credit to evade the restrictions of HOEPA.

Noncompliance with HOEPA entitles the borrower to rescind for up to three years. 12 C.F.R. §226.23(a)(3). In addition, there is a special damage provision: the borrower may recover an amount equal to all finance charges paid, either at closing (prepaid finance charges) or as part of the borrower's monthly payments. 15 U.S.C. §1640(a)(4).

### 5. Common Violations

In a surprising number of cases, the finance charge and annual percentage rate are not accurate. Often, this results from improper exclusion of items from the finance charge.

Common Truth in Lending Act violations in connection with mortgages include the following:

**a. Collection of fees for recording instruments that are not in fact disbursed to governmental agencies.** The exemption provides that "If itemized and disclosed, the following charges may be excluded from the finance charge: (1) Taxes and fees prescribed by law

that actually are or will be paid to public officials for determining the existence of or for perfecting, releasing, or satisfying a security interest." 12 C.F.R. §226.4(e)(1). At a minimum, these undisbursed fees are finance charges. *Payton v. New Century Mortg. Corp.,* 03 C 333, 03 C 703, 2003 WL 22349118 (N.D.Ill. Oct 14, 2003); *Brodo v. Bankers Trust Co.*, 847 F. Supp. 353 (E.D.Pa. 1994). Fees for assigning a mortgage are not within the exclusion and must be disclosed as finance charges. *Cheshire Mortg. Serv. v. Montes,* 223 Conn. 80; 612 A.2d 1130 (1992).

**b. Failure to include in the finance charge fees for closing the transaction.**

**c. Under-the-table payments by the borrower to mortgage brokers.** All compensation to a mortgage broker from a borrower is now defined as a finance charge (yield spread premiums, discussed below, are not finance charges, but they may be "points and fees" for purposes of the Home Ownership and Equity Protection Act of 1994 and other predatory lending statutes). For non-HOEPA loans, the violations must exceed the applicable tolerance. However, the only tolerance under HOEPA is $100 applicable to the "amount borrowed."

**d. Evasion of HOEPA.** There is a practice by certain lenders of making mortgage loans that are supposed to be just under the eight-percent HOEPA threshold on fees and points (*e.g.,* 7.99 percent); however, because the governmental fees are inflated or not paid over to governmental agencies or some other item is not included in the finance charge, the points and fees would be, in fact, 8.005 percent. If HOEPA is not complied with, and it will not have been if the lender is trying to make a loan just under the threshold, the loan is rescindable.

**e. Use of the wrong "notice of right to cancel" form on refinancings.** A refinancing by the same creditor (*i.e.,* the party to whom the note being refinanced is payable on its face is the same as the party to whom the new note is payable on its face) entitles the borrower to rescind only the increased credit. An assignment of the loan does not make the assignee a "creditor" for this purpose (although a merger does). Some mortgagees use the form providing for limited rescission rights in transactions that carry full rescission rights. This gives rise to a continuing three-year right to cancel with all payments applied to principal.

**f. Failure to fill in the notice of right to cancel handed to the borrower.** Often the borrower is given a blank copy, and only that retained by the closing agent is filled in. This does not do much for disclosure. Since TILA is a disclosure statute, the operative document is that given to the borrower. *Reese v. Hammer Financial Corp.,* No. 99 C 0716, 1999 U.S.Dist. LEXIS 18812 (N.D.Ill. Nov. 29, 1999); *Smith v. No. 2 Galesburg Crown Finance Corp.,* 615 F.2d 407, 418 (7th Cir. 1980) (borrower's copy of disclosure illegible). The usual form of rescission notice requires the borrower to acknowledge receipt of the document — this creates a rebuttable presumption of receipt — but the acknowledgment is that the borrower received two pieces of paper entitled "Notice of Right To Cancel," not that the notices complied with the law or were correctly filled out.

g. **Having the borrower sign at the closing a document representing that he or she has not rescinded.** This contradicts the required notice and renders it ineffective. *Rodash v. AIB Mortgage Co.,* 16 F.3d 1142 (11th Cir. 1994); *Adams v. Nationscredit Fin. Servs. Corp.*, 351 F. Supp. 2d 829 (N.D.Ill. 2004); *Latham v. Residential Loan Ctrs. of Am., Inc.,* 2004 U.S. Dist. LEXIS 7993, No. 03 C 7094, 2004 WL 1093315, at *4 (N.D. Ill. 2004); *Pulphus v. Sullivan*, 2003 U.S. Dist. LEXIS 7080, No. 02 C 5794, 2003 WL 1964333, at *15-16 (N.D. Ill. Apr. 28. 2003), later opinion, 2004 U.S. Dist. LEXIS 13234 (N.D.Ill., July 15, 2004); *Rodrigues v. Members Mortg. Co.,* 323 F. Supp. 2d 202 (D.Mass. 2004).

h. **Providing a correct notice of right to cancel but contradicting the information elsewhere.** *Jenkins v. Landmark Mortgage Corporation of Virginia,* 696 F.Supp. 1089 (W.D.Va. 1988); *Apaydin v. Citibank Federal Savings Bank (In re Apaydin),* 201 B.R. 716, 723 – 724 (Bankr. E.D.Pa. 1996). *See Smith v. Cash Store Management, Inc.,* 195 F.3d 325, 332 (7th Cir. 1999) (concurring and dissenting opinion).

i. **Permitting use of a mortgage broker agreement that requires the borrower to pay the broker fee if the borrower decides to cancel or not proceed with the transaction.** This contradicts the rescission notice and is illegal. *Manor Mortgage Corp. v. Giuliano,* 251 N.J.Super. 13, 596 A.2d 763 (App.Div. 1991). All compensation payable by the borrower to mortgage brokers is now defined as a finance charge, and upon exercise of the right to rescind, the borrower is relieved of any obligation to pay broker fees.

j. **Misdating the notice of right to cancel.** *Taylor v. Domestic Remodeling, Inc.,* 97 F.3d 96, 99 (5th Cir. 1996) (incorrect rescission date combined with disbursement of loan constitutes violation of TILA); *Williamson v. Lafferty,* 698 F.2d 767, 768 – 769 (5th Cir. 1983) (failure to fill in rescission expiration date violates TILA); *Johnson v. Thomas,* 342 Ill.App.3d 382, 397, 794 N.E.2d 919, 276 Ill.Dec. 669 (1st Dist. 2003). One court has held that stating a date that is too long, rather than one that is too short, is not actionable if the borrower, in fact, is given the extra period. *Hawaii Community Federal Credit Union v. Keka,* 94 Haw. 213, 11 P.3d 1 (2000). Some lenders attempt to close transactions long-distance, using courier services. It is very easy to violate TILA in this situation by misdating the notice of right to cancel or failing to deliver completed disclosures to the borrower.

k. **Failure to give the financial disclosures, two copies of the notice of right to cancel, and the HOEPA disclosures (if applicable) to each person entitled to rescind.** See above.

l. **Failure to provide these documents in a form in which the borrower can keep them prior to consummation.** Merely showing the documents to the borrower is not sufficient; the borrower must be free to leave with the documents. *Spearman v. Tom Wood Pontiac-GMC Inc.,* 312 F.3d 848 (7th Cir. 2002); *Lozada v. Dale Baker Oldsmobile, Inc.,* 197 F.R.D. 321, 327 (W.D.Mich. 2000); *Jenkins v. Landmark Mtg. Corp.*, 696 F. Supp. 1089, 1091 (W.D. Va. 1988) (holding consumer did not receive the disclosures in a form she could take with her where she

was shown and signed disclosures at time she signed contract, but did not receive a copy of disclosures until several days later). This was clarified by an April 9, 2002, amendment to the *Section 226.17 — General Disclosure Requirements,* Paragraph 17(b)3, Official Staff Interpretation, 12 C.F.R. Part 226, Supp. I, which added the provisions that (a) prior to becoming obligated, the consumer must be given possession of a copy of the disclosures, which may be the one the consumer signs, that he or she can take away if so desired and (b) upon signing, the consumer must be given a copy of the disclosures to keep. The creditor need not furnish two copies. However, the common practice (especially where closings occur at a home) of having the consumer sign one set of documents, taking it away, making a copy, and sending or delivering it to the consumer other than on the same day is a violation.

**m. Failure to disclose all payment levels on a HOEPA loan.** *Jeanty v. Washington Mut. Bank F.A.*, 305 F. Supp. 2d 962 (E.D.Wis. 2004).

**n. Inclusion of prepayment penalties that fail to conform to HOEPA restrictions.** HOEPA requires that a prepayment penalty provide by its terms that it does not apply to refinancing by the same creditor.

**o. Improper treatment of note provisions entitling the borrower to a rate reduction under specified circumstances.**

**p. Failure to disclose a balloon payment in a HOEPA notice.** 12 C.F.R. §226.32(c)(3) requires disclosure of any balloon payment for a loan with a term of five years or more.

**6. Remedies**

Besides rescission, remedies in a Truth in Lending Act case include statutory and actual damages and attorneys' fees. 15 U.S.C. §1640. Statutory damages in a non-HOEPA individual case involving residential real property security are twice the finance charge with a $200 floor and a $2,000 ceiling (increased to $400 to $4,000 in 2008). 15 U.S.C. §1640(a)(2)(A). As a practical matter, the ceiling always applies. The damages are assessed per transaction, and the fact that more than one obligor is involved does not multiply the damages. 15 U.S.C. §1640(d).

In a class action, the basic statutory damages are capped at one percent of the defendant's net worth or $500,000, whichever is less. 15 U.S.C. §1640(a)(2)(B). The minimum $200 does not apply. HOEPA damages are not changed.

**7. Limitations**

The statute of limitations for a damage claim under the Truth in Lending Act is generally one year. A TILA claim for damages may be asserted as a setoff after one year. *Wood Acceptance Co. v. King,* 18 Ill.App.3d 149, 309 N.E.2d 403 (1st Dist. 1974); *Associates Finance, Inc. v. Cedillo,* 89 Ill.App.3d 179, 411 N.E.2d 1194, 44 Ill.Dec. 828 (2d Dist. 1980); *Mt. Vernon Memorial*

*Estates, Inc. v. Wood,* 88 Ill.App.3d 666, 410 N.E.2d 995, 43 Ill.Dec. 862 (1st Dist. 1980); *National Boulevard Bank of Chicago v. Thompson,* 85 Ill.App.3d 1145, 407 N.E.2d 739, 41 Ill.Dec. 241 (1st Dist. 1980); *Public Finance Corp. v. Riddle,* 83 Ill.App.3d 417, 403 N.E.2d 1316, 38 Ill.Dec. 712 (3d Dist. 1980).

Under 15 U.S.C. §1635(g), in an action in which rescission is granted, the borrower is also entitled to assert claims for damages for violations not relating to the right to rescind. Whether this extends the limitations period is the subject of litigation.

### B. Real Estate Settlement Procedures Act and HUD Regulation X

Another statute that the foreclosure defense lawyer must be familiar with is the Real Estate Settlement Procedures Act of 1974, 12 U.S.C. §2601, *et seq.,* and its implementing Regulation X, 24 C.F.R. Part 3500, issued by the Department of Housing and Urban Development. This statute covers a number of issues concerning "federally related" residential mortgages, which are defined to cover nearly every loan made, held, or serviced by an institutional lender. 12 U.S.C. §2602(1).

#### 1. Good Faith Estimate

Regulation X requires that "the lender shall provide all applicants for a federally related mortgage loan with a good faith estimate of the amount of or range of charges for the specific settlement services the borrower is likely to incur in connection with the settlement." 24 C.F.R. §3500.7(a). The good faith estimate must be either delivered or placed in the mail "not later than three business days after the application is received or prepared," unless the application is denied within that period. *Id.*

> **A good faith estimate consists of an estimate, as a dollar amount or range, of each charge which:**
>
> **(1) Will be listed in section L of the HUD-1 or HUD-1A in accordance with the instructions set forth in Appendix A to this part; and**
>
> **(2) That the borrower will normally pay or incur at or before settlement based upon common practice in the locality of the mortgaged property. Each such estimate must be made in good faith and bear a reasonable relationship to the charge a borrower is likely to be required to pay at settlement, and must be based upon experience in the locality of the mortgaged property. As to each charge with respect to which the lender requires a particular settlement service provider to be used, the lender shall make its estimate based upon the lender's knowledge of the amounts charged by such provider. 24 C.F.R. §3500.7(c).**

Section 3500.7(b) imposes a similar obligation on a mortgage broker. The broker

"must provide a good faith estimate within three days of receiving a loan application based on his or her knowledge of the range of costs." *Id.*

There does not appear to be a private right of action under the Real Estate Settlement Procedures Act of 1974 for providing a "good faith estimate" that is not accurate and complete. *Chow v. Aegis Mortg. Corp.*, 286 F.Supp.2d 956 (N.D.Ill. 2003), citing *Collins v. FMHA-USDA,* 105 F.3d 1366, 1368 (11th Cir.1997); *Koch v. First Union Corp.,* 2002 WL 372939 (Pa.Com.Pl. Jan 10, 2002). However, the good faith estimate may give rise to a "bait and switch" claim under the Consumer Fraud and Deceptive Business Practices Act, 815 ILCS 505/1, *et seq.* See below.

### 2. Escrow Limitations

The Real Estate Settlement Procedures Act of 1974 and Regulation X impose limitations on escrow account deposit requirements. 12 U.S.C. §2605(g); 24 C.F.R. §3500.17. Overescrowing was formerly commonplace, but most lenders are now complying with the statute and regulations. *GMAC Mortgage Corporation of Pennsylvania v. Stapleton,* 236 Ill.App.3d 486, 603 N.E.2d 767, 177 Ill.Dec. 697 (1st Dist. 1992), *appeal denied,* 148 Ill.2d 641 (1993); *Leff v. Olympic Federal Savings & Loan Ass'n,* No. 86 C 3026, 1986 U.S.Dist. LEXIS 20198 (N.D.Ill. Sept. 18, 1986); *Aitken v. Fleet Mortgage Corp.,* No. 90 C 3708, 1991 U.S.Dist. LEXIS 10420 (N.D.Ill. July 29, 1991), and 1992 U.S.Dist. LEXIS 1687 (N.D.Ill. Feb. 12, 1992); *Poindexter v. National Mortgage Corp.,* No. 91 C 4223, 1991 U.S.Dist. LEXIS 19643 (Dec. 23, 1991), *later op.,* No. 94 C 5814, 1995 U.S.Dist. LEXIS 5396 (N.D.Ill. Apr. 18, 1995); *Sanders v. Lincoln Service Corp.,* No. 91 C 4542, 1993 U.S.Dist. LEXIS 4454 (N.D.Ill. Apr. 5, 1993); *Robinson v. Empire of America Realty Credit Corp.,* No. 90 C 5063, 1991 U.S.Dist. LEXIS 2084 (N.D.Ill. Feb. 20, 1991); *In re Mortgage Escrow Deposit Litigation,* No. 90 C 5816, 1994 U.S.Dist. LEXIS 12746 (N.D.Ill. Sept. 8, 1994) (cons.); *Greenberg v. Republic Federal Savings & Loan Ass'n,* No. 94 C 3789, 1995 U.S.Dist. LEXIS 5866 (N.D.Ill. Apr. 28, 1995); *Weinberger v. Bell Federal Savings & Loan Ass'n,* 262 Ill.App.3d 1047, 635 N.E.2d 647, 200 Ill.Dec. 308 (1st Dist. 1994).

There is probably no direct private right of action for violation of the escrow deposit limitations (*State of Louisiana v. Litton Mortgage Co.,* 50 F.3d 1298 (5th Cir. 1995); *Allison v. Liberty Savings,* 695 F.2d 1086 (7th Cir. 1982)), but overescrowing is actionable on other theories, such as breach of contract and consumer fraud.

### 3. Cranston-Gonzales National Affordable Housing Act

The Cranston-Gonzales National Affordable Housing Act, Pub.L. No. 101-625, 104 Stat. 4079 (1990), amends the Real Estate Settlement Procedures Act of 1974 to impose two obligations on mortgage servicers. 12 U.S.C. §2605.

