OFFICE OF THE ATTORNEY GENERAL
STATE OF ILLINOIS

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FILE NO. 96-037

FINANCIAL INSTITUTIONS:
Federal Preemption of Interest
Act Points Limitation

Frank C. Casillas
Director
Illinois Department of Financial Institutions
James R. Thompson Center, 15-700
Chicago, Illinois 60601

Dear Mr. Casillas:

I have your letter wherein you inquire whether section 501 of the Depository Institutions Deregulation and Monetary Control Act of 1980 (12 U.S.C. § 1735f-7a) (hereinafter referred to as "DIDMCA") preempts section 4.1a of the Illinois Interest Act (815 ILCS 205/4.1a (West 1994)), thereby permitting lenders in Illinois to charge more than three points on residential first mortgage loans. For the reasons hereinafter stated, it is my opinion that DIDMCA does preempt section 4.1a of the Illinois Interest Act, to the extent that section 4.1a would otherwise limit the points which lenders may charge on residential first mortgage loans with interest rates in excess of 8% per annum.

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The pertinent portion of section 4.1a of the Illinois Interest Act provides:

" * * *

> Where there is a charge in addition to the stated rate of interest payable directly or indirectly by the borrower and imposed directly or indirectly by the lender as a consideration for the loan, or for or in connection with the loan of money, whether paid or payable by the borrower, the seller, or any other person on behalf of the borrower to the lender or to a third party, or for or in connection with the loan of money, other than as hereinabove in this Section provided, whether denominated 'points,' 'service charge,' 'discount,' 'commission,' or otherwise, and without regard to declining balances of principal which would result from any required or optional amortization of the principal of the loan, the rate of interest shall be calculated in the following manner:
>
> The percentage of the principal amount of the loan represented by all of such charges shall first be computed, <u>which in the case of a loan with an interest rate in excess of 8% per annum secured by residential real estate, other than loans described in paragraphs (e) and (f) of Section 4, shall not exceed 3% of such principal amount</u>. Said percentage shall then be divided by the number of years and fractions thereof of the period of the loan according to its stated maturity. The percentage thus obtained shall then be added to the percentage of the stated annual rate of interest.
>
> * * * "
>
> (Emphasis added.)

The provisions limiting charges to 3% of the principal amount on loans bearing interest in excess of 8% that are secured by residential real estate were added to the section by Public Act

78-996, effective July 12, 1974. The quoted paragraphs have not been amended or re-enacted since that date.

Section 501 of DIDMCA (12 U.S.C. § 1735f-7a) provides, in pertinent part:

> "**(a) Applicability to loan, mortgage, credit sale, or advance; applicability to deposit, account, or obligation.** (1) The provisions of the constitution or the laws of any State expressly limiting the rate or amount of interest, discount points, finance charges, or other charges, which may be charged, taken, received, or reserved shall not apply to any loan, mortgage, credit sale, or advance which is--
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> > (A) secured by a first lien on residential real property, by a first lien on all stock allocated to a dwelling unit in a residential cooperative housing corporation or by a first lien on a residential manufactured home;
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> > (B) made after March 31, 1980; and
> >
> > (C) described in section 527(b) of the National Housing Act (12 U.S.C. 1735f-5(b)) * * *
>
> * * *
>
> **(b) Applicability to loan, mortgage, credit sale, or advance made in any State after April 1, 1980.** (1) Except as provided in paragraphs (2) and (3), the provisions of subsection (a)(1) shall apply to any loan, mortgage, credit sale, or advance made in any State on or after April 1, 1980.
>
> * * *
>
> (4) At any time after the date of enactment of this Act [enacted March 31, 1980], any State may adopt a provision of law placing limitations on discount points

> or such other charges on any loan, mortgage, credit sale, or advance described in subsection (a)(1).
>
> * * *

"

The express language of the Federal statute preempts the application of any State statute enacted prior to March 31, 1980, with respect to those loans to which the Federal enactment applies. The Federal Appellate Court so held in Currie v. Diamond Mortgage Corp. (7th Cir. 1988), 859 F.2d 1538. Your letter indicates, however, that confusion has arisen regarding whether the preemption extends to non-purchase money loans because of the decision of the Illinois Appellate Court in Fidelity Financial Services, Inc. v. Hicks (1991), 214 Ill. App. 3d 398, appeal denied, 141 Ill. 2d 539 (1991).

In Fidelity Financial Services, Inc. v. Hicks, the appellate court held that the lender had violated section 4.1a of the Illinois Interest Act by imposing a "prepaid finance charge" in excess of 13%. With respect to the issue of preemption, the court held that the mortgage in question was not a first lien, and that it was not a purchase-money mortgage; therefore, section 501 of DIDMCA did not preempt the State law. The conclusion that section 501 of DIDMCA did not apply to non-purchase money mortgages was not necessary to the result in the case (since the court had concluded that the loan was not a first lien), and there was no discussion of the Federal authorities on that issue.

Recently, in Gora v. Banc One Financial Services, Inc., No. 95C2542, 1995 U.S. Dist. LEXIS 15232 (N.D. Ill. Oct. 11, 1995), the district court discussed the decision in Fidelity Financial Services, Inc. v. Hicks together with Federal precedent relating to the application of section 501 of DIDMCA to non-purchase money loans. The court discussed Smith v. Fidelity Consumer Discount Co. (3rd Cir. 1990), 898 F.2d 907, in which the appellate court concluded that the plain language of section 501 of DIDMCA applies to all loans secured by a first lien of residential property, whether for purchase money or not. The district court followed that precedent, rejecting the reasoning of Fidelity Financial Services, Inc. v. Hicks.

The Illinois Supreme Court has held that Federal Court decisions supply the rule of law for interpreting Federal statutes. (Boyer v. Atchison, Topeka and Santa Fe Ry. Co. (1967), 38 Ill. 2d 31, cert. denied, 390 U.S. 949, 88 S. Ct. 1038 (1967); Elgin, Joliet and Eastern Ry. Co. v. Industrial Comm'n (1956), 9 Ill. 2d 505, 507.) Further, the Illinois Appellate Court has agreed that Federal decisions determine the preemptive reach of Federal statutes. Golden Bear Family Restaurants v. Murray (1986), 144 Ill. App. 3d 616, 619, appeal denied, 112 Ill. 2d 574 (1986); Busch v. Graphic Color Corp. (1996), 169 Ill. App. 2d 325, 335.

In accordance with the pertinent decisions of the Federal Courts, it is my opinion that section 501 of DIDMCA

preempts section 4.1a of the Illinois Interest Act, a pre-existing State statute, with respect to its limitation on the points that may be charged in connection with mortgage loans secured by a first lien on residential property, regardless of whether the loans constitute purchase money loans.

Sincerely,

JAMES E. RYAN
ATTORNEY GENERAL