

- SUBJECT:** Regulating the issuance of wrap mortgage loans
- COMMITTEE:** Investments and Financial Services — favorable, without amendment
- VOTE:** 7 ayes — Parker, Stephenson, Burrows, Dean, Holland, E. Johnson, Longoria
0 nays
- SENATE VOTE:** On final passage, May 15 — 26-4-1 (Burton, Hall, Huffines, and Huffman nay; V. Taylor present, not voting)
- WITNESSES:** For — Brian Engel, Barrett Daffin Frappier Turner and Engel, LLP; John Fleming, Texas Mortgage Bankers Association; Abby Batko-Taylor; Maria Emerson; Gloria Lugo; Ofelia Zapata; (*Registered, but did not testify*: Trish McAllister, Texas Access to Justice Commission; Ann Baddour, Texas Appleseed; Celeste Embrey, Texas Bankers Association; Nate Walker, Texas Low Income Housing Information Service; Shenoah Grove, Texas Wealth Network; Alan Ceshker; Jocelyn Fowler)

Against — None

On — Karen Neeley, Independent Bankers Association of Texas; (*Registered, but did not testify*: Ernest Garcia, Department of Savings and Mortgage Lending)
- BACKGROUND:** **Registration.** Finance Code, ch. 158 requires a person acting as a servicer for a residential mortgage loan secured by a lien on residential real estate to be registered with the Finance Commission of Texas.

Disclosure. Property Code, sec. 5.016 requires a person conveying an interest in residential real property with an existing debt-securing lien to provide the purchaser and each lienholder a written disclosure statement that provides information about the lien, including the amount of debt secured by the lien, the interest rate and periodic payments required on the debt, the amount of property taxes due on the property, and the details of

any insurance policy relating to the property.

Exemptions. Finance Code, ch. 156 regulates the operation of residential mortgage loan companies in Texas. Sec. 156.202(a-1)(3) provides that an owner of residential real estate who made five or fewer residential mortgage loans during any period of 12 consecutive months is exempt from the chapter's regulations.

Ch. 157 regulates the operation of residential mortgage loan originators in Texas. Sec. 157.0121(c)(2) provides that an owner of residential real estate who made five or fewer residential mortgage loans during any period of 12 consecutive months is exempt from the chapter's regulations.

Observers have noted a need to regulate the practice of issuing "wrap mortgage loans" on which a home is sold with an existing lien. When predatory lenders engage in wrap mortgage lending, nothing in statute requires them to use the borrower's payments to retire the previous debt. This can result in undue foreclosure for the new buyer and can ruin the original seller's credit.

DIGEST: SB 1994 would provide for the regulation of wrap mortgage loans.

Definitions. The bill would define a "wrap mortgage loan" to mean a residential loan that:

- was made to finance the purchase of real estate subject to a prior debt-securing lien; and
- obligated the borrower of the wrap loan to pay a debt to the lender, the principle amount of which included the outstanding debt on the lien and any remaining amount of the purchase price that was financed by the lender.

"Wrap lender" would mean a person who made a wrap mortgage loan or an owner of residential real estate who contracted to issue a wrap mortgage loan to a borrower on the owner's behalf to finance the owner's purchase of residential real estate.

License. The bill would require a wrap mortgage lender to be licensed to originate or make residential mortgage loans.

Registration. The bill would allow the savings and mortgage lending commissioner to conduct investigations into a wrap mortgage lender's registration as a residential mortgage loan servicer for reasonable cause. The commissioner's findings would be confidential to the public unless required to be disclosed by law, but the commissioner could share information with a state or federal agency with valid reason. The commissioner could be reimbursed for the expenses of an on-site investigation if records were located out of state and were not made available for inspection.

The bill would authorize the commissioner to subpoena a peace officer or other person authorized by law to serve a citation for a deposition or the production of documents.

The bill would require the Finance Commission of Texas to make rules governing investigations, including what would constitute reasonable cause.

Disclosure. The bill would require a wrap lender, who was not otherwise required, to provide the wrap borrower with a disclosure statement conforming to the guidelines in Property Code, sec. 5.016 at least seven days before the agreement was entered into.

The bill also would prescribe a sample statement concerning insurance coverage and liability. All wrap lenders would have to include this statement or a substantially similar statement in their disclosure.

If the negotiations preceding the execution of the wrap loan had been conducted primarily in a language other than English, the lender would have to provide the borrower a copy of the disclosure statement in that language.

If the lender failed to provide the required disclosure to the borrower, the statute of limitations for a violation of the law committed by the lender would be suspended until 120 days after the required disclosure was provided.

Execution. The bill would void any wrap mortgage loan that did not attach to the instrument for conveyance:

- each applicable lienholder's written consent;
- closure by an attorney or title company; and
- an affidavit confirming the closing location.

The bill would grant the Finance Commission of Texas the authority to adopt and enforce rules necessary to ensure compliance with wrap mortgage loan regulations.

Borrower's rights. The bill would grant a wrap borrower the right to bring action for:

- declaratory or injunctive relief to enforce the bill's regulations on wrap mortgage loans;
- recovery of actual damages sustained by the borrower due to a violation of the bill's regulations on wrap mortgage loans; or
- other remedies available for deceptive trade practices.

A borrower who prevailed in an action could recover court costs and reasonable attorney's fees. The bill would prohibit the borrower's right to bring action from being waived.

The bill would establish a fiduciary duty owed to a wrap borrower by a person collecting or receiving a payment from the borrower, requiring the collector to use payments to satisfy the borrower's obligations. Fiduciaries would be required to hold payments received from the borrower in trust for the borrower's benefit.

The bill would allow a borrower incurring a wrap mortgage loan for the

purchase of real estate to be used as the borrower's residence to deduct any amount for which the wrap lender was liable to the borrower from the amount owed to the lender. This authority would not apply to a borrower party to a wrap mortgage loan for sale of the wrap lender's homestead.

Enforcement. If the commissioner had reasonable cause to believe a lender was violating the bill's regulations on wrap mortgage loans, the commissioner could issue a cease and desist order or an order to take affirmative action without notice and hearing. An order would have to include a detailed statement of facts, and recipients would be entitled to request a hearing.

If a lender violated a cease and desist order, the commissioner could impose an administrative penalty in an amount up to \$1,000 for each day of the violation after giving notice and an opportunity for hearing. The commissioner also would be authorized to sue for injunctive relief to collect the penalty.

Exemptions. The bill's regulations on wrap mortgage loans would not apply to:

- a federally insured bank, savings and loan association, Farm Credit System Institution, credit union, or a subsidiary of these institutions;
- a licensed authorized lender;
- the state, a governmental agency, political subdivision, or other instrumentality of the state, or an employee of these institutions acting within the scope of their employment; or
- an owner of residential real estate who made five or fewer wrap mortgage loans during any consecutive period of 12 months.

The bill would specify that when determining the number of mortgage loans made during a 12-month period, two or more owners of residential real estate would be considered a single owner if any owner was an affiliate or had substantially common ownership as determined by the commissioner.

The bill also would not apply to a wrap mortgage loan made for the purchase of residential real estate on which a dwelling had not been constructed if the estate would not continue to be subject to a debt-securing unreleased lien and:

- the lien included a due-on-sale clause that could result in foreclosure of the lien; or
- the lien holder consented to the sale of the estate.

The bill would take effect September 1, 2017.