First, when servicing is transferred, both the transferor and transferee must give the borrower a notice containing prescribed information. Unless the notice is provided at closing, the transferor must generally give notice 15 days in advance of transfer and the transferee 15 days after transfer:

**(b) Notice by transferor of loan servicing at time of transfer.**

**(1) Notice requirement. Each servicer of any federally related mortgage loan shall notify the borrower in writing of any assignment, sale, or transfer of the servicing of the loan to any other person.**

**(2) Time of notice.**

**(A) In general. Except as provided under subparagraphs (B) and (C), the notice required under paragraph (1) shall be made to the borrower not less than 15 days before the effective date of transfer of the servicing of the mortgage loan (with respect to which such notice is made).**

**(B) Exception for certain proceedings. The notice required under paragraph (1) shall be made to the borrower not more than 30 days after the effective date of assignment, sale, or transfer of the servicing of the mortgage loan (with respect to which such notice is made) in any case in which the assignment, sale, or transfer of the servicing of the mortgage loan is preceded by —**

**(i) termination of the contract for servicing the loan for cause;**

**(ii) commencement of proceedings for bankruptcy of the servicer; or**

**(iii) commencement of proceedings by the Federal Deposit Insurance Corporation or the Resolution Trust Corporation for conservatorship or receivership of the servicer (or an entity by which the servicer is owned or controlled).**

**(C) Exception for notice provided at closing. The provisions of subparagraphs (A) and (B) shall not apply to any assignment, sale, or transfer of the servicing of any mortgage loan if the person who makes the loan provides to the borrower, at settlement (with respect to the property for which the mortgage loan is made), written notice under paragraph (3) of such transfer.**

**(3) Contents of notice. The notice required under paragraph (1) shall include the following information:**

**(A) The effective date of transfer of the servicing described in such**

**paragraph.**

**(B) The name, address, and toll-free or collect call telephone number of the transferee servicer.**

**(C) A toll-free or collect call telephone number for (i) an individual employed by the transferor servicer, or (ii) the department of the transferor servicer, that can be contacted by the borrower to answer inquiries relating to the transfer of servicing.**

**(D) The name and toll-free or collect call telephone number for (i) an individual employed by the transferee servicer, or (ii) the department of the transferee servicer, that can be contacted by the borrower to answer inquiries relating to the transfer of servicing.**

**(E) The date on which the transferor servicer who is servicing the mortgage loan before the assignment, sale, or transfer will cease to accept payments relating to the loan and the date on which the transferee servicer will begin to accept such payments.**

**(F) Any information concerning the effect the transfer may have, if any, on the terms of or the continued availability of mortgage life or disability insurance or any other type of optional insurance and what action, if any, the borrower must take to maintain coverage.**

**(G) A statement that the assignment, sale, or transfer of the servicing of the mortgage loan does not affect any term or condition of the security instruments other than terms directly related to the servicing of such loan.**

**(c) Notice by transferee of loan servicing at time of transfer.**

**(1) Notice requirement. Each transferee servicer to whom the servicing of any federally related mortgage loan is assigned, sold, or transferred shall notify the borrower of any such assignment, sale, or transfer.**

**(2) Time of notice.**

**(A) In general. Except as provided in subparagraphs (B) and (C), the notice required under paragraph (1) shall be made to the borrower not more than 15 days after the effective date of transfer of the servicing of the mortgage loan (with respect to which such notice is made).**

**(B) Exception for certain proceedings. The notice required under**

**paragraph (1) shall be made to the borrower not more than 30 days after the effective date of assignment, sale, or transfer of the servicing of the mortgage loan (with respect to which such notice is made) in any case in which the assignment, sale, or transfer of the servicing of the mortgage loan is preceded by —**

**(i) termination of the contract for servicing the loan for cause;**

**(ii) commencement of proceedings for bankruptcy of the servicer; or**

**(iii) commencement of proceedings by the Federal Deposit Insurance Corporation or the Resolution Trust Corporation for conservatorship or receivership of the servicer (or an entity by which the servicer is owned or controlled).**

**(C) Exception for notice provided at closing. The provisions of subparagraphs (A) and (B) shall not apply to any assignment, sale, or transfer of the servicing of any mortgage loan if the person who makes the loan provides to the borrower, at settlement (with respect to the property for which the mortgage loan is made), written notice under paragraph (3) of such transfer.**

**(3) Contents of notice. Any notice required under paragraph (1) shall include the information described in subsection (b)(3).** 12 U.S.C. §2605.

Payments made to the wrong party during the transition period cannot be treated as late:

**During the 60-day period beginning on the effective date of transfer of the servicing of any federally related mortgage loan, a late fee may not be imposed on the borrower with respect to any payment on such loan and no such payment may be treated as late for any other purposes, if the payment is received by the transferor servicer (rather than the transferee servicer who should properly receive payment) before the due date applicable to such payment. 12 U.S.C. §2605(d).**

Second, the statute imposes an obligation on a mortgage servicer to respond to a "qualified written request" inquiring or complaining about the account:

**(1) Notice of receipt of inquiry.**

**(A) In general. If any servicer of a federally related mortgage loan receives a qualified written request from the borrower (or an agent of the borrower) for**

**information relating to the servicing of such loan, the servicer shall provide a written response acknowledging receipt of the correspondence within 20 days (excluding legal public holidays, Saturdays, and Sundays) unless the action requested is taken within such period.**

**(B) Qualified written request. For purposes of this subsection, a qualified written request shall be a written correspondence, other than notice on a payment coupon or other payment medium supplied by the servicer, that —**

**(i) includes, or otherwise enables the servicer to identify, the name and account of the borrower; and**

**(ii) includes a statement of the reasons for the belief of the borrower, to the extent applicable, that the account is in error or provides sufficient detail to the servicer regarding other information sought by the borrower.**

**(2) Action with respect to inquiry. Not later than 60 days (excluding legal public holidays, Saturdays, and Sundays) after the receipt from any borrower of any qualified written request under paragraph (1) and, if applicable, before taking any action with respect to the inquiry of the borrower, the servicer shall —**

**(A) make appropriate corrections in the account of the borrower, including the crediting of any late charges or penalties, and transmit to the borrower a written notification of such correction (which shall include the name and telephone number of a representative of the servicer who can provide assistance to the borrower);**

**(B) after conducting an investigation, provide the borrower with a written explanation or clarification that includes —**

**(i) to the extent applicable, a statement of the reasons for which the servicer believes the account of the borrower is correct as determined by the servicer; and**

**(ii) the name and telephone number of an individual employed by, or the office or department of, the servicer who can provide assistance to the borrower; or**

**(C) after conducting an investigation, provide the borrower with a written explanation or clarification that includes —**

**(i) information requested by the borrower or an explanation of why the information requested is unavailable or cannot be obtained by the servicer; and**

**(ii) the name and telephone number of an individual employed by, or the office or department of, the servicer who can provide assistance to the borrower.**

**(3) Protection of credit rating. During the 60-day period beginning on the date of the servicer's receipt from any borrower of a qualified written request relating to a dispute regarding the borrower's payments, a servicer may not provide information regarding any overdue payment, owed by such borrower and relating to such period or qualified written request, to any consumer reporting agency (as such term is defined under [**§1681a of the Fair Credit Reporting Act, 15 U.S.C. §1681, *et seq.*]**).** 12 U.S.C. §2605(e).

The request must relate to "servicing." A request directed solely to the validity of the mortgage documents has been held not to qualify. *MorEquity, Inc. v. Naeem,* 118 F.Supp.2d 885, 901 (N.D.Ill. 2000). However, anything relating to debits and credits made to the account or to which the borrower may be entitled should qualify. If the borrower asks for the justification for some charge or fee and the justification is a provision in the note or mortgage, the instrument should be provided.

There is an express private right of action for violation of these obligations. 12 U.S.C. §2605(f) provides the following:

**Whoever fails to comply with any provision of this section shall be liable to the borrower for each such failure in the following amounts:**

**(1) Individuals. In the case of any action by an individual, an amount equal to the sum of —**

**(A) any actual damages to the borrower as a result of the failure; and**

**(B) any additional damages, as the court may allow, in the case of a pattern or practice of noncompliance with the requirements of this section, in an amount not to exceed $1,000.**

**(2) Class actions. In the case of a class action, an amount equal to the sum of —**

**(A) any actual damages to each of the borrowers in the class as a result of the failure; and**

**(B) any additional damages, as the court may allow, in the case of a pattern or practice of noncompliance with the requirements of this section, in an amount not greater than $1,000 for each member of the class, except that the total amount of damages under this subparagraph in any class action may not exceed the lesser of —**

**(i) $ 500,000; or**

**(ii) 1 percent of the net worth of the servicer.**

**(3) Costs. In addition to the amounts under paragraph (1) or (2), in the case of any successful action under this section, the costs of the action, together with any attorneys fees incurred in connection with such action as the court may determine to be reasonable under the circumstances.**

**(4) Nonliability. A transferor or transferee servicer shall not be liable under this subsection for any failure to comply with any requirement under this section if, within 60 days after discovering an error (whether pursuant to a final written examination report or the servicer's own procedures) and before the commencement of an action under this subsection and the receipt of written notice of the error from the borrower, the servicer notifies the person concerned of the error and makes whatever adjustments are necessary in the appropriate account to ensure that the person will not be required to pay an amount in excess of any amount that the person otherwise would have paid.**

### 4. Kickbacks, Yield Spread Premiums, and Bogus Charges

The Real Estate Settlement Procedures Act of 1974 (RESPA) and Regulation X prohibit referral fees and kickbacks. 12 U.S.C. §2607; 24 C.F.R. §3500.14. The scope and extent of the prohibition are the subject of much litigation and are unsettled.

The prohibitions of RESPA are the following:

**(a) Business referrals. No person shall give and no person shall accept any fee, kickback, or thing of value pursuant to any agreement or understanding, oral or otherwise, that business incident to or a part of a real estate settlement service involving a federally related mortgage loan shall be referred to any person.**

**(b) Splitting charges. No person shall give and no person shall accept any portion, split, or percentage of any charge made or received for the rendering of a real estate settlement service in connection with a transaction involving a federally related mortgage loan other than for services actually performed.**

**(c) Fees, salaries, compensation, or other payments. Nothing in this section shall be construed as prohibiting (1) the payment of a fee (A) to attorneys at law for services actually rendered or (B) by a title company to its duly appointed agent for services actually performed in the issuance of a policy of title insurance or (C) by a lender to its duly appointed agent for services actually performed in**

**the making of a loan, (2) the payment to any person of a bona fide salary or compensation or other payment for goods or facilities actually furnished or for services actually performed, or (3) payments pursuant to cooperative brokerage and referral arrangements or agreements between real estate agents and brokers, (4) affiliated business arrangements so long as (A) a disclosure is made of the existence of such an arrangement to the person being referred and, in connection with such referral, such person is provided a written estimate of the charge or range of charges generally made by the provider to which the person is referred (i) in the case of a face-to-face referral or a referral made in writing or by electronic media, at or before the time of the referral (and compliance with this requirement in such case may be evidenced by a notation in a written, electronic, or similar system of records maintained in the regular course of business); (ii) in the case of a referral made by telephone, within 3 business days after the referral by telephone, (and in such case an abbreviated verbal disclosure of the existence of the arrangement and the fact that a written disclosure will be provided within 3 business days shall be made to the person being referred during the telephone referral); or (iii) in the case of a referral by a lender (including a referral by a lender to an affiliated lender), at the time the estimates required under** [12 U.S.C. §2604(c)] **are provided (notwithstanding clause (i) or (ii)); and any required written receipt of such disclosure (without regard to the manner of the disclosure under clause (i), (ii), or (iii)) may be obtained at the closing or settlement (except that a person making a face-to-face referral who provides the written disclosure at or before the time of the referral shall attempt to obtain any required written receipt of such disclosure at such time and if the person being referred chooses not to acknowledge the receipt of the disclosure at that time, that fact shall be noted in the written, electronic, or similar system of records maintained in the regular course of business by the person making the referral), (B) such person is not required to use any particular provider of settlement services, and (C) the only thing of value that is received from the arrangement, other than the payments permitted under this subsection, is a return on the ownership interest or franchise relationship, or (5) such other payments or classes of payments or other transfers as are specified in regulations prescribed by the Secretary, after consultation with the Attorney General, the Secretary of Veterans Affairs, the Federal Home Loan Bank Board, the Federal Deposit Insurance Corporation, the Board of Governors of the Federal Reserve System, and the Secretary of Agriculture. For purposes of the preceding sentence, the following shall not be considered a violation of clause (4)(B): (i) any arrangement that requires a buyer, borrower, or seller to pay for the services of an attorney, credit reporting agency, or real estate appraiser chosen by the lender to represent the lender's interest in a real estate transaction, or (ii) any arrangement where an attorney or law firm represents a client in a real estate transaction and issues or law firm represents a client in a real estate transaction and issues or arranges for the issuance of a policy of title insurance in the transaction directly as agent or through a separate**

**corporate title insurance agency that may be established by that attorney or law firm and operated as an adjunct to his or its law practice.** 12 U.S.C. §2607.

12 U.S.C. §2607(d) creates a private right of action for three times the improper portion of the charge:

**(1) Any person or persons who violate the provisions of this section shall be fined not more than $10,000 or imprisoned for not more than one year, or both.**

**(2) Any person or persons who violate the prohibitions or limitations of this section shall be jointly and severally liable to the person or persons charged for the settlement service involved in the violation in an amount equal to three times the amount of any charge paid for such settlement service.**

**(3) No person or persons shall be liable for a violation of the provisions of** [subsection (c)(4)(A) of this section ] **if such person or persons proves by a preponderance of the evidence that such violation was not intentional and resulted from a bona fide error notwithstanding maintenance of procedures that are reasonably adapted to avoid such error.**

**(4) The Secretary, the Attorney General of any State, or the insurance commissioner of any State may bring an action to enjoin violations of this section.**

**(5) In any private action brought pursuant to this subsection, the court may award to the prevailing party the court costs of the action together with reasonable attorneys fees.**

**(6) No provision of State law or regulation that imposes more stringent limitations on affiliated business arrangements shall be construed as being inconsistent with this section.**

Regulation X originally tracked the language of 12 U.S.C. §2607. However, it was amended in 1994 to significantly expand its scope. Its current text is as follows:

**(a) Section 8 violation. Any violation of this section is a violation of section 8 of RESPA [**12 U.S.C. §2607] **and is subject to enforcement as such under** [24 C.F.R. §3500.19]**.**

**(b) No referral fees. No person shall give and no person shall accept any fee, kickback or other thing of value pursuant to any agreement or understanding, oral or otherwise, that business incident to or part of a settlement service involving a federally related mortgage loan shall be referred to any person. Any**

**referral of a settlement service is not a compensable service, except as set forth in** [24 C.F.R. §3500.14(g)(1)]**. A business entity (whether or not in an affiliate relationship) may not pay any other business entity or the employees of any other business entity for the referral of settlement service business.**

**(c) No split of charges except for actual services performed. No person shall give and no person shall accept any portion, split, or percentage of any charge made or received for the rendering of a settlement service in connection with a transaction involving a federally related mortgage loan other than for services actually performed. A charge by a person for which no or nominal services are performed or for which duplicative fees are charged is an unearned fee and violates this section. The source of the payment does not determine whether or not a service is compensable. Nor may the prohibitions of this Part be avoided by creating an arrangement wherein the purchaser of services splits the fee.**

**(d) Thing of value. This term is broadly defined in section 3(2) of RESPA** [12 U.S.C. §2602(2)]**. It includes, without limitation, monies, things, discounts, salaries, commissions, fees, duplicate payments of a charge, stock, dividends, distributions of partnership profits, franchise royalties, credits representing monies that may be paid at a future date, the opportunity to participate in a money-making program, retained or increased earnings, increased equity in a parent or subsidiary entity, special bank deposits or accounts, special or unusual banking terms, services of all types at special or free rates, sales or rentals at special prices or rates, lease or rental payments based in whole or in part on the amount of business referred, trips and payment of another person's expenses, or reduction in credit against an existing obligation. The term "payment" is used throughout** [24 C.F.R. §§3500.14 and 3500.15] **as synonymous with the giving or receiving any "thing of value" and does not require transfer of money.**

**(e) Agreement or understanding. An agreement or understanding for the referral of business incident to or part of a settlement service need not be written or verbalized but may be established by a practice, pattern or course of conduct. When a thing of value is received repeatedly and is connected in any way with the volume or value of the business referred, the receipt of the thing of value is evidence that it is made pursuant to an agreement or understanding for the referral of business.**

**(f) Referral.**

> **(1) A referral includes any oral or written action directed to a person which has the effect of affirmatively influencing the selection by any person of a provider of a settlement service or business incident to or part of a settlement service when such person will pay for such settlement**

**service or business incident thereto or pay a charge attributable in whole or in part to such settlement service or business.**

**(2) A referral also occurs whenever a person paying for a settlement service or business incident thereto is required to use (see [** 24 C.F.R. §3500.2**], "required use") a particular provider of a settlement service or business incident thereto.**

**(g) Fees, salaries, compensation, or other payments.**

**(1) Section 8 of RESPA permits:**

**(i) A payment to an attorney at law for services actually rendered;**

**(ii) A payment by a title company to its duly appointed agent for services actually performed in the issuance of a policy of title insurance;**

**(iii) A payment by a lender to its duly appointed agent or contractor for services actually performed in the origination, processing, or funding of a loan;**

**(iv) A payment to any person of a bona fide salary or compensation or other payment for goods or facilities actually furnished or for services actually performed;**

**(v) A payment pursuant to cooperative brokerage and referral arrangements or agreements between real estate agents and real estate brokers. (The statutory exemption restated in this paragraph refers only to fee divisions within real estate brokerage arrangements when all parties are acting in a real estate brokerage capacity, and has no applicability to any fee arrangements between real estate brokers and mortgage brokers or between mortgage brokers.);**

**(vi) Normal promotional and educational activities that are not conditioned on the referral of business and that do not involve the defraying of expenses that otherwise would be incurred by persons in a position to refer settlement services or business incident thereto; or**

**(vii) An employer's payment to its own employees for any**

**referral activities.**

**(2) The Department may investigate high prices to see if they are the result of a referral fee or a split of a fee. If the payment of a thing of value bears no reasonable relationship to the market value of the goods or services provided, then the excess is not for services or goods actually performed or provided. These facts may be used as evidence of a violation of section 8 and may serve as a basis for a RESPA investigation. High prices standing alone are not proof of a RESPA violation. The value of a referral (i.e., the value of any additional business obtained thereby) is not to be taken into account in determining whether the payment exceeds the reasonable value of such goods, facilities or services. The fact that the transfer of the thing of value does not result in an increase in any charge made by the person giving the thing of value is irrelevant in determining whether the act is prohibited.**

**(3) Multiple services. When a person in a position to refer settlement service business, such as an attorney, mortgage lender, real estate broker or agent, or developer or builder, receives a payment for providing additional settlement services as part of a real estate transaction, such payment must be for services that are actual, necessary and distinct from the primary services provided by such person. For example, for an attorney of the buyer or seller to receive compensation as a title agent, the attorney must perform core title agent services (for which liability arises) separate from attorney services, including the evaluation of the title search to determine the insurability of the title, the clearance of underwriting objections, the actual issuance of the policy or policies on behalf of the title insurance company, and, where customary, issuance of the title commitment, and the conducting of the title search and closing.**

**(h) Recordkeeping. Any documents provided pursuant to this section shall be retained for five (5) years from the date of execution.**

**(i) Appendix B of this part. Illustrations in Appendix B of this part demonstrate some of the requirements of this section.** 24 C.F.R. §3500.14.

