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March 16, 2023
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Community Home Lenders of America (CHLA) Comments
Draft Regulations - Illinois Community Reinvestment Act [205 ILCS 735].

Mr. Craig Cellini
Rules Coordinator, Office of the General Counsel
Illinoi Department of Financial and Professional Regulations
320 West Washington, 2nd Floor
Springfield, IL. 62786

Dear Mr. Cellini:

The Community Home Lenders of America (CHLA) writes to submit comments on behalf of our members - small and mid-sized non-bank independent mortgage banks (IMBs) - regarding draft regulations released on December 16, 2022, to implement the Illinois CRA law (hereinafter "ILCRA"). Our comments focus exclusively on Part 1055 [Mortgages], pages 146 through 174.

CHLA supports Fair Lending and the objective of encouraging more mortgage loans to low- and moderate-income and minority borrowers. However, applying CRA to IMBs is a solution in search of a problem, since: (1) IMBs already demonstrably outperform banks in mortgage loans to underserved borrowers and (2) IMBs don't take insured deposits out of communities, but instead access MBS markets and aggregators to bring mortgage credit into communities.

Moreover, the draft ILCRA regulations reflect a troubling lack of understanding of the IMB business model and will on balance likely result in **less** IMB lending to minority and underserved borrowers - as has proven to be the case when Massachusetts adopted CRA for IMBs in 2008.

Instead, CHLA suggests that Illinois take steps that could really make a difference - e.g., by using state CDBG and HOME funds to pay SAFE Act training and testing costs, in order to license up to 1,000 new low-income and minority IMB mortgage loan originators (see Appendix for numerical assumptions). This would help IMBs (which already outperform banks) to fund even more loans to underserved and minority borrowers and communities.

Moreover, the ILCRA regulations, as proposed**:**

1. **Will discourage IMB mortgage lenders from operating within Illinois.**
2. **Include provisions that are biased against IMBs in favor of banks.**
3. **Do not take into account the distinct aspects of how IMBs originate loans.**

CHLA writes to provide recommendations to address these flaws. The most important is that ILCRA regs should be streamlined for smaller IMBs, in order to incentivize good performance.

First, the proposed exemption threshold in the draft regulations should be increased from 50 mortgage loans a year to 500 loans a year for IMBs.

IMBs are not required to do business in Illinois or any other state. Without a higher exemption threshold, the main immediate impact of the ILCRA will be to: (1) discourage smaller IMBs in adjoining states or operating nationally from becoming licensed to originate mortgages in Illinois and (2) encourage existing smaller IMBs to exit. The low threshold (50 loans) means a smaller IMB lending in Illinois will face compliance costs, examinations, and assessments from ILCRA that may not warrant the comparatively small levels of lending and profitability in the State.

Second, there should a safe harbor option for IMBs with satisfactory low/moderate-income statistical loan performance and that don't have a pattern of complaints or discrimination. Such a safe harbor would exempt IMBs from ILCRA exams and fees - creating a powerful incentive for strong loan performance, which should be the ILCRA's main objective.

<u>**CHLA Proposal to Create up to 1,000 Low-income and Minority IMB Loan Originators**</u>

As noted, IMBs do not take insured deposits or have bank branches. More importantly, IMBs are fundamentally different from banks in that, according to our member surveys, less than 10% of mortgage loans are generated by a physical interaction with a borrower in an IMB's office.

Instead, IMBs generate business primarily through their loan originators. Thus, a critical factor in the ability of IMBs to generate loans to minority and low-income borrowers and communities is the availability of trained and licensed loan originators that live in those communities.

However, as you may know, a significant impediment to the availability of such loan originators is strict non-bank IMB licensing requirements. To be licensed to work at an IMB, an individual must complete 20 hours of SAFE Act pre-licensing courses, pass an <u>independent</u> background check, and pass a SAFE Act test. **Notably, none of these requirements apply to banks.**

The total cost of the required SAFE Act pre-licensing courses, taking the SAFE Act test, and related Illinois licensing fees is approximately $700. The process to get licensing takes several months. Finally, some 30% of individuals who take the SAFE Act test fail the test.

This creates a significant impediment to individuals pursuing this career path - of working for a non-bank as a loan originator - and by itself does not guarantee a job, since a lender hiring a new loan originator has to spend a significant amount of time and resources to integrate the individual into the firm's lending process, which can have an uncertain payback.

