Title 7. Banking and Securities
Part 8. Joint Financial Regulatory Agencies
Chapter 153. Home Equity Lending
§§153.1, 153.5, 153.15, & 153.51

The Finance Commission of Texas and the Texas Credit Union Commission ("commissions") propose amendments to the following home equity lending interpretations: §§153.1, concerning Definitions, 153.5, concerning Three percent fee limitation, 153.15, concerning Location of Closing, and 153.51, concerning Consumer Disclosure.

The amendments apply the administrative interpretation of the home equity lending provisions of Article XVI, Section 50 of the Texas Constitution ("Section 50") allowed by Section 50(u) and Texas Finance Code, §§11.308 and 15.413.

The main purpose of the proposed amendments is to implement the Texas Supreme Court's decision in *Finance Commission of Texas v. Norwood*, 418 S.W.3d 566 (Tex. 2013). In *Norwood*, the court held that portions of three interpretations adopted by the commissions were invalid: §§153.1, 153.5, and 153.15.

In 1997, the Texas Constitution was amended to authorize home equity loans. After further amendments in 2003, the commissions were authorized to adopt interpretations of the constitution's home equity provisions, subject to the requirements of the Texas Administrative Procedure Act. The commissions adopted their interpretations in 2004. A group of homeowners sued the commissions, challenging several of the adopted interpretations. The case was ultimately appealed to the Texas Supreme Court and resulted in the court's decision in *Finance Commission of Texas v. Norwood*.

In *Norwood*, the court invalidated certain provisions interpreting Section 50(a)(6)(E), which provides that a home equity loan may not "require the owner or the owner's spouse to pay, in addition to any interest, fees to any person that are necessary to originate, evaluate, maintain, record, insure, or service the extension of credit that exceed, in the aggregate, three percent of the original principal amount of the extension of credit." The court invalidated §153.1(11) of the commissions' interpretations, which defined "interest" for purposes of the three percent limitation as "interest as defined in the Texas Finance Code §301.002(4) and as interpreted by the courts." The court held that interest means "the amount determined by multiplying the loan principal by the interest rate." 418 S.W.3d at 588. The court also invalidated paragraphs (3), (4), (6), (8), (9), and (12) of §153.5, which applied the commissions' original definition of "interest" to several specific types of charges for purposes of the three percent limitation. In the supplemental opinion, the court explained that interest includes per diem interest and legitimate discount points, and that these amounts are not included in the three percent limitation. 418 S.W.3d at 596.

The court also invalidated provisions interpreting Section 50(a)(6)(N), which provides that a home equity loan must be "closed only at the office of the lender, an attorney at law, or a title company." The court invalidated §153.15(2), which allowed

a lender to accept a properly executed power of attorney authorizing someone to close a loan on a homeowner's behalf. It also invalidated §153.15(3), which allowed a lender to accept the homeowner's consent by mail. In the supplemental opinion, the court explained that "a power of attorney must be part of the closing to show the attorney-in-fact's authority to act." 418 S.W.3d at 596.

After the court issued its supplemental opinion, the Texas Department of Banking, the Texas Department of Savings and Mortgage Lending, the Office of Consumer Credit Commissioner, and the Texas Credit Union Department ("agencies") prepared an initial draft of amendments implementing the court's decision. The agencies distributed the initial draft to home equity stakeholders for precomments, in order to prepare an informed and well-balanced proposal for the commissions. The agencies received written precomments from several stakeholders.

Upon review of the precomments, the agencies prepared a second precomment draft incorporating several of the suggestions from the initial round of precomments. The agencies sent this second precomment draft to stakeholders, together with written explanations of the changes that had been made from the initial draft. The agencies received additional written precomments on the second draft.

The agencies have incorporated certain suggestions offered by stakeholders into the proposed amendments. The agencies believe that this early participation of stakeholders has greatly benefited the resulting proposal.