Two principal issues are presented by the text of the current statute and regulation: (a) Does it prohibit "yield spread premiums?" and (b) Does it require a "split" of charges?

**a. Yield Spread Premiums**

A yield spread premium is a payment by a lender to the borrower's mortgage broker that is tied to an increase in the borrower's interest rate. The lender establishes a base or "par" interest rate, at which it will make or purchase a loan from a given class of borrower. If the broker induces

the borrower to sign loan papers at a higher rate, the lender pays a "yield spread premium" linked to the increase in the rate.

On its face, such a payment would appear to violate the Real Estate Settlement Procedures Act of 1974 (RESPA) and Regulation X. See 12 U.S.C. §2607; 24 C.F.R. §3500.14. It is a payment for the broker's referral of a borrower induced to pay an above-market interest rate.

Nevertheless, under pressure from the banking industry, HUD has sought to legalize yield spread premiums. On March 1, 1999, HUD issued Statement of Policy 1999-1, 64 Fed.Reg. 10,080, in which it imposed two requirements for a yield spread premium to not violate 12 U.S.C. §2607 and 24 C.F.R. §3500.14: (1) it must be "clearly disclosed so that the consumer can understand the nature and recipient of the payment," and (2) it must represent reasonable compensation for services rendered. 64 Fed.Reg. 10,080, 10,086 (Mar. 1, 1999).

In addition, some courts read HUD Statement 1999-1 to impose a third requirement that under the agreement between the broker and lender, the yield spread premium in fact represents compensation for services rendered and not a payment for bringing the lender a borrower induced to pay a supracompetitive rate. *Culpepper v. Inland Mortgage Corp.,* 132 F.3d 692, *op. on denial of reh'g,* 144 F.3d 717 (11th Cir. 1998), *class certified on remand,* 189 F.R.D. 668, *order stayed pending appeal,* No. CV 96-BU-0917-S, 1999 U.S.Dist. LEXIS 15986 (N.D.Ala., July 19, 1999).

In a second opinion, *Culpepper v. Irwin Mortgage Corp.,* 253 F.3d 1324, 1332 (11th Cir. 2001), the court reaffirmed that a yield spread premium determined by whether the borrower was signed up at a rate above "par" on a rate chart violates RESPA.

HUD then issued Statement of Policy 2001-1, which purports to eliminate the third requirement, that the yield spread premium represent compensation for services rendered. 66 Fed.Reg. 53,052 (Oct. 18, 2001).

Following the issuance of HUD Statement 2001-1, the Eleventh Circuit Court reversed its position in *Culpepper,* held that Statement 2001-1 is valid, and decided that as long as the total compensation to the broker was reasonable, the payment was permissible. *Heimmermann v. First Union Mortgage Corp.,* 305 F.3d 1257 (11th Cir. 2002).

The Eighth Circuit, in *Glover v. Standard Federal Bank,* 283 F.3d 953, 961 – 962 (8th Cir. 2002), gave effect to HUD Statement 2001-1 on the "yield spread" issue:

> **When reviewing an agency's construction of a statute it administers, a court must first ask whether Congress has directly spoken to the precise question at issue. *Chevron U.S.A. Inc. v. Natural Res. Defense Council, Inc.,* 467 U.S. 837, 842, 81 L.Ed.2d 694, 104 S.Ct. 2778 (1984). The legality of a YSP payment (or any other specific type of payment) to a mortgage broker is not directly addressed by RESPA. Neither is how one deals with the tension created by the words of Sections 8(a) and 8(c). Thus, the intent of Congress on this issue is not expressly**

**set forth in the statute. Therefore, under *Chevron,* we must determine whether HUD's analysis as set forth in its regulation is based on a permissible construction of the statute. 467 U.S. at 843.**

**"If Congress has explicitly left a gap for the agency to fill, there is an express delegation of authority to the agency to elucidate a specific provision of the statute by regulation." 467 U.S. at 843 – 44. Agency regulations promulgated under express congressional authority are given controlling weight unless they are arbitrary, capricious, or manifestly contrary to the statute. 467 U.S. at 844. In the instant case, it appears Congress did intend to delegate authority to HUD by expressly authorizing HUD to "prescribe such rules and regulations, to make such interpretations, and to grant such reasonable exemptions for classes of transactions, as may be necessary to achieve the purposes of [RESPA]." 12 U.S.C. §2617(a). HUD promulgated rules under RESPA at 24 C.F.R. §3500.01** *et. seq.,* **subject to notice-and-comment. Because these rules were promulgated under the express authority of Congress and adjudicated with apparent congressional intent to carry the force of law, they are accorded** *Chevron* **deference.** *United States v. Mead Corp.,* **533 U.S. 218, 150 L.Ed.2d 292, 121 S.Ct. 2164, 2172 (2001). However, these regulations are not directly at issue today, as the language of the Section 8(a) regulation issued by HUD simply mirrors that of the statute.**

*** * ***

**In this case, however, we have a duly promulgated regulation, which has the force of law under** *Chevron,* **but which for our purposes continues the statutory ambiguity. It remains unstated and unclear under the regulation, as under the statute, whether payment of a YSP to a mortgage broker does, or must, in whole or in part, constitute an unearned fee. Thus we are not dealing with** *Mead,* **and its corresponding line of cases, which address the issue of deference due regulations or other congressionally authorized interpretations of a guiding statute.** *See Mead,* **533 U.S. 218, 121 S.Ct. 2164, 150 L.Ed.2d 292;** *Chevron,* **467 U.S. at 842;** *Skidmore v. Swift & Co.,* **323 U.S. 134, 140, 89 L.Ed. 124, 65 S.Ct. 161 (1944) (giving lesser agency rulings, statements, interpretations and opinions concerning statutory meaning deference only proportional to their power to persuade given the agency's specialized experience, investigations and available information).**

**We look, instead, to** *Bowles v. Seminole Rock & Sand Co.* **and its progeny for guidance in determining what deference is due an agency interpretation of its own ambiguous regulation.** *See Christensen,* **529 U.S. at 588 (giving deference to an agency's interpretation of its own regulation only if the language of the**

**regulation is ambiguous);** *Auer v. Robbins,* **519 U.S. 452, 461, 137 L.Ed.2d 79, 117 S.Ct. 905 (1997) (giving controlling deference to an agency's interpretation of its own ambiguous regulation unless plainly erroneous or inconsistent with the regulation);** *Bowles v. Seminole Rock & Sand Co.,* **325 U.S. 410, 413 – 14, 89 L.Ed. 1700, 65 S.Ct. 1215 (1945) ("Since this involves an interpretation of an administrative regulation a court must necessarily look to the administrative construction of the regulation if the meaning of the words used is in doubt. . . . The ultimate criterion is the administrative interpretation, which becomes of controlling weight unless it is plainly erroneous or inconsistent with the regulation."). Referring to this line of cases, we believe that HUD's Policy Statements interpreting its own ambiguous regulation are controlling authority unless they are plainly erroneous or inconsistent with the regulation or the purpose of RESPA.** *Christensen,* **529 U.S. at 588 (construing** *Auer v. Robbins,* **519 U.S. at 462).**

**However, if** *Christensen* **does not contemplate situations, as here, where the agency regulation does nothing more than mirror the ambiguous language of the statute, our decision to give deference to HUD's Policy Statements remains steadfast.** *See Cunningham v. Scibana,* **259 F.3d 303, 307 n. 1 (4th Cir. 2001) (holding that** *Christensen* **does not apply if there is no ambiguous interpretive language in the regulation, that is if the agency "simply repeated the statutory language in the regulation and left its interpretation of [the statutory language] to a program [or policy] statement,"** *Skidmore* **principles apply). HUD's Policy Statements in this instance pack sufficient power to persuade given HUD's specialized mission, experience and broad investigation into the consumer lending market.** *Skidmore,* **323 U.S. at 140.**

*Accord Schuetz v. Banc One Mortgage Corp.,* 292 F.3d 1004, 1013 (9th Cir. 2002).

**b. Requirement of "Split"**

The other current issue under §7 of the Real Estate Settlement Procedures Act of 1974 is whether a "split" is required. 12 U.S.C. §2606. In many cases, a lender or title company will simply "mark up" an item (*e.g.,* charging $50 for a credit report that actually costs $40). HUD has long taken the position that this is a violation of §7, whether the lender just overcharged or whether the credit report issuer is privy to the arrangement (*i.e.,* it gets $50 and kicks back $40).

In *Echevarria v. Chicago Title & Trust Co.,* 256 F.3d 623 (7th Cir. 2001), the Seventh Circuit took the position that a "split" was essential. This raises the question of what constitutes a "split." In *Echevarria,* the court of appeals cited with approval the decision in *Christakos v. Intercounty Title Co.,* 196 F.R.D. 496 (N.D.Ill. 2000), in which both the lender that was paid off and the title company charged fees for recording the release of the loan being paid off. Only one release was recorded. The court in *Christakos* held that a "split" existed when

**Ms. Christakos claims that she paid $52.50 for the settlement charge to record the release, $ 23.50 of which went to Mellon, who actually recorded the release and thus earned the fee, and $ 29 of which went to Intercounty, who did nothing in return. These payments were made from the same pool of funds from the loan proceeds over which Intercounty, as settlement agent, had control and directed payments made from. Therefore, Intercounty received an unearned "portion" of a settlement fee that was unearned, in violation of 2607(b).** 196 F.R.D. at 503.

HUD Statement of Policy 2001-1, 66 Fed.Reg. 53,052, states that *Echevarria* is wrong and formally adopts the position that a "split" is not required. However, the Seventh Circuit rejected this position in *Krzalic v. Republic Title Co.,* 314 F.3d 875 (7th Cir. 2002), cert. denied, 123 S.Ct. 2641, 156 L.Ed.2d 656(2003), in which it held that the statute requires a "split."

### C. Fair Debt Collection Practices Act

An assignee who acquires a debt that is already in default, either for its own account or for purposes of collection, meets the definition of a "debt collector" under §1692a(6) of the Fair Debt Collection Practices Act (FDCPA), 15 U.S.C. §1692, *et seq. Schlosser v. Fairbanks Capital Corp.,* 323 F.3d 534 (7th Cir. 2003); *Kimber v. Federal Financial Corp.,* 668 F.Supp. 1480 (M.D.Ala. 1987). Lawyers who regularly collect debts by foreclosing on real estate also meet the definition of a "debt collector." *Miller v. McCalla, Raymer, Padrick, Cobb, Nichols, and Clark, L.L.C.,* 214 F.3d 872 (7th Cir. 2000); *Littles v. Lieberman (In re Littles),* 90 B.R. 669, 676 (Bankr.), *aff'd as modified sub nom. Crossley v. Lieberman,* 90 B.R. 682 (E.D.Pa. 1988), *aff'd,* 868 F.2d 566 (3d Cir. 1989); *Shapiro & Meinhold v. Zartman,* 823 P.2d 120 (Colo. 1992). The original lender is exempt from being defined as a "debt collector," as is someone who "services" a loan that is not claimed to be in default. 15 U.S.C. §§1692a(6)(A), 1692a(6)(F).

The FDCPA imposes certain notification requirements. 15 U.S.C. §§1692e(11), 1692g. Many debt collectors do not comply with these requirements. *Miller, supra.* The FDCPA also prohibits collection practices that are misleading (15 U.S.C. §1692e), unfair (15 U.S.C. §1692f), or harassing or abusive (15 U.S.C. §1692d).

Among the mortgage company practices specifically prohibited by the FDCPA, assuming its applicability, are adding attorneys' fees or servicing expenses not authorized by law or contract (15 U.S.C. §§1692e(2)(B), 1692f(1)) and inaccurate credit reporting (15 U.S.C. §1692e(8)).

### D. Equal Credit Opportunity Act and Federal Reserve Board Regulation B

The Equal Credit Opportunity Act (ECOA), 15 U.S.C. §1691, *et seq.,* makes it unlawful for a

**creditor to discriminate against any applicant, with respect to any aspect of a credit transaction —**

> **(1) on the basis of race, color, religion, national origin, sex or marital status, or age (provided the applicant has the capacity to contract);**
>
> **(2) because all or part of the applicant's income derives from any public assistance program; or**
>
> **(3) because the applicant has in good faith exercised any right under the Consumer Credit Protection Act** [15 U.S.C. §1601, *et seq.*]**.** 15 U.S.C. §1691(a).

Federal Reserve Board Regulation B, 12 C.F.R. Part 202, prohibits a lender from requiring the signature of a spouse if the applicant alone qualifies for the proposed transaction. 12 C.F.R. §202.7(d). There is a considerable body of case law addressing the issue of when requiring a spouse to guaranty a loan is a violation of the statute. If a violation exists, the spouse's obligation is nullified.

ECOA also prohibits "reverse redlining," in which members of minority groups are not denied credit but are extended credit on unfavorable terms. *See Newton v. United Companies Financial Corp.,* 24 F.Supp.2d 444, 455 (E.D.Pa. 1998); *Williams v. Gelt Financial Corp.,* 237 B.R. 590, 594 (E.D.Pa. 1999); *United Companies Lending Corp. v. Sargeant,* 20 F.Supp.2d 192, 203 n. 5 (D.Mass. 1998).

ECOA also prohibits retaliation for exercising rights under any section of the Consumer Credit Protection Act, 15 U.S.C. §1601, *et seq.* This includes the Truth in Lending Act, the Home Ownership and Equity Protection Act of 1994, and the Fair Credit Reporting Act.

Regulation B extends the application of ECOA to discrimination in servicing or enforcement of credit obligations as well as discrimination in the extension of credit.

Finally, ECOA and Regulation B require written notice of the denial of credit. 15 U.S.C. §1691(d); 12 C.F.R. §202.9. Literally, there is an exemption if the creditor makes a counteroffer that is accepted by the consumer. However, some cases have required that the counteroffer be similar to the credit initially requested and imposed liability if the creditor makes an offer substantially different from the one requested. *Newton, supra.*

The notification provisions of ECOA may be violated regardless of whether there is any substantive discrimination claim. *Pinkett v. Payday Today Loans, LLC,* No. 99 C 3332, 1999 U.S.Dist. LEXIS 12098 (N.D.Ill. July 22, 1999).

### E. Fair Housing Act and 42 U.S.C. §§1981 – 1982

The Fair Housing Act (Title VIII of the Civil Rights Act of 1968), 42 U.S.C. §3601, *et seq.,* and 42 U.S.C. §§1981 and 1982 also prohibit "reverse redlining," in which members of minority groups are not denied credit but are extended credit on unfavorable terms. *See Johnson v.*

*Equicredit Corporation of America,* No. 01 C 5197, 2002 U.S.Dist. LEXIS 4817 (N.D.Ill. Mar. 21, 2002); *Matthews v. New Century Mortgage Corp.,* 185 F.Supp.2d 874 (S.D. Ohio 2002).

### F. Fair Credit Reporting Act

Most provisions of the Fair Credit Reporting Act, 15 U.S.C. §1681, *et seq.,* regulate credit bureaus. However, §1681s-2 creates a private right of action if a consumer complains to a credit bureau that an item is inaccurate, the credit bureau (as is its obligation) contacts that creditor for information about the item, and the creditor furnishes false information to the credit bureau in response to the verification request.

### G. Consumer Fraud and Deceptive Business Practices Act

Section 2 of the Consumer Fraud and Deceptive Business Practices Act ("ICFA"), 815 ILCS 505/1, *et seq.,* provides the following:

> **Unfair methods of competition and unfair or deceptive acts or practices, including but not limited to the use or employment of any deception, fraud, false pretense, false promise, misrepresentation or the concealment, suppression or omission of any material fact, with intent that others rely upon the concealment, suppression or omission of such material fact, or the use or employment of any practice described in [**815 ILCS 510/2**], in the conduct of any trade or commerce are hereby declared unlawful whether any person has in fact been misled, deceived or damaged thereby. In construing this section consideration shall be given to the interpretations of the Federal Trade Commission and the federal courts relating to [**§45(a) of the Federal Trade Commission Act, 15 U.S.C. §41, *et seq.*]. **815 ILCS 505/2.

Section 2(a) of the Uniform Deceptive Trade Practices Act, 815 ILCS 510/1, *et seq.,* referred to in §2 of the ICFA, provides the following:

> **A person engages in a deceptive trade practice when, in the course of his or her business, vocation or occupation, the person:**
>
> * * *
>
> **(5) represents that goods or services have . . . characteristics . . . [or] benefits . . . that they do not have;**
>
> * * *
>
> **(9) advertises goods or services with intent not to sell them as advertised;**

* * *

> **(12) engages in any other conduct which similarly creates a likelihood of confusion or of misunderstanding. 815 ILCS 510/2(a).**

See also 815 ILCS 505/2K, prohibiting advertising of “bank rates,” “bank financing,” and the like by any creditor that is not a bank.