Therefore, the most significant thing the State of Illinois could do would be to subsidize the costs of entry - by paying for the direct costs of SAFE Act pre-licensing courses, the SAFE Act test, and state licensing fees for minority and underserved non-bank loan originators.

The Appendix to this letter outlines CHLA's proposal and numbers. An alternative funding source could be to use funds from the state Housing Trust Fund for this purpose.

<u>**Streamlining ILCRA to Avoid Disincentivizing IMB Lending in Illinois**</u>

As noted, CHLA is proposing to raise the ILCRA annual mortgage threshold from 50 loans to 500 loans and to create a safe harbor from exams and ILCRA fees for IMBs with a satisfactory low- and moderate-income statistical loan, that do not have a pattern of consumer complaints. and that do have actions taken against them by federal regulators under ECOA or fair lending.

To some extent, these recommendations are based on feedback from our members. However, we also point to our November 2021 **Letter to the Conference of State Bank Supervisors (CSBS),** which uses HMDA data to show that the IMB proportionate share of mortgage loans in Massachusetts declined compared to national averages after it adopted its 2008 CRA law.

Moreover, a smaller IMB should not be required serve all geographic areas of the state if it decides to lend in the state - so a statistical test for a safe harbor exam and compliance exemption based on mortgage loan performance to low- and moderate-income borrowers is sufficient.

Finally, for this or any ILCRA loan performance analysis, the ILCRA should compare IMB loan performance to **all** mortgage loans in the State, not just IMB loans. CHLA's latest **IMB Report** documents that IMBs consistently originate a higher percentage of loans than banks to minority and underserved borrowers. A comparison baseline that only includes IMBs loans is not fair.

Eliminating Biases in the Draft ILCRA Regulations against IMBs

Section (c) of 1055.220 [LENDING TEST} appears to state that a lender may not receive ILCRA credit for a loan sold to a bank that claims the same loan for federal CRA credit. This subsection also appears to state that a lender may not receive credit if another lender claims ILCRA credit for the same loan (although it is unclear which lender has priority for such credit).

Subsection 1055.220(c) should be eliminated. This section is clearly biased against smaller IMBs that originate loans and sell them to aggregators, particularly to bank aggregators that commonly buy these loans for the purpose of meeting federal CRA requirements.

If finalized, this provision could mean that a smaller correspondent IMB lender could do an outstanding job of originating FHA loans, primarily serving first-time, minority, and underserved homebuyers - but receive zero credit for such loans - and thereby fail the Illinois CRA exam.

If anything, the reverse should be true. If a smaller IMB originates an FHA loan and sells it to a correspondent bank, (1) the loan **would likely not have been made** if the IMB had not originated the loan, and (2) the loan likely **would have been made** if that particular bank had purchased the loan, as there are other aggregators ready, willing, and able to buy the loan.

Secondly, Section 1055.230 [SERVICE TEST], prong (3) refers to *"Community Development Services."* *"Community development service"* is defined as *"a service that: Has as its primary purpose community development; and Is related to the provision of financial services, including technical services."*

IMBs are mortgage lenders only, generally have no community development capabilities, and should not be rated at all on whether they engage in community development lending or services.

Therefore, Section 1055.230(3) should not be used to adversely affect the CRA rating of an IMB. An IMB's participation in community development services should only be used to grant additional credit in the ILCRA rating of an IMB.

Adapting the Regulations to Reflect the IMB Business Model

As noted, IMBs do not take insured deposits or have bank branches. More importantly, IMBs are fundamentally different than banks in that, according to our member surveys, less than 10% of mortgage loans are generated by a physical interaction with a borrower in an IMB's office.

Instead, IMBs generate business through their loan originators, through relationships in the community, and through other marketing devices (which are appropriately referenced in Section 1055.230(d)(1) of the draft regulations as *"the availability and effectiveness of systems for delivering mortgage lending services (e.g., internet, telephone solicitation, direct mail*").

Again, IMBs have a choice whether to enter a state to originate loans. As long as an IMB is meeting the credit needs of low- and moderate-income borrowers in the state, it is inappropriate to require a smaller IMB to serve the entire state if it decides to enter the state in the first place.

Therefore, we recommend elimination of the phrase "the dispersion of lending in the state and. . ." in Section (b)(1)(A) of 1055.220 [the Lending Test].