As stated earlier, the main purpose of the proposed amendments is to implement the Texas Supreme Court's decision in *Finance Commission of Texas v. Norwood*. The individual purposes of each amendment are provided below.

The proposed amendment to §153.1(11) replaces the previous definition of "interest" with the definition used by the court. One precommenter suggested including the phrase "over a period of time" in the definition. This phrase is included in the proposed amendment in order to clarify the time component in the definition. In addition, in its supplemental opinion, the court used the phrase "over a period of time" in applying the general definition of "interest." 418 S.W.3d at 596.

The precise mathematical formulation of interest and the exact nature of the applicable time period will be described in the loan contract. For example, in a loan contract using the true-daily-earnings method, the interest is calculated by dividing an annual rate by 365 and multiplying that amount by the outstanding principal each day. Other loan contracts will use different methods. Because different contracts will describe different methods for calculating interest, it is unnecessary for the amendments to specify a precise method. The purpose of the amendment is to describe how an amount already calculated under the contract will be excluded from the three percent limitation. The definition as proposed appears to achieve this purpose.

The proposed amendment to §153.5(3)(A) specifies that per diem interest is interest and is not subject to the three percent limitation. In the supplemental opinion, the court considered all per diem interest to be interest, as did the parties. The court stated: "We agree with [the parties] that per diem interest is still interest, though prepaid; it is calculated by applying a rate to principal over a period of time." 418 S.W.3d

at 596. In other words, the fact that per diem interest is prepaid does not affect its basic character as interest.

The proposed amendment to §153.5(3)(B) specifies that legitimate discount points are interest and are not subject to the three percent limitation. The amendment also identifies the conditions that must be satisfied in order for discount points to be considered legitimate under the court's supplemental opinion, and it provides that a lender may rely on an established system to evidence that the discount points it offers are legitimate.

The proposed amendments to paragraphs (4), (6), (8), (9), and (12) of §153.5 add the phrase "as defined by §153.1(11) of this title" after "that are not interest" in provisions describing charges that are subject to the three percent limitation.

In response to precomments, paragraphs (9) and (12), regarding charges to maintain and service the loan, are also amended to provide clarity and delete redundant text. These changes are intended to be nonsubstantive. Charges to maintain or service the loan that are not customarily included at inception because they arise due to subsequent events (e.g., nonsufficient funds fees, payoff statement fees, fees for an updated flood determination) would continue not to be subject to the three percent limitation under the amended text.

The proposed amendment to §153.15(2) specifies that any power of attorney allowing an attorney-in-fact to execute closing documents must be signed at the office of the lender, an attorney at law, or a title company. It also provides that a lender may rely on an established system to evidence the date and place at which a power of attorney was signed. In response to precomments, the amendment permits the use of an affidavit or written certification of a person who was present when the power of attorney was executed.

Several stakeholders expressed concern that the amendments would somehow restrict the use of powers of attorney to the circumstances specified in the amendments. The amendments acknowledge three situations in which powers of attorney can be used (closing documents, signing the required consent, and receiving the consumer disclosure), but this does not prohibit the use of a power of attorney in other circumstances. The purpose of the amendments is to address the portion of the court's decision relating to the location of closing. It would be outside the intended scope of the amendments to provide a comprehensive statement of the circumstances in which a lender can (or should) use powers of attorney, or a statement of the conditions that must be satisfied in every power of attorney relating to a home equity loan. Apart from the circumstances described in the proposed amendments, the use of powers of attorney is largely an underwriting decision for the lender.

One stakeholder suggested that the amendments specify that the power of attorney must be signed at a permanent physical address. This change does not seem necessary. The current text of §153.15(1) already specifies that the authorized physical location for closing must be a permanent physical address. This provision should be sufficient to prohibit lenders from circumventing the interpretations through the use of nonpermanent locations.

The proposed amendment to §153.15(3) specifies that the required consent form must be signed at the office of the lender, an attorney at law, or a title company. In response to a precomment, the proposed amendment also specifies that the consent may be signed by an attorney-in-fact described by paragraph (2).