A private right of action is authorized by 815 ILCS 505/10a, which provides the following:

> **(a) Any person who suffers actual damage as a result of a violation of this Act committed by any other person may bring an action against such person. The court, in its discretion may award actual economic damages or any other relief which the court deems proper. . . .**
>
> **(b) Such action may be commenced in the county in which the person against whom it is brought resides, has his principal place of business, or is doing business, or in the county where the transaction or any substantial portion thereof occurred.**
>
> **(c) Except as provided in subsections (f), (g), and (h) of this Section, in any action brought by a person under this Section, the Court may grant injunctive relief where appropriate and may award, in addition to the relief provided in this Section, reasonable attorney’s fees and costs to the prevailing party.**
>
> **(d) Upon commencement of any action brought under this Section the plaintiff shall mail a copy of the complaint or other initial pleading to the Attorney General and, upon entry of any judgment or order in the action, shall mail a copy of such judgment or order to the Attorney General.**
>
> **(e) Any action for damages under this Section shall be forever barred unless commenced within 3 years after the cause of action accrued; provided that, whenever any action is brought by the Attorney General or a State’s Attorney for a violation of this Act, the running of the foregoing statute of limitations, with respect to every private right of action for damages which is based in whole or in part on any matter complained of in said action by the Attorney General or State’s Attorney, shall be suspended during the pendency thereof, and for one year thereafter.**

The extension of credit is the provision of a "service" subject to the ICFA. *Law Offices of William J. Stogsdill v. Cragin Federal Bank for Savings,* 268 Ill.App.3d 433, 645 N.E.2d 564, 206 Ill.Dec. 559 (2d Dist. 1995); *Bankier v. First Federal Savings & Loan Association of Champaign,* 225 Ill.App.3d 864, 588 N.E.2d 391, 167 Ill.Dec. 750 (4th Dist.), *appeal denied,* 146 Ill.2d 622 (1992); *Allenson v. Hoyne Savings Bank,* 272 Ill.App.3d 938, 651 N.E.2d 573, 209 Ill.Dec. 395 (1st Dist. 1995); *Fidelity Financial Services, Inc. v. Hicks,* 214 Ill.App.3d 398, 574 N.E.2d 15, 158 Ill.Dec. 221 (1st Dist. 1991).

**1. Deception**

Section 2 of the Consumer Fraud and Deceptive Business Practices Act makes unlawful both "deceptive" and "unfair" practices. 815 ILCS 505/2. The basic elements of a deception claim are (a) a deceptive act or practice, (b) at least, if an omission is concerned, the defendant's intent that the plaintiff relied on the deception, and (c) that the deception occurred in the course of conduct involving trade or commerce. *Vance v. National Benefit Ass'n,* No. 99 C 2627, 1999 U.S.Dist. LEXIS 13846 at *13 (N.D.Ill. Aug. 26, 1999); *Shields v. Lefta, Inc.,* 888 F.Supp. 891 (N.D.Ill. 1995); *Siegel v. Levy Organization Development Co.,* 153 Ill.2d 534, 607 N.E.2d 194, 198, 180 Ill.Dec. 300 (1992); *Brandt v. Time Insurance Co.,* 302 Ill.App.3d 159, 704 N.E.2d 843, 846, 235 Ill.Dec. 270 (1st Dist. 1998); *Bankier v. First Federal Savings & Loan Association of Champaign,* 225 Ill.App.3d 864, 588 N.E.2d 391, 167 Ill.Dec. 750 (4th Dist.), *appeal denied,* 146 Ill.2d 622 (1992).

The test of "deception" is whether a representation "creates 'the likelihood of deception or [has] the capacity to deceive' " the persons exposed to the practice in the particular case. *Elder v. Coronet Insurance Co.,* 201 Ill.App.3d 733, 558 N.E.2d 1312, 146 Ill.Dec. 978 (1st Dist. 1990), quoting *Williams v. Bruno Appliance & Furniture Mart, Inc.,* 62 Ill.App.3d 219, 379 N.E.2d 52, 54, 19 Ill.Dec. 537 (1st Dist. 1978); *Beard v. Gress,* 90 Ill.App.3d 622, 413 N.E.2d 448, 46 Ill.Dec. 8 (4th Dist. 1980).

The ICFA imposes an affirmative duty to disclose material facts pertaining to a transaction: "Under the Act the omission of any material fact is deceptive conduct." *Crowder v. Bob Oberling Enterprises, Inc.,* 148 Ill.App.3d 313, 499 N.E.2d 115, 118, 101 Ill.Dec. 748 (4th Dist. 1986); *Simeon Management Corp. v. Federal Trade Commission,* 579 F.2d 1137, 1145 (9th Cir. 1978) ("[f]ailure to disclose material information may cause an advertisement to be false or deceptive within the meaning of the [Federal Trade Commission Act] even though the advertisement does not state false facts"); *J. B. Williams Co. v. Federal Trade Commission,* 381 F.2d 884, 888 (6th Cir. 1967) (court found violation of §5 of Federal Trade Commission Act based on manufacturer's failure to disclose that "Geritol" was useful only to individuals who were deficient in one of the vitamins or minerals contained in product and required affirmative disclosure of "the negative fact that a great majority of persons who experience these symptoms do not experience them because there is a vitamin or iron deficiency"). Thus, material omissions are actionable even if no duty to disclose the omitted information, other than that imposed by the ICFA itself, exists. *Celex Group, Inc. v. Executive Gallery, Inc.,* 877 F.Supp. 1114, 1129 (N.D.Ill. 1995), citing *Totz v. Continental*

*DuPage Acura,* 236 Ill.App.3d 891, 602 N.E.2d 1374, 177 Ill.Dec. 202 (2d Dist. 1992) (car dealer has duty to disclose that vehicle has been previously damaged in accident).

Even "the 'ignorant, the unthinking, and the credulous' " are protected from deceptive conduct. *Bruno Appliance, supra,* 379 N.E.2d at 54, quoting *In re Rodale Press, Inc.,* 71 F.T.C. 1184, 1237 – 1238 (1967). Accordingly, lack of due diligence on the part of the injured party is no defense. *Zimmerman v. Northfield Real Estate, Inc.,* 156 Ill.App.3d 154, 510 N.E.2d 409, 109 Ill.Dec. 541 (1st Dist. 1986); *Beard, supra,* 413 N.E.2d at 452 ("neither the mental state of the person making a misrepresentation nor the diligence of the party injured to check as to the accuracy of the misrepresentation [is] material to the existence of a cause of action for that misrepresentation"); *Carter v. Mueller,* 120 Ill.App.3d 312, 457 N.E.2d 1335, 75 Ill.Dec. 776 (1st Dist. 1983). Deception is evaluated from the perspective of an unsophisticated consumer. As *Federal Trade Commission v. Standard Education Society,* 302 U.S. 112, 82 L.Ed. 141, 58 S.Ct. 113, 115 (1937), stated, "The fact that a false statement may be obviously false to those who are trained and experienced does not change its character, nor take away its power to deceive others less experienced. . . . Laws are made to protect the trusting as well as the suspicious." *See also Clomon v. Jackson,* 988 F.2d 1314, 1318 – 1319 (2d Cir. 1993) (law protects "that vast multitude which includes the ignorant, the unthinking and the credulous," and "in evaluating the tendency of language to deceive," courts and agencies "look not to the most sophisticated readers but rather to the least"), quoting *Charles of the Ritz Distributors, Corp. v. Federal Trade Commission,* 143 F.2d 676, 679 (2d Cir. 1944), and *Exposition Press, Inc. v. Federal Trade Commission,* 295 F.2d 869, 872 (2d Cir. 1961); *Gammon v. GC Services Limited Partnership,* 27 F.3d 1254, 1257 (7th Cir. 1994) (following *Clomon,* standard is that of "unsophisticated" consumer and protects average consumer "who is uninformed, naive, or trusting").

The fact that an astute consumer could have detected the practice is irrelevant when the fact is that most consumers under the circumstances do not check. For example, in *People ex rel. Hartigan v. Stianos,* 131 Ill.App.3d 575, 475 N.E.2d 1024, 86 Ill.Dec. 645 (2d Dist. 1985), the court held that a retailer's practice of charging consumers sales tax in an amount slightly greater than that authorized by law was both deceptive and unfair:

> **We conclude the practice described in this case is both deceptive and unfair as those terms are used in the Consumer Fraud Act. The sales tax rates which may be charged to consumers have been fixed by statute; the legislature set the tax rate at 1.25%, but the evidence here is that defendants collected an average of 4.75%. While the three sales upon which this case is premised reflect only a few cents in overcharges, it is apparent that similar overcharges, if permitted to continue, could aggregate very substantial losses and injury to the consuming public. It is also unfair to permit the extraction from the consumer of excessive sums under the guise it is a lawful tax. If, as defendants alleged in their answer, the excess sums collected were turned over to the State, defendants' conduct remains unfair and deceptive to the consumers'**

> **injury.** 475 N.E.2d at 1029.

Obviously, the amount of sales tax is set by law, and a consumer who looks up the statute and then does the computations on being presented with a cash register tape at the supermarket could detect the overcharge. Of course, consumers generally do not whip out the Revenue Act and a calculator when the clerk rings up their grocery purchase. They simply accept the supermarket's representation of the amount of the tax and pay. Given the context in which the representation was made ( *i.e.,* the normal shopping habits of consumers), inflating the amount of the tax has the "tendency" and "capacity" to deceive.

#### 2. Unfairness

The prohibitions of "unfair" and "deceptive" practices are distinct. *Robinson v. Toyota Motor Credit Corp.,* 201 Ill.2d 403, 775 N.E.2d 951, 266 Ill.Dec. 879 (2002); *Elder v. Coronet Insurance Co.,* 201 Ill.App.3d 733, 558 N.E.2d 1312, 146 Ill.Dec. 978 (1st Dist. 1990). In determining whether a practice is "unfair," both federal and state law consider

> **"(1) whether the practice, without necessarily having been previously considered unlawful, offends public policy as it has been established by statutes, the common law, or otherwise — whether, in other words, it is within at least the penumbra of some common-law, statutory, or other established concept of unfairness; (2) whether it is immoral, unethical, oppressive, or unscrupulous; (3) whether it causes substantial injury to consumers (or competitors or other businessmen)."** *Federal Trade Commission v. Sperry & Hutchinson Co.,* 405 U.S. 233, 31 L.Ed.2d 170, 92 S.Ct. 898, 905 n. 5 (1972), quoting 29 Fed.Reg. 7317, 8355 (May 28, 1964).

*See also Robinson, supra; Scott v. Association for Childbirth at Home, International,* 88 Ill.2d 279, 430 N.E.2d 1012, 58 Ill.Dec. 761 (1981); *Elder, supra; People ex rel. Hartigan v. All American Aluminum & Construction Co.,* 171 Ill.App.3d 27, 524 N.E.2d 1067, 121 Ill.Dec. 19 (1st Dist. 1988); *People ex rel. Hartigan v. Stianos,* 131 Ill.App.3d 575, 475 N.E.2d 1024, 86 Ill.Dec. 645 (2d Dist. 1985); *People ex rel. Fahner v. Hedrich,* 108 Ill.App.3d 83, 438 N.E.2d 924, 63 Ill.Dec. 782 (2d Dist. 1982); *People ex rel. Fahner v. Walsh,* 122 Ill.App.3d 481, 461 N.E.2d 78, 77 Ill.Dec. 691 (2d Dist. 1984); *People ex rel. Hartigan v. Knecht Services, Inc.,* 216 Ill.App.3d 843, 575 N.E.2d 1378, 159 Ill.Dec. 318 (2d Dist. 1991); *Ekl v. Knecht,* 223 Ill.App.3d 234, 585 N.E.2d 156, 165 Ill.Dec. 760 (2d Dist. 1991). The *Robinson* decision approved and adopted the discussion of "unfair practice" in *Cheshire Mortgage Service, Inc. v. Montes,* 223 Conn. 80, 612 A.2d 1130 (1992), which held that violations of the Truth in Lending Act and a Connecticut law regulating the number of points that can be charged in residential mortgage transactions established an "unfairness" violation.

#### 3. Elimination of Common Law Fraud Restrictions

There is no requirement of reliance on the part of the consumer. *Martin v. Heinold Commodities, Inc.,* 163 Ill.2d 33, 643 N.E.2d 734, 754, 205 Ill.Dec. 443 (1994); *Swanagan v. Al Piemonte Ford Sales, Inc.,* No. 94 C 4070, 1995 U.S.Dist. LEXIS 11863 (N.D.Ill. Aug. 15, 1995); *Brooks v. Midas-International Corp.,* 47 Ill.App.3d 266, 361 N.E.2d 815, 819 – 820, 5 Ill.Dec. 492 (1st Dist. 1977) (if Midas represented in its advertising that replacement auto exhaust systems would be installed for only installation charge but actually imposed additional charges, all of Midas's customers would be entitled to refund of additional charges irrespective of whether they relied on or even saw advertisement). It is not necessary that the representation or omission be made directly to the consumer as long as it is intended to impact on the consumer. *Fisher v. Quality Hyundai, Inc.,* No. 01 C 3243, 2002 U.S.Dist. LEXIS 407 (N.D.Ill. Jan. 8, 2002) (misrepresentation made to source of financing). It is necessary, however, to show a causal connection between the violation and the amount sought as damages. This is generally quite simple in the case of inflated or unauthorized charges.

Misrepresentations of opinion, false promises of future conduct, and misrepresentations by innuendo are prohibited, even though they might not have been actionable at common law. *Duhl v. Nash Realty, Inc.,* 102 Ill.App.3d 483, 429 N.E.2d 1267, 1277, 57 Ill.Dec. 904 (1st Dist. 1981); *Buzzard v. Bolger,* 117 Ill.App.3d 887, 453 N.E.2d 1129, 1131 – 1132, 73 Ill.Dec. 140 (2d Dist. 1983). Privity is not required. *Ramson v. Layne,* 668 F.Supp. 1162 (N.D.Ill. 1987) (liability of endorser); *Elder v. Coronet Insurance Co.,* 201 Ill.App.3d 733, 558 N.E.2d 1312, 146 Ill.Dec. 978 (1st Dist. 1990).

The fact that mortgage brokers and lenders are regulated under the Residential Mortgage License Act of 1987, 205 ILCS 635/1-1, *et seq.,* does not immunize them from challenge under the Consumer Fraud and Deceptive Business Practices Act. *People ex rel. Hartigan v. Northern Illinois Mortgage Co.,* 201 Ill.App.3d 356, 559 N.E.2d 14, 147 Ill.Dec. 14 (1st Dist. 1990).

### 4. Mortgage Practices Challenged Under Consumer Fraud and Deceptive Business Practices Act

Specific practices relating to mortgage lending that have been held to be deceptive or unfair include the following:

**a. Last-minute addition of fees and charges.** *People ex rel. Hartigan v. Northern Illinois Mortgage Co.,* 201 Ill.App.3d 356, 559 N.E.2d 14, 147 Ill.Dec. 14 (1st Dist. 1990); *Provident Bank v. Wright,* No. 00 C 6027, 2001 U.S.Dist. LEXIS 9621 (N.D.Ill. July 9, 2001). *See In re Peacock Buick, Inc.,* 86 F.T.C. 1532 (1975).

**b. Bait-and-switch practices and failing to honor promises relating to interest rates.** *Northern Illinois Mortgage, supra; Provident Bank, supra. See Ashlock v. Sunwest Bank of Roswell, N.A.,* 107 N.M. 100, 753 P.2d 346 (1988) (bank that

advertised payment of certain rate of interest was obligated to pay that rate); *Williams v. Bruno Appliance & Furniture Mart, Inc.,* 62 Ill.App.3d 219, 379 N.E.2d 52, 54, 19 Ill.Dec. 537 (1st Dist. 1978) (bait-and-switch practices actionable); *Hawaii Community Federal Credit Union v. Keka,* 94 Haw. 213, 11 P.3d 1 (2000).

**c. Yield spread premiums paid to mortgage brokers.** *Vargas v. Universal Mortgage Corp.,* No. 01 C 0087, 2001 U.S.Dist. LEXIS 6696 (May 18, 2001), *later op.,* 2001 U.S.Dist. LEXIS 19635 (Nov. 29, 2001); *DeLeon v. Beneficial Construction Co.,* 998 F.Supp. 859 (1998), *later op.,* 55 F.Supp.2d 819 (N.D.Ill. 1999); *Hastings v. Fidelity Mortgage Decisions Corp.,* 984 F.Supp. 600 (N.D.Ill. 1997). *See Browder v. Hanley Dawson Cadillac Co.,* 62 Ill.App.3d 623, 379 N.E.2d 1206, 20 Ill.Dec. 138 (1st Dist. 1978); *Fox v. Industrial Casualty Insurance Co.,* 98 Ill.App.3d 543, 424 N.E.2d 839, 54 Ill.Dec. 89 (1st Dist. 1981); *Fitzgerald v. Chicago Title & Trust Co.,* 72 Ill.2d 179, 380 N.E.2d 790, 20 Ill.Dec. 581 (1978).

**d. Imposition of unauthorized charges.** *In re Orkin Exterminating Co.,* 108 F.T.C. 263 (1986), *aff'd,* 849 F.2d 1354 (11th Cir. 1988); *Haroco, Inc. v. American National Bank & Trust Company of Chicago,* 747 F.2d 384 (7th Cir. 1984) (prime rate case), *aff'd,* 105 S.Ct. (1985), *on remand,* 647 F.Supp. 1026 (N.D.Ill. 1986); *Littlefield v. Goldome Bank,* 142 A.D.2d 978, 530 N.Y.S.2d 400 (N.Y.App.Div. 1988) (unauthorized charges); *Leff v. Olympic Federal Savings & Loan Ass'n,* No. 86 C 3026, 1986 U.S.Dist. LEXIS 20198 (N.D.Ill. Sept. 18, 1986) (overescrowing); *Rumford v. Countrywide Funding Corp.,* 287 Ill.App.3d 330, 678 N.E.2d 369, 222 Ill.Dec. 757 (2d Dist. 1997).