Secondly, we recommend eliminating the criteria in Section (b)(1(B)) of 1055.200, which refers to "the number and amount of loans in low-, moderate-, middle-, and upper-income geographies in the State." This performance criteria appears to be based on volume alone and is therefore discriminatory against smaller IMBs (and other smaller lenders).

Additionally, there are two references in Subsection (b) of this same section 1055.220 that do not appropriately take into account the way IMBs do business.

Subsection (b)(3) cites *"Innovative or flexible lending practices."* IMBs are industry leaders in originating FHA loans, which disproportionately serve first-time, minority and underserved borrowers with low down payment needs or credit blemishes. These programs do not generally allow "flexibility or innovation." The same is true for VA, RHS, and GSE loans, which also serve higher proportions of underserved and minority borrowers than bank portfolio loans.

To address this flaw, we recommend amending subsection (b)(3), by adding a safe harbor for lenders that predominately originate FHA, VA, RHS and GSE loans. For lenders that do so, it would be reasonable to consider whether they impose credit overlays, which exclude underserved borrowers, e.g., through a higher minimum FICO score than the program permits.

We are also concerned about Section (b)(4), which refers to *"Loss Mitigation Efforts."* Federal agency mortgage loan programs (FHA, VA, RHS, and GSE loans) have loss mitigation requirements that are far stronger than most bank and other portfolio loan practices.

Therefore, some reference should be added this section to create a safe harbor for lenders that predominately originate these government agency mortgage loans, providing the IMB is not cited by the program for noncompliance with these program's loss mitigation requirements.

We also recommend deletion of Subsection (b)(6), which refers to "Loss of Affordable Housing." This criteria would make sense in assessing multifamily housing lending. But as drafted, it would give higher performance ratings to lower borrower default levels.

For lenders primarily using FHA, RHS, VA, and GSE loan programs, which have strict underwriting and loss mitigation guidelines, it makes no sense to penalize a lender for originating MORE loans to these underserved or low- and moderate -income borrowers.

<u>Effect of Record of Performance on Applications</u>

Finally, we would like to address Section 1055.250, which states that a poor CRA assessment rating could be used as a basis for the State to refuse to renew a mortgage license, establish or renew an office, approve a merger or grant some other State approval.

CHLA understands that the ILCRA rating process and application of Section 1055.250 will both become more apparent as they are implemented. However, we are concerned that the language in this subsection is unnecessarily vague.

In general, we would recommend that the standards for using CRA ratings to take adverse actions against lenders should be as transparent, objective and performance-based as possible.

Additionally, we hope that this authority is not used by the State to leverage requests to make investments in non-profits or other community development or affordable housing activities, as

an explicit or implicit condition of securing such approvals. If such investments are determined to be worthy, we believe the State should appropriate funds directly for such purposes.

Thank you for consideration of these comments and recommendations.

Sincerely,

COMMUNITY HOME LENDERS OF AMERICA

CC: James M. Cooper, President and CEO, Conference of State Bank Supervisors (CSBS)

[See Appendix - following page]

Appendix

Numerical Basis for CHLA Illinois Loan Originator Proposal

In Fiscal 2022, Illinois received $48.5 million in combined CDBG and HOME funds. With increased FY 2023 funding levels, this should be approximately $50 million.

A major objective for CDBG and HOME fund use is to promote homeownership for low- and minority homebuyers, and CDBG and HOME may be used for the purposes proposed by CHLA.

CHLA PROPOSAL: Illinois to use 1% of its combined CDBG and HOME allocations each of the next 2 years to pay IMB LO SAFE Act required pre-licensing and testing costs.

<u>STATISTICAL ASSUMPTIONS:</u>

1. **Target: create 1,000 new minority and low income IMB LOs**
[By way of comparison, Illinois currently has 4,000 licensed IMB loan originators]

* Average SAFE Act test, application, and state fees = $280
* Average SAFE Act Pre-licensing courses = $420
* Combined Cost = $700

* 70% SAFE Act Test pass rate

2. **Thus, average third-party cost to license a low-income or minority IMB LO = $1,000**

* Cost to implement the CHLA proposal: $1 million
[1,000 new LOs at an average cost of $1,000 each]

Projected combined IL CDBG and HOME allocation in FY 2023: $50 million

3. Thus, the initiative could be funded with 1% of the state allocation over the next 2 years.