One stakeholder expressed concern about executing the consent form at one location and sending it to another. The amendments do not prohibit any party from sending documents from one place to another, as long as the documents are executed at an authorized location.

In §153.51, proposed new paragraph (5) specifies that if a power of attorney described by §153.15(2) has been executed, then the attorney-in-fact may accept the disclosures required under Section 50(g).

Harold Feeney, Credit Union Commissioner, on behalf of the Texas Credit Union Commission and Leslie L. Pettijohn, Consumer Credit Commissioner, on behalf of the Finance Commission of Texas have determined that for the first five-year period the amendments are in effect there will be no fiscal implications for state or local government as a result of administering the interpretations.

Commissioner Feeney and Commissioner Pettijohn have also determined that for each year of the first five years the proposed amendments are in effect, the public benefits anticipated as a result of the amendments will be to create standards and guidelines for both lenders and borrowers, fostering a stable environment for the extension of home equity loans.

There is no anticipated cost to persons who are required to comply with the amendments as proposed. Any costs are imposed by the constitution and are not imposed by the proposed amendments. There will be no adverse economic effect on small or micro-businesses. There will be no effect on individuals required to comply with the amendments as proposed.

Comments on the proposed amendments may be submitted in writing to Laurie Hobbs, Assistant General Counsel, Office of Consumer Credit Commissioner, 2601 North Lamar Boulevard, Austin, Texas 78705-4207 or by email to laurie.hobbs@occc.state.tx.us. To be considered, a written comment must be received on or before the 31st day after the date the proposed amendments are published in the *Texas Register*. At the conclusion of the 31st day after the proposed amendments are published in the *Texas Register*, no further written comments will be considered or accepted by the commissions.

The amendments are proposed under Article XVI, Section 50(u) of the Texas Constitution and Texas Finance Code, §§11.308 and 15.413, which authorize the commissions to adopt interpretations of Article XVI, Section 50(a)(5)-(7), (e)-(p), (t), and (u) of the Texas Constitution.

The constitutional provisions affected by the proposed amendments are contained in Article XVI, Section 50 of the Texas Constitution.

§153.1. Definitions.

Any reference to Section 50 in this interpretation refers to Article XVI, Texas Constitution, unless otherwise noted. These words and terms have the following

meanings when used in this chapter [~~section~~], unless the context indicates otherwise:

(1) - (10) (No change.)

(11) Interest--As used in Section 50(a)(6)(E), "interest" means the amount determined by multiplying the loan principal by the interest rate over a period of time. [~~Interest--interest as defined in the Texas Finance Code §301.002(4) and as interpreted by the courts.~~]

(12) - (15) (No change.)

§153.5. Three percent fee limitation: Section 50(a)(6)(E)

An equity loan must not require the owner or the owner's spouse to pay, in addition to any interest, fees to any person that are necessary to originate, evaluate, maintain, record, insure, or service the extension of credit that exceed, in the aggregate, three percent of the original principal amount of the extension of credit.

(1) - (2) (No change.)

(3) Charges that are Interest. Charges an owner or an owner's spouse is required to pay that constitute interest under §153.1(11) of this title (relating to Definitions) [~~the law, for example per diem interest and points,~~] are not fees subject to the three percent limitation.

(A) Per diem interest is interest and is not subject to the three percent limitation.

(B) Legitimate discount points are interest and are not subject to the three percent limitation. Discount points are legitimate if the discount points truly correspond to a reduced interest rate and are not necessary to originate, evaluate, maintain, record, insure, or service the loan. A lender may rely on an established system of verifiable procedures to evidence that the discount points it offers are legitimate. This system may include documentation of options that the owner is offered in the course of negotiation, including a contract rate without discount points and a lower contract rate based on discount points.

(4) Charges that are not Interest. Charges an owner or an owner's spouse is required to pay that are not interest under §153.1(11) of this title are fees subject to the three percent limitation.