**e. Misstating the annual percentage rate or finance charge.** *Kleidon v. Rizza Chevrolet, Inc.,* 173 Ill.App.3d 116, 527 N.E.2d 374, 122 Ill.Dec. 876 (1st Dist.), *appeal denied,* 123 Ill.2d 559 (1988); *Beard v. Gress,* 90 Ill.App.3d 622, 413 N.E.2d 448, 46 Ill.Dec. 8 (4th Dist. 1980); *April v. Union Mortgage Co.,* 709 F.Supp. 809 (N.D.Ill. 1989) (misstatement of finance charge required to be disclosed under Truth in Lending Act actionable as Consumer Fraud and Deceptive Business Practices Act violation).

**f. Misrepresentations as to the time in which or terms on which loan applications could be closed.** *People ex rel. Hartigan v. Commonwealth Mortgage Corporation of America,* 732 F.Supp. 885 (N.D.Ill. 1990); *Northern Illinois Mortgage, supra.*

**g. Wrongful foreclosure.** *Smith v. Keycorp Mortgage, Inc.,* 151 B.R. 870 (N.D.Ill. 1993).

**h. Home improvement fraud.** *Heastie v. Community Bank of Greater Peoria,* 690 F.Supp. 716 (1988), *later op.,* 125 F.R.D. 669, *summary judgment granted in part,* 727 F.Supp. 1133, *summary judgment granted,* 727 F.Supp. 1140 (N.D.Ill.

1989); *People ex rel. Hartigan v. All American Aluminum & Construction Co.,* 171 Ill.App.3d 27, 524 N.E.2d 1067, 121 Ill.Dec. 19 (1st Dist. 1988); *Mason v. Fieldstone Mortgage Co.,* No. 00 C 0228, 2000 U.S.Dist. LEXIS 16415 (N.D.Ill. Oct. 10, 2000); *Diamond Mortgage Corporation of Illinois v. Armstrong,* 176 Ill.App.3d 64, 530 N.E.2d 1041, 125 Ill.Dec. 632 (1st Dist. 1988).

**i. Overescrowing.** *GMAC Mortgage Corporation of Pennsylvania v. Stapleton,* 236 Ill.App.3d 486, 603 N.E.2d 767, 177 Ill.Dec. 697 (1st Dist. 1992), *appeal denied,* 148 Ill.2d 641 (1993); *Leff, supra; Aitken v. Fleet Mortgage Corp.,* No. 90 C 3708, 1991 U.S.Dist. LEXIS 10420 (N.D.Ill. July 29, 1991), and 1992 U.S.Dist. LEXIS 1687 (N.D.Ill. Feb. 12, 1992); *Poindexter v. National Mortgage Corp.,* No. 91 C 4223, 1991 U.S.Dist. LEXIS 19643 (Dec. 23, 1991), *later op.,* No. 94 C 5814, 1995 U.S.Dist. LEXIS 5396 (N.D.Ill. Apr. 18, 1995); *Sanders v. Lincoln Service Corp.,* No. 91 C 4542, 1993 U.S.Dist. LEXIS 4454 (N.D.Ill. Apr. 5, 1993); *Robinson v. Empire of America Realty Credit Corp.,* No. 90 C 5063, 1991 U.S.Dist. LEXIS 2084 (N.D.Ill. Feb. 20, 1991); *In re Mortgage Escrow Deposit Litigation,* No. 90 C 5816, 1994 U.S.Dist. LEXIS 12746 (N.D.Ill. Sept. 8, 1994) (cons.); *Greenberg v. Republic Federal Savings & Loan Ass'n,* No. 94 C 3789, 1995 U.S.Dist. LEXIS 5866 (N.D.Ill. Apr. 28, 1995); *Weinberger v. Bell Federal Savings & Loan Ass'n,* 262 Ill.App.3d 1047, 635 N.E.2d 647, 200 Ill.Dec. 308 (1st Dist. 1994).

**j. Flipping.** *Chandler v. American General Finance, Inc.,* 329 Ill.App.3d 729, 768 N.E.2d 60, 263 Ill.Dec. 300 (1st Dist. 2002).

**k. Improper allocation of payments between principal and interest.** *Allenson v. Hoyne Savings Bank,* 272 Ill.App.3d 938, 651 N.E.2d 573, 209 Ill.Dec. 395 (1st Dist. 1995).

**l. Interference with rescission rights.** *Horvath v. Adelson, Golden & Loria, P.C.,* No. 97-266-F, 2000 WL 33159239 (Mass.Super. June 16, 2000).

**m. Making loans that cannot reasonably be expected to be repaid except through foreclosure.** *Fidelity Financial Services, Inc. v. Hicks,* 214 Ill.App.3d 398, 574 N.E.2d 15, 158 Ill.Dec. 221 (1st Dist. 1991).

### H. Residential Improvement Loan Act

The Residential Improvement Loan Act, 815 ILCS 135/0.01, *et seq.,* makes it unlawful to (1) "disburse funds to or for the account of, or as directed by a contractor pursuant to a loan transaction for improvement or repair of (including remodeling of and additions to) a residential structure without requiring and receiving prior to each such disbursement a completion certificate as prescribed by this Act" (815 ILCS 135/1), (2) "disburse funds to or for the account of, or as directed by, a contractor pursuant to an

issuance or transfer thereto of a negotiable instrument evidencing a loan for improvement or repair of (including remodeling of and additions to) a residential structure without requiring and receiving prior to each such disbursement a completion certificate as prescribed by this Act" (815 ILCS 135/2), or (3) disburse funds "which are in excess of the value of labor performed and materials delivered as certified in a duly executed and delivered completion certificate" (815 ILCS 135/4).

A form of completion certificate is provided under 815 ILCS 135/3. FHA Title I loans are not covered. 815 ILCS 135/5.

Only criminal penalties are provided for. There is one case holding that the statute does not create a private right of action. *Luckett v. Alpha Construction & Development, Inc.,* No. 00 C 4553, 2001 U.S.Dist. LEXIS 17623 (N.D.Ill. Oct. 22, 2001). However, it should be treated as part of the terms of the contract on the theory that "[i]n the absence of language to the contrary, the laws and statutes pertinent to a contract and in force at the time the contract is executed are considered a part of that contract as through they were expressly incorporated therein." *Brandt v. Time Insurance Co.,* 302 Ill.App.3d 159, 704 N.E.2d 843, 850, 235 Ill.Dec. 270 (1st Dist. 1998).

## I. Residential Mortgage License Act and Regulations

The Residential Mortgage License Act of 1987, 205 ILCS 635/1-1, *et seq.,* regulates mortgage brokers and lenders and provides for their licensing. The regulatory agency is the Office of Banks and Real Estate.

A number of provisions of the statute and regulations are pertinent to predatory lending litigation.

Effective January 1, 2008, amendments made by S.B. 1167:

1. Require that brokers act with good faith and in the best interests of borrowers as their agents, effectively imposing by statute a fiduciary duty. New 205 ILCS 635/5-7 provides:

   **(a) A mortgage broker shall be considered to have created an agency relationship with the borrower in all cases and shall comply with the following duties:**

   **(1) A mortgage broker shall act in the borrower's best interest and in good faith toward the borrower. A mortgage broker shall not accept, give, or charge any undisclosed compensation or realize any undisclosed remuneration, either through direct or indirect means, that inures to the benefit of the mortgage broker on an**

**expenditure made for the borrower;**

**(2) Mortgage brokers shall carry out all lawful instructions given by borrowers;**

**(3) Mortgage brokers shall disclose to borrowers all material facts of which the mortgage broker has knowledge which might reasonably affect the borrower's rights, interests, or ability to receive the borrower's intended benefit from the residential mortgage loan, but not facts which are reasonably susceptible to the knowledge of the borrower;**

**(4) mortgage brokers shall use reasonable care in performing duties; and**

**(5) mortgage brokers shall account to a borrower for all the borrower's money and property received as agent.**

**(b) Nothing in this section prohibits a mortgage broker from contracting for or collecting a fee for services rendered and which had been disclosed to the borrower in advance of the provision of those services.**

**(c) Nothing in this section requires a mortgage broker to obtain a loan containing terms or conditions not available to the mortgage broker in the mortgage broker's usual course of business, or to obtain a loan for the borrower from a mortgage lender with whom the mortgage broker does not have a business relationship.**

2. Brokers and lenders must verify and document the borrower’s ability to repay. New 205 ILCS 635/5-6 provides:

**Sec. 5-6. Verification of borrower's ability to repay.**

**(a) No licensee may make, provide, or arrange for a residential mortgage loan without verifying the borrower's reasonable ability to pay the principal and interest on the loan, real estate taxes, homeowner's insurance, assessments, and mortgage insurance premiums, if applicable.**

**For residential mortgage loans in which the interest rate may vary, the reasonable ability to pay the principal and interest on**

**the loan shall be determined based on a fully indexed rate, which rate shall be calculated by using the index rate prevailing at the time of origination of the loan plus the margin that will apply when calculating the adjustable rate under the terms of the loan, assuming a fully amortizing repayment schedule based on the term of the loan.**

**For loans that allow for negative amortization, the principal amount of the loan shall be calculated by including the maximum amount the principal balance may increase due to negative amortization under the terms of the loan.**

**(b) For all residential mortgage loans made by a licensee, the borrower's income and financial resources must be verified by tax returns, payroll receipts, bank records, or other reasonably reliable methods, based upon the circumstances of the proposed loan. Nothing in this section shall be construed to limit a licensee's ability to rely on criteria other than the borrower's income and financial resources to establish the borrower's reasonable ability to repay a residential mortgage loan; however, such other criteria must be verified through reasonably reliable methods and documentation. A statement by the borrower to the licensee of the borrower's income and resources is not sufficient to establish the existence of the income or resources when verifying the reasonable ability to pay. Stated income should be accepted only if there are mitigating factors that clearly minimize the need for direct verification of ability to repay.**

3. Require that licensees inform borrowers of any material changes in loan terms or fees at least 24 hours before closing.

4. Require inclusion of taxes and insurance in monthly payment quotes.

5. Require delivery of any appraisal to the borrower prior to closing.

A private right of action is available. New 205 ILCS 635/4-16 provides:

**Sec. 4-16. Private right of action. A borrower injured by a violation of the standards, duties, prohibitions, or requirements of sections 5-6, 5-7, 5-8, 5-9, 5-10, 5-11, 5-12, 5-14, 5-15, and 5-16 of this act shall have a private right of action.**

**(a) A licensee is not liable for a violation of this act if:**

**(1) Within 30 days of the loan closing and prior to receiving any notice from the borrower of the violation, the licensee has made appropriate restitution to the borrower and appropriate adjustments are made to the loan; or**

**(2) The violation was not intentional and resulted from a bona fide error in fact, notwithstanding the maintenance of procedures reasonably adopted to avoid such errors, and within 60 days of the discovery of the violation and prior to receiving any notice from the borrower of the violation, the borrower is notified of the violation, appropriate restitution is made to the borrower, and appropriate adjustments are made to the loan.**

**(b) The remedies and rights provided for in this act are not exclusive, but cumulative, and all other applicable claims are specifically preserved.**

The regulations require a written agreement between the broker and client setting forth exactly what the broker is to do, and they provide that attorneys' fees are awardable in action for breach. 38 Ill.Admin. Code §1050.1010 provides the following:

**Before a mortgage loan applicant, also referred to herein as "borrower" or "customer", signs a completed residential mortgage loan application or gives the licensee any consideration, whichever comes first, a loan brokerage agreement shall be required and shall be in writing and signed by both the mortgage loan applicant and a licensee whose services to such customer shall be loan brokering as defined at** [205 ILCS 635/1-4(o)]**.**

**a) The loan brokerage agreement shall carry a clear and conspicuous statement that, upon request, a copy shall be made available to the borrower or the borrower's attorney for review prior to signing.**

**b) Both the licensee's authorized representative and the borrower shall sign and date the loan brokerage agreement at the same time, and a copy of the executed agreement shall be given to the customer at the time of signing.**

**c) The loan brokerage agreement shall contain an explicit description of the services the licensee agrees to perform for the borrower and a good faith estimate of all consideration and remuneration to be exchanged in conjunction with such services. In the same area of the agreement shall be language, of prominence equal to or greater than such estimate, listing the**

**types of situations or conditions which could materially affect the amounts indicated due to details which could not be known by the licensee at the time of signing the loan brokerage agreement. "Examples of such situation or conditions may include, but not be limited to, an appraised value different from that estimated by the borrower or credit obligations which the borrower fails to report."**

**d) The loan brokerage agreement shall carry a clear and conspicuous statement as to the conditions under which the borrower is obligated to pay the licensee.**

**e) The loan brokerage agreement shall provide that if the licensee makes false or misleading statements in such agreement, the borrower may, upon written notice:**

**1) void the agreement;**

**2) recover monies paid to the broker for which no services have been performed; and**

**3) recover actual costs, including attorney fees for enforcing the borrower's rights under the loan brokerage agreement.**

**f) The loan brokerage agreement shall incorporate by reference the "Loan Brokerage Disclosure Statement" described in [**38 Ill.Admin. Code §1050.1020**].**

**g) Except for a Rate-Lock Fee Agreement in accordance with** [38 Ill.Admin. Code §1050.1335]**, the loan brokerage agreement shall be the only agreement between the borrower and licensee with respect to a single loan; except, the licensee shall also provide to the customer any disclosure statement necessary to comply with federal and State requirements, including but not limited to, the Consumer [**Credit Protection**] Act (15 U.S.C. 1601), Equal Credit Opportunity Act (Title VII), and Truth in Lending Act (Title I) and Consumer Fraud and Deceptive Business Practices Act.**

Another regulation, 38 Ill.Admin. Code §1050.840, provides that "[a] licensee will make a good faith effort to process and properly credit to a mortgage loan account any payment from a mortgagor on the same calendar date such payment is physically delivered, either in person or via United States Mail, at the address designated by the licensee for payments."

Section 1050.860(b) provides that "[w]ithin ten (10) business days of receipt of a written request from an entity authorized by the borrower, a licensee shall furnish a written notice of the total amount required to pay in full an outstanding mortgage loan, as of a specified date. Such payoff letter shall itemize and explain all charges included in the total figure stated."

Reports filed under the Residential Mortgage License Act of 1987 may contain useful information. For example, 38 Ill.Admin. Code §1050.630(a) requires an "Annual Report of Mortgage Activity" that must include "the number and aggregate dollar amount of application for, and the number granted and the aggregate dollar amount of, loans" broken down by residential mortgage loans, construction loans, and home improvement and rehabilitation loans and by census tract or zip code. See also 38 Ill.Admin. Code §§1050.640 and 1050.650.

Effective July 1, 2004, the Residential Mortgage License Act was amended to create a new category of regulated person, that of "loan originator," defined as "any natural person who, for compensation or in the expectation of compensation, either directly or indirectly makes, offers to make, solicits, places, or negotiates a residential mortgage loan." (205 ILCS 635/1-4(hh)). Under 205 ILCS 635/7-1, "it is unlawful for any natural person to act or assume to act as a loan originator . . . without being registered with the Commissioner unless the natural person is exempt under items (1) and (1.5) of subsection (d) of Section 1-4 of this Act. The Commissioner shall promulgate rules prescribing the criteria for the registration and regulation of loan originators, including but not limited to, qualifications, fees, examination, education, supervision, and enforcement."

### J. Illinois High Risk Home Loan Act

Illinois enacted, effective January 1, 2004, the High Risk Home Loan Act, S.B. 1784, Public Act 93-561, 815 ILCS 137/1 et seq.

1. Applicability

The Act applies to a "High risk home loan," defined as one "in which (i) at the time of origination, the annual percentage rate 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 or (ii) 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 in accordance with the Consumer Price Index. Excluded are purchase money mortgages, open end credit, and "a loan that is made primarily for a business purpose unrelated to the residential real property securing the loan". The borrower must reside in the property securing the loan. (815 ILCS 137/10)

The definition of "points and fees" is (a) the HOEPA definition, (b) plus " 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" plus (c) "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 otherwise included in 12 CFR 226.4." 815 ILCS 137/10 provides:

> **"High risk home loan" means a home equity loan in which (i) at the time of origination, the annual percentage rate 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 or (ii) 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. The $800 figure shall be adjusted annually on January 1 by the annual percentage change in the Consumer Price Index for All Urban Consumers for all items published by the United States Department of Labor. "High risk home loan" does not include a loan that is made primarily for a business purpose unrelated to the residential real property securing the loan or to an open-end credit plan subject to 12 CFR 226 (2000, no subsequent amendments or editions are included).**

### 2. Substantive prohibitions

Substantive prohibitions applicable to high risk home loans include the following:

**a. Unaffordable loans.** A prohibition on making loans that cannot be expected to be repaid except from the equity. 815 ILCS 137/15 provides:

> **Ability to repay. A creditor or broker shall not transfer, deal in, offer, or make a high risk home loan 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 to repay the obligation based upon a consideration of his or her 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 shall be presumed to be able to repay the loan if, at the time the loan is consummated, 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 (including principal, interest, taxes, insurance, and assessments) , combined with the scheduled payments for**

> **all other disclosed debts, do not exceed 50% of the borrower's monthly gross income.**

The lender is required to verify the borrower's ability to repay. (815 ILCS 137/20) This requires at a minimum:

> **(1) That the borrower prepare and submit to the lender a personal income and expense statement in a form prescribed by the state;**
>
> **(2) That the borrower's income is verified by means of tax returns, pay stubs, accounting statements, or other prudent means.**
>
> **(3) That a credit report is obtained regarding the borrower.** (815 ILCS 137/20)

**b. Good faith.** A requirement that "A lender must act in good faith in all relations with a borrower, including but not limited to, transferring, dealing in, offering, or making a high risk home loan". (815 ILCS 137/25) "Good faith" is defined as " honesty in fact in the conduct or transaction concerned." (815 ILCS 137/10)

**c. Deception.** A prohibition of "fraudulent or deceptive acts or practices in the making of a high risk home loan, including deceptive marketing and sales efforts." (815 ILCS 137/25)

**d. Prepayment penalties.** A limitation on prepayment penalties on any loan subject to the Act but not within the scope of HOEPA. 815 ILCS 137/30 provides:

> **§ 30. Prepayment penalty. For any loan that is subject to the provisions of this Act and is not subject to the provisions of the Home Ownership and Equity Protection Act of 1994, no lender shall make a high risk home loan that includes a penalty provision for payment made: (i) after the expiration of the 36-month period following the date the loan was made; or (ii) that is more than:**
>
> > **(1) 3% of the total loan amount if the prepayment is made within the first 12- month period following the date the loan was made;**
> >
> > **(2) 2% of the total loan amount if the prepayment is made within the second 12- month period following the date the loan was made; or**
> >
> > **(3) 1% of the total loan amount if the prepayment is made within**

**the third 12-month period following the date the loan was made.**

**e. Single premium insurance.** A prohibition of single premium insurance. 815 ILCS 137/40 provides:

> **Pre-paid insurance products and warranties. No lender shall transfer, deal in, offer or make a high risk home loan that finances a single premium credit life, credit disability, credit unemployment, or any other life or health insurance, directly or indirectly. Insurance calculated and paid on a monthly basis shall not be considered to be financed by the lender.**

**f. Flipping.** A prohibition on refinancing a high risk home loan with additional points and fees within a 12-month period "unless the refinancing results in a tangible net benefit to the borrower". 815 ILCS 137/45 provides:

> **Refinancing prohibited in certain cases. No lender shall refinance any high risk home loan where such refinancing charges additional points and fees within a 12-month period after the original loan agreement was signed, unless the refinancing results in a tangible net benefit to the borrower.**

**g. Financing points and fees.** A prohibition on financing points and fees in excess of 6% of the total loan amount. 815 ILCS 137/55 provides:

> **Financing of points and fees. No lender shall transfer, deal in, offer, or make a high risk home loan that finances points and fees in excess of 6% of the total loan amount.**

**h. Home improvement contractors.** A prohibition on disbursing funds on home improvement loans directly to the contractor. 815 ILCS 137/60 provides:

> **Payments to contractors. No lender shall make a payment of any proceeds of a high risk home loan directly to a contractor under a home improvement contract other than:**
>
> > **(1) by instrument payable to the borrower or payable jointly to the borrower and contractor; or**
> >
> > **(2) at the election of the borrower, by a third-party escrow agent in accordance with the terms established in a written agreement that is signed by the borrower, the lender, and the contractor before the date of payment.**

**i. Negative amortization.** A prohibition on negative amortization, except on reverse mortgages. 815 ILCS 137/65 provides:

> **Negative amortization. No lender shall transfer, deal in, offer, or make a high risk home loan, other than a loan secured only by a reverse mortgage, with terms under which the outstanding balance will increase at any time over the course of the loan because the regular periodic payments do not cover the full amount of the interest due, unless the negative amortization is the consequence of a temporary forbearance sought by the borrower.**

**j. LTV in excess of 100%.** A prohibition on making high risk home loans in excess of 100% of the value of the property. 815 ILCS 137/70 provides:

> **Negative equity. No lender shall transfer, deal in, offer, or make a high risk home loan where the loan amount exceeds the value of the property securing the loan.**

**k. Late charges.** A limitation on late payment fees. 815 ILCS 137/80 provides:

> **Late payment fee. A lender shall not transfer, deal in, offer, or make a high risk home loan that provides for a late payment fee, except under the following conditions:**
>
> > **(1) the late payment fee shall not be in excess of 5% of the amount of the payment past due;**
> >
> > **(2) the late payment fee shall only be assessed for a payment past due for 15 days or more;**
> >
> > **(3) the late payment fee shall not be imposed more than once with respect to a single late payment;**
> >
> > **(4) a late payment fee that the lender has collected shall be reimbursed if the borrower presents proof of having made a timely payment; and**
> >
> > **(5) a lender shall treat each payment as posted on the same business day as it was received by the lender, servicer, or lender's agent or at the address provided to the borrower by the lender, servicer, or lender's agent for making payments.**

**l. Payments from proceeds.** A prohibition on loan terms under which more than 2 monthly payments are paid in advance from the loan proceeds. 815 ILCS 137/85 provides:

> **Payment compounding. No lender shall transfer, deal in, offer, or make a high risk home loan that includes terms under which more than 2 periodic payments required under the loan are consolidated and paid in advance from the loan proceeds provided to the borrower.**

**m. Call provisions.** A prohibition on calling or accelerating loans except for default. 815 ILCS 137/90 provides:

> **No lender shall transfer, deal in, offer, or make a high risk home loan that contains a provision that permits the lender, in its sole discretion, to accelerate the indebtedness, provided that this provision does not prohibit acceleration of a loan in good faith due to a borrower's failure to abide by the material terms of the loan.**

**n. Credit counseling.** A notice upon default of the availability of credit counseling, plus a 30-day forbearance period that can be invoked by notice from the credit counselor. 815 ILCS 137/100 provides:

> **Counseling prior to perfecting foreclosure proceedings.**
>
> **(a) If a high risk home loan becomes delinquent by more than 30 days, the servicer shall send a notice advising the borrower that he or she may wish to seek approved credit counseling.**
>
> **(b) The notice required in subsection (a) shall, at a minimum, include the following language:**
>
>> **"YOUR LOAN IS OR WAS MORE THAN 30 DAYS PAST DUE. YOU MAY BE EXPERIENCING FINANCIAL DIFFICULTY. IT MAY BE IN YOUR BEST INTEREST TO SEEK APPROVED CREDIT COUNSELING. A LIST OF APPROVED CREDIT COUNSELORS MAY BE OBTAINED FROM EITHER THE ILLINOIS DEPARTMENT OF FINANCIAL INSTITUTIONS OR THE ILLINOIS OFFICE OF BANKS AND REAL ESTATE."**
>
> **(c) If, within 15 days after mailing the notice provided for under subsection (b), a lender, servicer, or lender's agent is notified in writing by an approved credit counselor and the approved credit counselor**

**advises the lender, servicer, or lender's agent that the borrower is seeking approved credit counseling, then the lender, servicer, or lender's agent shall not institute legal action under Part 15 of Article XV of the Code of Civil Procedure for 30 days after the date of that notice. Only one such 30-day period of forbearance is allowed under this Section per subject loan.**

**(d) If, within the 30-day period provided under subsection (c), the lender, servicer, or lender's agent, the approved credit counselor, and the borrower agree to a debt management plan, then the lender, servicer, or lender's agent shall not institute legal action under Part 15 of Article XV of the Code of Civil Procedure for as long as the debt management plan is complied with by the borrower.**

**The agreed debt management plan must be in writing and signed by the lender, servicer, or lender's agent, the approved credit counselor, and the borrower. No modification of an approved debt management plan can be made without the mutual agreement of the lender, servicer, or lender's agent, the approved credit counselor, and the borrower.**

**Upon written notice to the lender, servicer, or lender's agent, the borrower may change approved credit counselors.**

**(e) If the borrower fails to comply with the agreed debt management plan, then nothing in this Section shall be construed to impair the legal right of the lender, servicer, or lender's agent to enforce the contract.**

**o. A special right to cure.** Thirty days' advance notice must be provided before institution of foreclosure. Attorney's fees may not be assessed against the borrower until the conclusion of the 30 day period. The lender or assignee must accept any partial payment made or tendered in response to the notice. At any time prior to the transfer of title by foreclosure, the borrower may reinstate by tendering the missing payments plus attorney's fees, which must be justified on a "lodestar" basis. Attorney's fees are limited to $100 prior to the actual filing of a foreclosure. 815 ILCS 137/105 provides:

**Right to cure.**

**(a) Before an action is filed to foreclose or collect money due pursuant to a high risk home loan or before other action is taken to seize or transfer ownership of property subject to a high risk home loan, the lender or lender's assignee of the loan shall deliver to the borrower a notice of the right to cure the default, informing the borrower of all of the following:**

**(1) The nature of the default.**

**(2) The borrower's right to cure the default by paying the sum of money required, provided that a lender or assignee shall accept any partial payment made or tendered in response to the notice. If the amount necessary to cure the default will change within 30 days of the notice due to the application of a daily interest rate or the addition of late fees, as allowed by the Act, the notice shall give sufficient information to enable the borrower to calculate the amount at any point within the 30-day period.**

**(3) The date by which the borrower may cure the default to avoid a court action, acceleration and initiation of foreclosure, or other action to seize the property, which date shall not be less than 30 days after the date the notice is delivered, and the name, address, and telephone number of a person to whom the payment or tender shall be made.**

**(4) That if the borrower does not cure the default by the date specified, the lender or assignee may file an action for money due or take steps to terminate the borrower's ownership in the property by requiring payment in full of the high risk home loan and commencing a foreclosure proceeding or other action to seize the property.**

**(5) The name, address, and telephone number of a person whom the borrower may contact if the borrower disagrees with the assertion that a default has occurred or the correctness of the calculation of the amount required to cure the default.**

**(b) If a lender or assignee asserts that grounds for acceleration exist and requires the payment in full of all sums secured by the high risk home loan, the borrower or anyone authorized to act on the borrower's behalf may, at any time before the title is transferred by means of foreclosure, by judicial proceeding and sale, or other means, cure the default, and reinstate the high risk home loan. Cure of the default shall reinstate the borrower to the same position as if the default had not occurred and shall nullify, as of the date of the cure, an acceleration of any obligation under the high risk home loan arising from the default.**

**(c) To cure a default under this Section, a borrower shall not be required to pay any charge, fee, or penalty attributable to the exercise of the right to cure a default, other than the fees specifically allowed by this subsection. The borrower shall not be liable for any attorney fees relating to the default that are incurred by the lender or assignee prior to or during the 30-day period set forth in subsection (a) of this Section, nor for**

**any such fees in excess of $100 that are incurred by the lender or assignee after the expiration of the 30-day period but before the lender or assignee files a foreclosure or other judicial action or takes other action to seize or transfer ownership of the real estate. After the lender or assignee files a foreclosure or other judicial action or takes other action to seize or transfer ownership of the real estate, the borrower shall only be liable for attorney fees that are reasonable and actually incurred by the lender or assignee, based on a reasonable hourly rate and a reasonable number of hours.**

**(d) If a default is cured prior to the initiation of any action to foreclose or to seize the residence, the lender or assignee shall not institute a proceeding or other action for that default. If a default is cured after the initiation of any action, the lender or assignee shall take such steps as are necessary to terminate the action.**

**(e) A lender or a lender's assignee of a high risk home loan that has the legal right to foreclose shall use the judicial foreclosure procedures provided by law. In such a proceeding, the borrower may assert the nonexistence of a default and any other claim or defense to acceleration and foreclosure, including any claim or defense based on a violation of the Act, though no such claim or defense shall be deemed a compulsory counterclaim.**

**p. Arbitration.** Prohibition of a mandatory arbitration provision of a high risk home loan agreement "that is oppressive, unfair, unconscionable, or substantially in derogation of the rights of the borrower" (815 ILCS 137/130)

**3. Disclosures.** Special disclosure requirements are also imposed on high risk home loans, including a disclosure three days prior to the closing that states:

YOU SHOULD BE AWARE THAT YOU MIGHT BE ABLE TO OBTAIN A LOAN AT A LOWER COST. YOU SHOULD SHOP AROUND AND COMPARE LOAN RATES AND FEES. LOAN RATES AND CLOSING COSTS AND FEES VARY BASED ON MANY FACTORS, INCLUDING YOUR PARTICULAR CREDIT AND FINANCIAL CIRCUMSTANCES, YOUR EMPLOYMENT HISTORY, THE LOAN-TO-VALUE REQUESTED, AND THE TYPE OF PROPERTY THAT WILL SECURE YOUR LOAN. THE LOAN RATE AND FEES COULD ALSO VARY BASED ON WHICH LENDER OR BROKER YOU SELECT. IF YOU ACCEPT THE TERMS OF THIS LOAN, THE LENDER WILL HAVE A MORTGAGE LIEN ON YOUR HOME. YOU COULD LOSE YOUR HOME AND ANY MONEY YOU PUT INTO IT IF YOU DO NOT MEET YOUR

PAYMENT OBLIGATIONS UNDER THE LOAN. YOU SHOULD CONSULT AN ATTORNEY-AT-LAW AND AN APPROVED CREDIT COUNSELOR OR OTHER EXPERIENCED FINANCIAL ADVISOR REGARDING THE RATE, FEES, AND PROVISIONS OF THIS LOAN BEFORE YOU PROCEED. A LIST OF APPROVED CREDIT COUNSELORS IS AVAILABLE BY CONTACTING EITHER THE ILLINOIS DEPARTMENT OF FINANCIAL INSTITUTIONS OR THE ILLINOIS OFFICE OF BANKS AND REAL ESTATE. YOU ARE NOT REQUIRED TO COMPLETE THIS LOAN AGREEMENT MERELY BECAUSE YOU HAVE RECEIVED THIS DISCLOSURE OR HAVE SIGNED A LOAN APPLICATION. ALSO, YOUR PAYMENTS ON EXISTING DEBTS CONTRIBUTE TO YOUR CREDIT RATINGS. YOU SHOULD NOT ACCEPT ANY ADVICE TO IGNORE YOUR REGULAR PAYMENTS TO YOUR EXISTING LENDERS.

(815 ILCS 137/95)

**4. Notice of a Mortgage Awareness Program** to be administered by OBRE and DFI. (815 ILCS 137/110)

**5. Reporting of default rates.** Servicers must report default and foreclosure rates on conventional loans twice each year. (815 ILCS 137/115)

**6. Remedies.** A civil remedies provision (815 ILCS 137/135) provides that any "knowing" violation of the Act is a violation of the Consumer Fraud Act, that provisions of agreements that violate the Act are unenforceable, and limited liability for assignees:

**(a) The remedies provided in this Act are cumulative and apply to persons or entities subject to this Act.**

**(b) Any knowing violation of this Act constitutes a violation of the Consumer Fraud and Deceptive Business Practices Act.**

**(c) If any provision of an agreement for a high risk home loan violates this Act, then that provision is unenforceable against the borrower.**

The assignee liability provision, 815 ILCS 137/135(d), states:

**(1) Any natural or artificial person who purchases or otherwise is assigned or subsequently holds a high risk home loan shall be subject to all affirmative claims and defenses with respect to the loan that the borrower could assert against the lender or broker of the loan, provided**

**that this item (d)(1) shall not apply if the purchaser, assignee or holder demonstrates by a preponderance of the evidence that it:**

> **(A) has in place, at the time of the purchase, assignment or transfer of the loans, policies that expressly prohibit its purchase, acceptance of assignment or holding of any high risk home loans;**
>
> **(B) requires by contract that a seller, assignor or transferor of high risk home loans to the purchaser, assignee or transferee represents and warrants to the purchaser, assignee or transferee that either (i) the seller, assignor or transferor will not sell, assign or transfer any high risk home loans to the purchaser, assignee or transferee, or (ii) the seller, assignor or transferor is a beneficiary of a representation and warranty from a previous seller, assignor or transferor to that effect; and**
>
> **(C) exercises reasonable due diligence at the time of the purchase, assignment or transfer of high risk home loans, or within a reasonable period of time after the purchase, assignment or transfer of such home loans, which is intended by the purchaser, assignee or transferee to prevent the purchaser, assignee or transferee from purchasing or taking assignment or otherwise holding any high risk home loans, provided that this reasonable due diligence requirement may be met by sampling and need not require loan-by-loan review.**

**(2) Limited to the amount required to reduce or extinguish the borrower's liability under the high cost home loan plus the amount required to recover costs, including reasonable attorney fees. A borrower acting only in an individual capacity may assert claims that the borrower could assert against a lender of the home loan against a subsequent holder or assignee of the home loan as follows:**

> **(A) within 5 years of the closing date of a high risk home loan, a violation of this Act in connection with the loan as an original action; and**
>
> **(B) at any time during the term of a high risk home loan, after an action to collect on the home loan or to foreclose on the collateral securing the home loan has been initiated, or the debt arising from the home loan has been accelerated, or the home loan has become 60 days in default, any defense, claim, counterclaim or action to enjoin foreclosure or preserve or obtain possession of the home that secures the loan.**

**(e) In addition to the limitation of liability afforded to subsequent purchasers, assignees, or holders under subsection (d) of this Section, a lender and a subsequent purchaser, assignee, or holder of the high risk home loan is not liable for a violation of this Act if:**

**(1) within 30 days of the loan closing and prior to receiving any notice from the borrower of the violation, the lender has made appropriate restitution to the borrower and appropriate adjustments are made to the loan; or**

**(2) the violation was not intentional and resulted from a bona fide error in fact, notwithstanding the maintenance of procedures reasonably adopted to avoid such errors, and within 60 days of the discovery of the violation and prior to receiving any notice from the borrower of the violation, the borrower is notified of the violation, appropriate restitution is made to the borrower, and appropriate adjustments are made to the loan.**

This provision may actually restrict the common-law exposure of assignees of residential mortgages. See below.