(5) (No change.)

(6) Charges to Originate. Charges an owner or an owner's spouse is required to pay to originate an equity loan that are not interest under §153.1(11) of this title are fees subject to the three percent limitation.

(7) (No change.)

(8) Charges to Evaluate. Charges an owner or an owner's spouse is required to pay to evaluate the credit decision for an equity loan, that are not interest under §153.1(11) of this title, are fees subject to the three percent limitation. Examples of these charges include fees collected to cover the expenses of a credit report, survey, flood zone determination, tax certificate, title report, inspection, or appraisal.

(9) Charges to Maintain. Charges paid by an owner or an owner's spouse [~~at the inception of an equity loan~~] to maintain an equity [~~the~~] loan that are not interest under §153.1(11) of this title are fees subject

to the three percent limitation if the charges are paid at the inception of the loan, or if the charges are customarily paid at the inception of an equity loan but are deferred for later payment after closing. [~~Charges that are not interest that an owner pays at the inception of an equity loan to maintain the equity loan, or that are customarily paid at the inception of an equity loan to maintain the equity loan, but are deferred for later payment after closing, are fees subject to the three percent limitation.~~]

(10) - (11) (No change.)

(12) Charges to Service. Charges paid by an owner or an owner's spouse [~~at the inception of an equity loan~~] for a party to service an equity [~~the~~] loan that are not interest under §153.1(11) of this title are fees subject to the three percent limitation if the charges are paid at the inception of the loan, or if the charges are customarily paid at the inception of an equity loan but are deferred for later payment after closing. [~~Charges that are not interest that an owner pays at the inception of an equity loan to service the equity loan, or that are customarily paid at the inception of an equity loan to service the equity loan, but are deferred for later payment after closing, are fees subject to the three percent limitation.~~]

(13) - (16) (No change.)

§153.15. Location of Closing: Section 50(a)(6)(N)

An equity loan may be closed only at an office of the lender, an attorney at law, or a title company. The lender is anyone authorized under Section 50(a)(6)(P) that advances funds directly to the owner or is identified as the payee on the note.

(1) (No change.)

(2) Any [~~A lender may accept a properly executed~~] power of attorney allowing an [~~the~~] attorney-in-fact to execute closing documents on behalf of the owner or the owner's spouse must be signed by the owner or the owner's spouse at an office of the lender, an attorney at law, or a title company. A lender may rely on an established system of verifiable procedures to evidence compliance with this paragraph. For example, this system may include one or more of the following:

(A) a written statement in the power of attorney acknowledging the date and place at which the power of attorney was executed;

(B) an affidavit or written certification of a person who was present when the power of attorney was executed, acknowledging the date and place at which the power of attorney was executed; or

(C) a certificate of acknowledgement signed by a notary public under Chapter 121, Civil Practice and Remedies Code, acknowledging the date and place at which the power of attorney was executed.

(3) The [~~A lender may receive~~] consent required under Section 50(a)(6)(A) must be signed by the owner and the owner's spouse, or an attorney-in-fact described by paragraph (2) of this subsection, at an office of the lender, an attorney at law, or a title company [~~by mail or other delivery of the party's signature to an authorized physical location and not the homestead~~].

§153.51. Consumer Disclosure: Section 50(g)

An equity loan may not be closed before the 12th day after the lender provides the owner with the consumer disclosure on a separate instrument.

(1) - (4) (No change.)

(5) If the owner has executed a power of attorney described by §153.15(2) of this title (relating to Location of Closing: Section 50(a)(6)(N)), then the lender may provide the consumer disclosure to the attorney-in-fact instead of providing it to the owner.

Certification

The agencies hereby certify that the proposal has been reviewed by legal counsel and found to be within the commissions' legal authority to adopt.

Issued in Austin, Texas on June 20, 2014.

Leslie Pettijohn
Consumer Credit Commissioner
Joint Financial Regulatory Agencies