The Act replaces the prior rules. (815 ILCS 137/150)

Except for participation in the Mortgage Awareness Act, waiver is prohibited. (815 ILCS 137/165)

815 ILCS 137/170 provides that "To the extent this Act conflicts with any other Illinois State financial regulation laws, except the Interest Act, this Act is superior and supersedes those laws for the purposes of regulating high risk home loans in Illinois."

### K. Prior regulations.

The High Risk Home Loan Act replaced regulations that had been issued, effective May 17, 2001,by the Office of Banks and Real Estate (OBRE) pursuant to the Illinois Residential Mortgage License Act as well as under the statutes regulating credit unions and state chartered banks and thrifts to issue new predatory mortgage regulations. 38 Ill.Admin. Code Part 345. Identical regulations were issued by the Department of Financial Institutions (DFI) under the Consumer Installment Loan Act (CILA), 205 ILCS 670/1, *et seq.,* and Sales Finance Agency Act, 205 ILCS 660/1, *et seq.*

The regulations were challenged as preempted by the Alternative Mortgage Transactions Parity Act of 1982, 12 U.S.C. §3801, *et seq.* The District Court rejected the challenge (*Illinois Association of Mortgage Brokers v. Office of Banks & Real Estate,* 174 F.Supp.2d 815 (N.D.Ill. 2001)), but a panel of the Seventh Circuit reversed (308 F.3d 762 (7th

Cir. 2002)).

Neither the regulations nor the Residential Mortgage License Act contained an express private right of action. However, OBRE and the DFI have stated that a private right of action should be implied. See Topoluk, *Predatory Lending: Illinois and Minnesota Developments,* 55 Consumer Fin.L.Q. 86 (2001). In any event, the CILA does have a private right of action. Violations should in any event be cognizable under the Consumer Fraud and Deceptive Business Practices Act.

### 1. Applicability

The Illinois regulations expanded on the "triggers" of the Home Ownership and Equity Protection Act of 1994. 38 Ill.Admin. Code §345.10. Illinois defines "points and fees" to mean (a) "all items required to be disclosed as points and fees under 12 CFR 226.32," plus (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," and plus (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 otherwise included in 12 CFR 226.4." *Id.* The latter includes yield spread premiums.

Illinois then defined a "[h]igh risk home loan on residential real property" as

> **a home equity loan in which:**
>
> **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; or**
>
> **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. The $800 figure shall be adjusted annually on January 1 by the annual percentage change in the Consumer Price Index.** *Id.*

The U.S. Treasury yields were at about six percent in early April 2002. Any loan with an interest rate above 11 percent should be analyzed as to whether the rate "trigger" is met.

The regulations exclude "a loan that is made primarily for a business purpose unrelated to the residential real property securing the loan or to an open-end credit plan subject to 12 CFR 226" and purchase money loans. *Id.*

### 2. Prohibitions

Among the prohibitions to which "subject loans" were subject under the regulation were the following:

**a. Repayment ability.** 38 Ill.Admin. Code §345.20 provided the following:

> **A lender shall not make a high risk home loan if the lender does not believe at the time the loan is consummated that the borrower or borrowers 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 shall be presumed to be able to repay the loan if, at the time the loan is consummated, 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 (including principal, interest, taxes, insurance and assessments), combined with the scheduled payments for all other disclosed debts, do not exceed 50% of the borrower's monthly gross income.**

The lender is required to verify the borrower's ability to repay the loan. Minimum verification requirements include the following:

> **(a) The borrower prepares and submits to the lender a personal income and expense statement in a form prescribed by the Commissioner. . .**
>
> **(b) Income is verified by means of tax returns, pay stubs, accounting statements or other prudent means.**
>
> **(c) A credit report is obtained regarding the borrower.** 38 Ill.Admin. Code §345.30.

**b. Prohibition of deceptive practices.** 38 Ill.Admin. Code §345.40 provides that "[n]o lender shall employ fraudulent or deceptive acts or practices in the making of a high risk home loan, including deceptive marketing and sales efforts."

**c. Prepayment penalties.** 38 Ill.Admin. Code §345.45 limits prepayment penalties as follows:

**No lender shall make a high risk home loan that includes a penalty provision for payment made:**

**(a) after the expiration of the 36 month period following the date the loan was made; or**

**(b) that is more than:**

**(1) 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**

**(2) 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**

**(3) 1% of the total loan amount, if the prepayment is made within the third 12 month period following the date the loan was made.**

**d. Single premium insurance.** 38 Ill.Admin. Code §345.50 prohibits financing of single premium insurance:

**No lender shall make a high risk home loan that finances a single premium credit life, credit disability, credit unemployment, or any other life or health insurance, directly or indirectly. Insurance calculated and paid on a monthly basis shall not be considered to be financed by the lender.**

**e. Flipping.** 38 Ill.Admin. Code §345.60 limits refinancing:

**No lender shall refinance any high risk home loan, where such refinancing charges additional points and fees, within a 12 month period after the original loan agreement was signed, unless the refinancing results in a financial benefit to the borrower.**

**f. Balloon payments.** 38 Ill.Admin. Code §345.65 limits balloon payments:

**No lender shall make a high risk home loan that contains a scheduled final payment that is more than twice as large as the average of earlier scheduled monthly payments unless such balloon payment becomes due and payable at least 15 years after the loan's origination. This prohibition**

**does not apply when the payment schedule is adjusted to account for the seasonal or irregular income of the borrower or if the purpose of the loan is a "bridge" loan connected with the acquisition or construction of a dwelling intended to become the borrower's principal dwelling.**

**g. Financing of points and fees.** 38 Ill.Admin. Code §345.70 limits financing of points and fees:

**No lender shall make a high risk home loan that finances points and fees in excess of 6% of the total loan amount.**

**h. Disbursements to home improvement contractors.** 38 Ill.Admin. Code §345.80 limits payments to home improvement contractors:

**No lender shall make a payment of any proceeds of a high risk home loan to a contractor under a home improvement contract other than:**

**(a) by instrument payable to the borrower or jointly to the borrower and the contractor; or**

**(b) at the election of the borrower, by a third party escrow agent in accordance with the terms established in a written agreement signed by the borrower, the lender, and the contractor before the date of payment.**

**i. Negative amortization.** 38 Ill.Admin. Code §345.90 prohibits negative amortization:

**No lender shall make a high risk home loan, other than a loan secured only by a reverse mortgage, with terms under which the outstanding balance will increase at any time over the course of the loan because the regular periodic payments do not cover the full amount of the interest due, unless the negative amortization is the consequence of a temporary forbearance sought by the borrower.**

**j. High LTV loans**. 38 Ill.Admin. Code §345.100 prohibits loans with a loan-to-value ratio in excess of 100 percent:

**No lender shall make 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.**

**k. Foreclosure counseling.** 38 Ill.Admin. Code §345.110 requires counseling prior to foreclosure proceedings:

**(a) In the event that a high risk home loan becomes delinquent by more than 30 days, the servicer shall send a notice advising the borrower that he or she may wish to seek consumer credit counseling.**

**(b) The notice required in subsection (a) shall, at a minimum, include the following language:**

> **"YOUR LOAN IS OR WAS MORE THAN 30 DAYS PAST DUE. YOU MAY BE EXPERIENCING FINANCIAL DIFFICULTY. IT MAY BE IN YOUR BEST INTEREST TO SEEK APPROVED CONSUMER CREDIT COUNSELING. A LIST OF APPROVED CREDIT COUNSELORS MAY BE OBTAINED FROM THE ILLINOIS OFFICE OF BANKS AND REAL ESTATE."**

**(c) If, within 15 days after mailing the notice provided for under subsection (b), a lender or its agent is notified in writing by an approved consumer credit counselor and the approved consumer credit counselor advises the lender or its agent that the borrower is seeking approved consumer credit counseling, then the lender and its agent shall not institute legal action under Part 15 of Article XV of the Code of Civil Procedure for 30 days from the date of that notice. Only one such 30-day period of forbearance is allowed under this Section per subject loan.**

**(d) If, within the 30-day period provided under subsection (c), the lender or its agent, the approved consumer credit counselor, and the borrower agree to a debt management plan, then the lender and its agent shall not institute legal action under Part 15 of Article XV of the Code of Civil Procedure for so long as the debt management plan is complied with by the borrower.**

> **(1) The agreed debt management plan must be in writing and signed by the lender or its agent, the approved consumer credit counselor, and the borrower. No modification of an approved debt management plan can be made without the mutual agreement of the lender or its agent, the approved consumer credit counselor, and the borrower.**
>
> **(2) Upon written notice to the lender or its agent, the borrower may change approved consumer credit counselors.**

**(e) If the borrower fails to comply with the agreed debt management plan, then nothing in this Subpart shall be construed to impair the legal right of the lender or its agent to enforce contracts or mortgage agreements.**

**(f) This Section applies only to high risk home loans as defined by [**38 Ill.Admin. Code §345.10**].**

**L. County and City Ordinances**

There are Cook County and City of Chicago ordinances that define predatory lending and provide that the county and city will not deposit money into institutions engaged in predatory lending practices. The Cook County Predatory Lending Ordinance may be found at www.cookctyclerk.com/agendas/2001/041701/orddoc.htm, and the City of Chicago ordinance is Chicago Municipal Code §2-32-455. Neither ordinance has a private right of action.

**M. Interest Act**

Under the Interest Act, 815 ILCS 205/0.01, *et seq.,* Illinois no longer imposes any rate limitation on mortgage loans. 815 ILCS 205/4. However, the Interest Act does contain several provisions regulating terms of mortgage loans.

**1.** The Interest Act contained a provision that points are limited to three if the stated interest rate (not the annual percentage rate) exceeds eight percent. 815 ILCS 205/4.1a(f). However, the Illinois Supreme Court has declared that it is ineffective. *United States Bank Nat'l Ass'n v. Clark*, No. 98379, 2005 Ill. LEXIS 961 (Sept. 22, 2005), reversing *U.S. Bank Nat. Ass'n v. Clark,* 807 N.E.2d 1109 (Ill.App. 1st Dist. Mar 31, 2004), and disapproving *Fidelity Financial Services, Inc. v. Hicks,* 214 Ill.App.3d 398, 574 N.E.2d 15, 158 Ill.Dec. 221 (1st Dist. 1991).

**2.** Until 2008, prepayment penalties are prohibited if the stated interest rate exceeds eight percent. 815 ILCS 205/4(2)(a). Effective January 1, 2008, amendments made by S.B. 1167 require that lenders and brokers quote loans with and without prepayment penalties, disclose the rate reduction that results from accepting a prepayment penalty, and limit the prepayment penalty to 3% during the first year, 2% during the second, and 1% during the third.

**3.** Late charges are limited to five percent of the outstanding payment. 815 ILCS 205/4.1a(f).

**4.** Interest may not be charged for any period after the total indebtedness if it is paid in full. 815 ILCS 205/4(3).

**5.** The charging and collecting of contractually unauthorized interest may violate the Interest Act. 815 ILCS 205/5.

**6.** The Interest Act also contains provisions authorizing home equity plans, which must exceed $5,000 before a mortgage may be obtained. 815 ILCS 205/4.2, 205/4.3. This limits transaction and annual fees and closing costs.

**7.** An alternative scheme authorizing home equity plans is provided by the Illinois Financial Services Development Act, 205 ILCS 675/1, *et seq.* These plans may be used by any bank, savings and loan association, savings bank, or credit union that has an Illinois home office or branch, and any licensee under the Consumer Installment Loan Act or the Sales Finance Agency Act. 205 ILCS 675/4. It authorizes more charges and fees than the Interest Act. 205 ILCS 675/6.

**8.** There are also provisions dealing with home equity plan terms in the Illinois Banking Act, 205 ILCS 5/1, *et seq.,* the Illinois Credit Union Act, 205 ILCS 305/1, *et seq.,* and the Illinois Savings and Loan Act of 1985, 205 ILCS 105/1-1, *et seq.,* governing home equity plans issued by the listed types of institutions. See 205 ILCS 5/5d, 305/46(2), 105/1-6b.

**9.** The Interest Act provides stiff penalties for violation, coupled with a good-faith defense. 815 ILCS 205/6.

**10.** An assignment of a beneficial interest in a land trust may or may not qualify as a mortgage loan within the Interest Act provisions eliminating rate caps on mortgage loans.

**11.** There is extensive federal preemption of the above provisions, the exact extent of which is unclear.

**a.** The Alternative Mortgage Transactions Parity Act, 12 U.S.C. §§3801 et seq. ("AMTPA"), and implementing OTS regulations may authorize the prepayment penalties with respect to ARMs and balloon loans. *Illinois Association of Mortgage Brokers v. Office of Banks & Real Estate,* 308 F.3d 762 (7th Cir. 2002); *Reed v. World Wide Financial Services, Inc.,* No. 98 C 4294, 1998 U.S.Dist. LEXIS 19452 (N.D.Ill. Nov. 25, 1998); *Gora v. Banc One Financial Services, Inc.,* No. 95 C 2542, 1995 U.S.Dist. LEXIS 15232 (N.D.Ill. Oct. 11, 1995).

The OTS regulations do impose certain conditions, one of which is that in the case of adjustable rate loans, variable rate program disclosures be furnished when an application form is furnished or when a nonrefundable fee is paid by the consumer, whichever comes first. 12 C.F.R. §560.210. Occasionally, this is not complied with, particularly when brokers try to "bait and switch" the borrower. *See McCarthy v. Option One Mortgage Corp.,* No. 01 C 3935, 2001 U.S.Dist. LEXIS 22711 (N.D.Ill. Feb. 11, 2001).

**b.** The National Bank Act and Office of the Comptroller of the Currency (OCC) regulations may also preempt some state regulation in this area. See 12 U.S.C. §§85, 86, 371; 12 C.F.R. Parts 7, 34. For example, OCC regulations define late fees as "interest" within the meaning of the National Bank Act. 12 C.F.R. §7.4001(a). A national bank may generally "export" rates and charges considered to be "interest" from its home state into any state in which it does business. *Smiley v. Citibank (South Dakota), N.A.,* 517 U.S. 735, 135 L.Ed.2d 25, 116 S.Ct. 1730 (1996).

## N. Consumer Installment Loan Act and Department of Financial Institutions Regulations, 38 Ill.Admin. Code, Part 110

The Consumer Installment Loan Act (CILA), 205 ILCS 670/1, *et seq.,* provides for licensing of consumer lenders making loans up to $25,000, including loans secured by real estate. 205 ILCS 670/1. There no longer are any restrictions on the rate of interest that may be charged, as 205 ILCS 670/15(a) states that a licensee "may charge, contract for and receive thereon interest at the rate agreed upon by the licensee and the borrower, subject to the provisions of this Act." Loans may be either interest-bearing or pre-computed. 205 ILCS 670/15(c).

Section 15(e)(4) of CILA authorizes late charges on each installment in default for a period of not less than ten days in an amount not exceeding five percent of the installment on installments in excess of $200, or $10 on installments of $200 or less, but only one delinquency or collection charge may be collected on any installment regardless of the period during which it remains in default.

205 ILCS 670/15d provides the following:

> **No amount in addition to the charges authorized by this Act shall be directly or indirectly charged, contracted for, or received, except (1) lawful fees paid to any public officer or agency to record, file or release security; (2) (i) costs and disbursements actually incurred in connection with a real estate loan, for any title insurance, title examination, abstract of title, survey, or appraisal, or paid to a trustee in connection with a trust deed, and (ii) in connection with a real estate loan those charges authorized by [815 ILCS 205/4.1a], whether called "points" or otherwise, which charges are imposed as a condition for making the loan and are not refundable in the event of prepayment of the loan; (3) costs and disbursements, including reasonable attorney's fees, incurred in legal proceedings to collect a loan or to realize on a security after default; (4) an amount not exceeding $25, plus any actual expenses incurred in connection with a check or draft that is not honored because of insufficient or uncollected funds or because no such account exists; and (5) a document preparation fee not to exceed $25 for obtaining and reviewing credit reports and preparation of other documents.**

Other charges authorized in other sections include interest, late charges, and premiums for credit and property insurance and "insurance in lieu of perfecting a security interest provided that the premiums for such insurance do not exceed the fees that otherwise could be contracted for by the licensee under this Section." *Id.*

CILA imposes certain disclosure requirements, but provides that "[a] licensee who complies with the federal Truth in Lending Act, amendments thereto, and any regulations issued or which may be issued thereunder, shall be deemed to be in compliance with the provisions of this Section." 205 ILCS 670/16.

Section 16b of CILA prohibits security interests in real estate if the principal amount is $3,000 or less.

Section 18 prohibits "false, misleading or deceptive" advertising and advertising that quotes rates other than as an annual percentage rate.

Sections 20(b) and 20.7 provide a cause of action for violations of 205 ILCS 670/1, 670/12, 670/15, 670/15a, 670/15b, 670/15d, 670/15e, 670/16, 670/17, 670/18, or 670/19.1.

### O. Fiduciary Liability of Mortgage Broker

One who undertakes to find and arrange financing or similar products for another becomes the latter's agent for that purpose and owes statutory, contractual, and fiduciary duties to act in the interest of the principal and make full disclosure of all material facts. "A person who undertakes to manage some affair for another, on the authority and for the account of the latter, who is called the principal, is an agent." *In re Estate of Morys,* 17 Ill.App.3d 6, 307 N.E.2d 669, 671 (1st Dist. 1973).

A mortgage loan broker is an agent procured by the borrower to obtain a loan. *Wyatt v. Union Mortgage Co.,* 24 Cal.3d 773, 782, 598 P.2d 45 (1979) (mortgage broker owes fiduciary duty of " 'highest good faith toward his principal,' " the prospective borrower, and "is 'charged with the duty of fullest disclosure of all material facts concerning the transaction that might affect the principal's decision,' " quoting *Batson v. Strehlow,* 68 Cal.2d 662, 675, 441 P.2d 101 (1968), and *Rattray v. Scudder,* 28 Cal.2d 214, 223, 169 P.2d 371 (1946)). *Accord Allabastro v. Cummins,* 90 Ill.App.3d 394, 413 N.E.2d 86, 45 Ill.Dec. 753 (1st Dist. 1980); *Phillips v. Dukes (In re Dukes),* 24 B.R. 404, 412 (Bankr. E.D.Mich. 1982) ("the fiduciary . . . failed to provide the borrower-principal with any sort of estimate as to the ultimate charges until a matter of minutes before the borrower was to enter into the loan agreement"); *Community Federal Savings v. Reynolds,* No. 87 C 4948, 1989 U.S.Dist. LEXIS 10115 (N.D.Ill. Aug. 18, 1989); *First City Mortgage Co. v. Gillis,* 694 S.W.2d 144, 147 (Tex.App. 1985) (requirement of fiduciary duty forbids conduct on part of broker that is fraudulent or adverse to principal's interest and also imposes duty of full disclosure of facts

material to principal); *Russell v. Fidelity Consumer Discount Co. (In re Russell),* 72 B.R. 855 (Bankr. E.D.Pa 1987); *Langer v. Haber Mortgages, Ltd.* (N.Y.Sup.), N.Y.L.J., p. 21 (Aug. 2, 1995).

In Illinois, effective January 1, 2008, amendments to the Residential Mortgage License Act made by S.B. 1167, require that brokers act with good faith and in the best interests of borrowers, effectively imposing by statute a fiduciary duty. A private right of action is available.

Many predatory practices of mortgage brokers, including, particularly, the receipt of yield spread premiums, are arguably violations of fiduciary duty. Other promising candidates include repetitive refinancings of little or no benefit to the borrower. Note that if the mortgage lender is on notice of the breach or induces it through the payment of a yield spread premium, the taint may extend to the lender.

### P. Equitable Defenses in Mortgage Foreclosures

Illinois recognizes equitable defenses such as unclean hands in a mortgage foreclosure, but the equities have to arise out of the transaction that gave rise to the note and mortgage. *Northern Trust Co. v. Halas,* 257 Ill.App.3d 565, 629 N.E.2d 158, 195 Ill.Dec. 850 (1st Dist. 1993); *State Bank of Geneva v. Sorenson,* 167 Ill.App.3d 674, 521 N.E.2d 587, 118 Ill.Dec. 305 (2d Dist. 1988). Conduct that makes the loan unaffordable, such as payment of yield spread premiums, may constitute a valid defense.

Unless expressly disclaimed, every contract in Illinois includes an implied obligation of good faith and fair dealing. *Falk v. Northern Trust Co.,* 327 Ill.App.3d 101, 763 N.E.2d 380, 261 Ill.Dec. 410 (1st Dist. 2001). While this covenant does not override express contract provisions, it limits the exercise of discretion by a party to avoid unfair surprise and oppression. *Chemical Bank v. Paul,* 244 Ill.App.3d 772, 614 N.E.2d 436, 185 Ill.Dec. 302 (1st Dist. 1993). It may be of particular relevance to lender practices relating to the allocation of payments and escrow deposit requirements.

### Q. Unconscionability

Outrageous interest rates have been found to be unconscionable by several courts. *Brown v. C.I.L., Inc.,* 1996 U.S.Dist. LEXIS 4053 (Mar. 29, 1996), *adopting* No. 94 C 1479, 1996 U.S.Dist. LEXIS 4917 (N.D.Ill. Jan. 28, 1996) (motion to dismiss denied); *Cobb v. Monarch Financial Corp.,* 913 F.Supp. 1164 (1995), *summary judgment granted in part, denied in part,* 1996 U.S.Dist. LEXIS 2814 (Mar. 8, 1996), *motion to reconsider denied,* 1996 U.S.Dist. LEXIS 7776 (June 6, 1996), *motion to enforce settlement denied,* No. 95 C 1007, 1997 U.S.Dist. LEXIS 754 (N.D.Ill. Jan. 27, 1997); *Carboni v. Arrospide,* 2 Cal.Rptr.2d 845 (App. 1991) (200 percent).

### R. Illinois Fairness in Lending Act

Effective January 1, 2004, the Illinois Fairness in Lending Act was amended to add prohibitions against "equity stripping" and "loan flipping." 815 ILCS 120/3.

"Equity stripping" is defined (815 ILCS 120/2) to "assist a person in obtaining a loan secured by the person's principal residence for the primary purpose of receiving fees related to the financing when (i) the loan decreased the person's equity in the principal residence and (ii) at the time the loan is made, the financial institution does not reasonably believe that the person will be able to make the scheduled payments to repay the loan.

"Loan flipping" is defined (815 ILCS 120/2) to "assist a person in refinancing a loan secured by the person's principal residence for the primary purpose of receiving fees related to the refinancing when (i) the refinancing of the loan results in no tangible benefit to the person and (ii) at the time the loan is made, the financial institution does not reasonably believe that the refinancing of the loan will result in a tangible benefit to the person."

The only remedy provided (815 ILCS 120/5) is an individual action for actual damages. Attorneys fees are not provided for. Furthermore, under 815 ILCS 120/5(b)), "If the same events or circumstances would constitute the basis for an action under this Act or an action under any other Act, the aggrieved person may elect between the remedies proposed by the two Acts but may not bring actions, either administrative or judicial, under more than one of the two Acts in relation to those same events or circumstances."

## VIII. LIABILITY OF ASSIGNEES AND HOLDERS

In many cases, the foreclosure defense lawyer will be attempting to assert claims arising from the origination of the loan against a later holder or assignee of the loan.

### A. FTC "Holder" Rule

In 1976, the Federal Trade Commission (FTC) promulgated 16 C.F.R. Part 433, intended to address the problem of consumer liability to financial institutions that finance the purchase of defective goods. As explained in the FTC's Staff Guidelines on Trade Regulation Rule Concerning Preservation of Consumers' Claims and Defenses, the purpose of the regulation was to make it impossible "for a seller to arrange credit terms for buyers which separate the consumer's legal duty to pay from the seller's legal duty to keep his promises." Prior to the regulation, this could be accomplished in three ways: (1) "[T]he seller may execute a credit contract with a buyer which contains a promissory note," which was then negotiated to a financing institution. (2) "[T]he seller may incorporate a written provision called a 'waiver of defenses' in the text of an installment sales agreement" and then assign the agreement to a financing institution. (3) "[A] seller may arrange a direct loan for his buyer" from the financing institution. *Id.*

The FTC regulation "is directed at all three of the above situations." Seller-

arranged direct loans were expressly included because "[i]n jurisdictions where efforts have been made to curtail the use of promissory notes and waivers of defenses, the Commission documented a significant increase in the use of arranged loans to accomplish the same end." *Id.*

The FTC regulation has two parts. The first part, 16 C.F.R. §433.2(a), applies to situations (1) and (2) above, in which the seller and the consumer enter into an obligation that is then assigned or transferred to a financing institution. In these situations, the FTC regulation eliminates holder-in-due-course status for the financing institution by requiring that the contract contain the following statement:

> **ANY HOLDER OF THIS CONSUMER CREDIT CONTRACT IS SUBJECT TO ALL CLAIMS AND DEFENSES WHICH THE DEBTOR COULD ASSERT AGAINST THE SELLER OF GOODS OR SERVICES OBTAINED PURSUANT HERETO OR WITH THE PROCEEDS HEREOF. RECOVERY HEREUNDER BY THE DEBTOR SHALL NOT EXCEED AMOUNTS PAID BY THE DEBTOR HEREUNDER.**

The second part of the regulation, 16 C.F.R. §433.2(b), applies to situation (3) above, in which the seller refers the consumer to a lender that proceeds to enter into a loan agreement with the consumer. Section 433.2(b) is triggered when a "creditor" makes a cash advance to a consumer that the consumer applies, "in whole or substantial part, to a purchase of goods or services from a seller who (1) refers consumers to the creditor or (2) is affiliated with the creditor by common control, contract, or business arrangement." 16 C.F.R. §433.1(d). Section 433.2(b) requires that "any consumer credit contract made in connection with such purchase money loan" (*i.e.,* the contract between the consumer and the lender) contain the following notice:

> **ANY HOLDER OF THIS CONSUMER CREDIT CONTRACT IS SUBJECT TO ALL CLAIMS AND DEFENSES WHICH THE DEBTOR COULD ASSERT AGAINST THE SELLER OF GOODS OR SERVICES OBTAINED WITH THE PROCEEDS HEREOF. RECOVERY HEREUNDER BY THE DEBTOR SHALL NOT EXCEED AMOUNTS PAID BY THE DEBTOR HEREUNDER.**

The Seventh and Eleventh Circuits and the Illinois Supreme Court have held that the FTC required notice does not overcome the limitation on assignee liability in the Truth in Lending Act, 15 U.S.C. §1641. *Walker v. Wallace Auto Sales, Inc.,* 155 F.3d 927 (7th Cir. 1998); *Ellis v. General Motors Acceptance Corp.,* 160 F.3d 703 (11th Cir. 1998); *Jackson v. South Holland Dodge, Inc.,* 197 Ill.2d 39, 755 N.E.2d 462, 258 Ill.Dec. 79 (2001). The Illinois Supreme Court has held that it applies only if the consumer could claim rescission or revocation of acceptance. *Jackson, supra.*

## B. Truth in Lending Act

### 1. Rescission

Any consumer who has the right to rescind a mortgage loan under the Truth in Lending Act can rescind against any transferee of the loan. 15 U.S.C. §1641(c) provides the following:

> **Any consumer who has the right to rescind a transaction under [15 U.S.C. §1635] may rescind the transaction as against any assignee of the obligation.**

### 2. HOEPA Loans

The transferee of a loan under the Home Ownership and Equity Protection Act of 1994 has limited damage liability as well. 15 U.S.C. §1641(d) provides the following:

> **(1) In General Any person who purchases or is otherwise assigned a mortgage referred to in [**15 U.S.C. §1602(aa)**] shall be subject to all claims and defenses with respect to that mortgage that the consumer could assert against the creditor of the mortgage, unless the purchaser or assignee demonstrates, by a preponderance of the evidence, that a reasonable person exercising ordinary due diligence, could not determine, based on the documentation required by this title, the itemization of the amount financed, and other disclosure of disbursements that the mortgage was a mortgage referred to in [**§1602(aa)**]. The preceding sentence does not affect rights of a consumer under subsection (a), (b), or (c) of this section or any other provision of this title.**
>
> **(2) Limitation on damages Notwithstanding any other provision of law, relief provided as a result of any action made permissible by paragraph (1) may not exceed —**
>
> > **(A) with respect to actions based upon a violation of this title, the amount specified in [**15 U.S.C. §1640**]; and**
> >
> > **(B) with respect to all other causes of action, the sum of —**
> >
> > > **(i) the amount of all remaining indebtedness; and**
> > >
> > > **(ii) the total amount paid by the consumer in connection with the transaction.**

**(3) Offset The amount of damages that may be awarded under paragraph (2)(B) shall be reduced by the amount of any damages awarded under paragraph (2)(A).**

**(4) Notice Any person who sells or otherwise assigns a mortgage referred to in** [15 U.S.C. §1602(aa)] **shall include a prominent notice of the potential liability under this subsection as determined by the Board.**

**3. Non-HOEPA Loans**

Truth in Lending damage liability of an assignee of a mortgage loan that is not under the Home Ownership and Equity Protection Act of 1994 is dependent on whether the violation is apparent on the face of the documents transferred. 15 U.S.C. §1641(e) provides the following:

**(1) In general Except as otherwise specifically provided in this title, any civil action against a creditor for a violation of this title, and any proceeding under** [15 U.S.C. §1607] **against a creditor, with respect to a consumer credit transaction secured by real property may be maintained against any assignee of such creditor only if —**

**(A) the violation for which such action or proceeding is brought is apparent on the face of the disclosure statement provided in connection with such transaction pursuant to this title; and**

**(B) the assignment to the assignee was voluntary.**

**(2) Violation apparent on the fact of the disclosure described For the purpose of this section, a violation is apparent on the face of the disclosure statement if —**

**(A) the disclosure can be determined to be incomplete or inaccurate by a comparison among the disclosure statement, any itemization of the amount financed, the note, or any other disclosure of disbursement; or**

**(B) the disclosure statement does not use the terms or format required to be used by this title.**

However, there is some tendency to construe §1641(d) narrowly. *Dowdy v. First Metropolitan Mortgage Co.,* No. 01 C 7211, 2002 WL 745851 (N.D.Ill. Jan. 29, 2002).

## C. Common Law Liability of Assignees

Mortgage companies often claim to be holders in due course. They rarely are. The first problem is that most home mortgage 'notes' are not negotiable instruments under the criteria of UCC §3-104 because they impose obligations other than the payment of money. Neil Cohen, *The Calamitous Law of Notes,* 68 Ohio St. L.J. 161 (2007). "A note given in connection with a mortgage in a real estate transaction generally is not a negotiable instrument." *P & K Marble, Inc. v. LaPaglia*, 147 A.D.2d 804, 537 N.Y.S.2d 682, 683 (3d Dep't 1989); see also *Felin Assoc. v. Rogers*, 38 A.D.2d 6, 326 N.Y.S.2d 413 (1st Dep't 1971); *Rudes v. Magnes Stables Co.*, 227 A.D.2d 236, 642 N.Y.S.2d 296 (1st Dep't 1996).

Second, mortgage loan documents are generally not transferred by endorsement on the note. This is essential to make one a "holder." *Adams v. Madison Realty & Development, Inc.,* 853 F.2d 163 (3d Cir. 1988) ("holder" is one who receives by endorsement on note/mortgage or "allonge" physically affixed thereto; usual practice of executing assignment does not make recipient "holder"). If *any* transferee did not take by endorsement, it and later owners are *not* "holders." *Lopez v. Puzina,* 49 Cal.Rptr. 122 (App. 1966).

Under Illinois law, an assignee of a note and mortgage who is *not* a holder in due course takes it subject to whatever infirmities it has in the hands of the original obligee. "The rule is that the assignee of a contract takes it subject to the defenses which existed against the assignor at the time of the assignment." *Allis-Chalmers Credit Corp. v. McCormick,* 30 Ill.App.3d 423, 331 N.E.2d 832, 833 (4th Dist. 1975). *Accord Montgomery Ward & Co. v. Wetzel,* 98 Ill.App.3d 243, 423 N.E.2d 1170, 1175, 53 Ill.Dec. 366 (1st Dist. 1981) ("the assignee thus takes the assignor's interest subject to all legal and equitable defenses existing at the time of assignment"); *Inland Real Estate Corp. v. Oak Park Trust & Savings Bank,* 127 Ill.App.3d 535, 469 N.E.2d 204, 209, 82 Ill.Dec. 670 (1st Dist. 1983) ("[i]t is a well established general rule that the assignee of a trust deed in the nature of a mortgage takes it subject to the same defenses that existed between the original parties to the instrument"); *Hirsh v. Arnold,* 318 Ill. 28, 148 N.E. 882, 888 (1925) (usury case: "a purchaser of a mortgage or trust deed takes it subject to all the infirmities to which it is liable in the hands of the mortgagee, and in equity the mortgagor is entitled to every defense against the assignee which he would have made against the original mortgagee"); *Chicago City Bank & Trust Co. v. Garvey,* No. 89 C 8094, 1990 U.S.Dist. LEXIS 10903 at *6 (Aug. 17, 1990), quoting *Inland Real Estate, supra,* 469 N.E.2d at 209 ("[t]he assignee of a mortgage takes it subject to the same equities it was subject to in the hands of the assignor"), *aff'g Chicago City Bank & Trust Co. v. Radford (In re Radford),* 1988 Bankr. LEXIS 1898 (Bankr. N.D.Ill. Oct. 27, 1988); *Cobe v. Guyer,* 237 Ill. 568, 86 N.E. 1088, 1090 (1908) (usury was defense in suit by receiver of original creditor: "[s]o long as any part of the original debt remains unpaid, the debtor may insist upon the deduction of the usury"); *House v. Davis,* 60 Ill. 367, 370 (1871) ("if the assignee had notice of the usury, the defense could be made as to him," and "so long as any part of the debt remains unpaid, the debtor may insist upon a deduction of the usury from the part remaining unpaid," and may bring affirmative action to restrain collection of

amounts beyond that); *Central Life Insurance Company of Illinois v. Sawiak,* 262 Ill.App. 569, 577 (1st Dist. 1931) (defense of usury sustained against assignee).

The mortgagor has the right to bring an affirmative claim, at least to the extent of a right to have title quieted and the mortgage removed. *Garvey, supra.*

C:\Documents and Settings\Administrator\Desktop\Edelman\foreclosure 2008_3.wpd