

BILL ANALYSIS

Senate Research Center

S.B. 173
By: Patterson
State Affairs
3-24-97
Committee Report (Amended)

DIGEST

Currently, the Texas Constitution prohibits the use of equity in a home for collateral for loans other than home improvement loans. S.B. 173 authorizes a voluntary, consensual encumbrance on homestead property for the purpose of an equity loan.

PURPOSE

As proposed, S.B. 173 authorizes an encumbrance on the use of a homestead property for an equity loan and sets forth procedures and restrictions regarding the making of an equity loan utilizing homestead property as collateral.

RULEMAKING AUTHORITY

Rulemaking authority is granted to the Finance Commission of Texas under SECTION 2 and to the commissioner of insurance under SECTION 5 (Article 5A.29(e), Article 5069-1.01 et seq., V.T.C.S., Section 9.07(g), Insurance Code) of this bill.

SECTION BY SECTION ANALYSIS

SECTION 1. Amends Section 41.001(b), Property Code, to authorize encumbrances to be properly fixed on homestead property for an equity loan, as defined by Article 5A.01, Title 79, V.T.C.S..

SECTION 2. Amends Title 79, V.T.C.S., by adding Chapter 5A, as follows:

CHAPTER 5A. EQUITY LOANS

Art. 5A.01. DEFINITIONS. Defines "advance," "application," "blended equity loan," "business day," "equity loan," "lender," and "reverse mortgage."

Art. 5A.02. CONSTRUCTION OF CHAPTER. Sets forth the terms under which an equity loan is considered closed. Sets forth the provisions regarding the establishment of the fair market value of a homestead property.

Art. 5A.03. APPLICABILITY OF CHAPTER AND OTHER LAW. Requires a lender making, originating, negotiating, or arranging an equity loan, including a reverse mortgage, to comply with certain laws. Provides that a blended equity loan is governed by this chapter. Provides that a loan made for the payment or refinancing of all or part of a valid encumbrance on homestead property authorized by Section 41.001(b) (1), (2), (3), (4), or (5), Property Code, is not an equity loan, but may be made subject to this chapter under certain conditions. Provides that the inclusion of closing costs in the loan amount for a loan described by this subsection does not cause the loan to be an equity loan. Sets forth additional provisions regarding closing costs.

Art. 5A.04. AUTHORIZED LENDERS. Authorizes an equity loan to be made, originated, negotiated, or arranged, by a bank, savings and loan association, savings bank, or credit union; a person licensed under Chapter 3 of this title; a person approved as a mortgagee by the U.S. Department of Housing and Urban Development to make insured loans under the National Housing Act; or a person contracted to make, originate, or arrange loans qualified

for purchase by the Federal National Mortgage Association or Federal Home Loan Mortgage Corporation.

Art. 5A.05. **ELIGIBLE PROPERTY.** Prohibits an equity loan from being secured by homestead property that is designated for agricultural use as provided by Chapter 23C, Tax Code.

Art. 5A.06. **ONE EQUITY LOAN AUTHORIZED; IDENTIFICATION REQUIREMENT.** Prohibits a homestead from being encumbered by more than one equity loan in addition to any valid encumbrances on homestead property authorized by Section 41.001(b) (1), (2), (3), (4), or (5), Property Code. Sets forth the required contents of a recorded lien instrument, including a deed of trust or security agreement. Sets forth the required language for the headings. Provides that a recorded lien instrument used to secure an equity loan is not made invalid because the lender fails to comply with this article.

Art. 5A.07. **ADVANCES AND REPAYMENT DETERMINED BY AGREEMENT.** Authorizes an equity loan to provide for funding to or for the benefit of the borrower in one or more advances at a frequency and for a term to which the parties agree. Allows an equity loan to provide for repayment in one or more payments on a payment schedule and in amounts to which the parties agree.

Art. 5A.08. **CREDIT CARD ACCESS PROHIBITED.** Prohibits an equity loan from being in the form of a credit card transaction, as defined by Section 1.01(g) of this title.

Art. 5A.09. **PERCENT OF VALUE LIMIT.** Prohibits the committed principal amount of an equity loan plus the aggregate total of the outstanding balances of other indebtedness secured by valid encumbrances of record against the homestead property from exceeding 90 percent of the fair market value of the homestead property on the date the equity loan is closed. Provides that violation of this article does not affect the validity of other indebtedness secured by valid encumbrances of record against the homestead property.

Art. 5A.10. **ADVANCE NOT INCLUDED AS OUTSTANDING INDEBTEDNESS.** Provides that for the purposes of Article 5A.09, the aggregate total of outstanding balances of indebtedness secured by valid encumbrances of record against the homestead property does not include any advance made by a lender to protect a lien, security interest, or other valid encumbrance on the homestead property securing the loan, including the payment of hazard insurance premiums, repairs to the homestead property, or payments on any indebtedness secured by a prior valid encumbrance on the homestead property.

Art. 5A.11. **LIMIT ON COLLATERAL AND USE OF PROCEEDS.** Prohibits a lender from requiring or accepting real or personal property as additional collateral on an equity loan, with exceptions. Sets forth prohibitions for a lender regarding requirements for borrowers. Provides that this article does not prohibit any lawful statutory lien, valid common law lien, or right of offset, or prevent a lender from requiring insurance authorized by this chapter as additional security for an equity loan. Sets forth provisions regarding the use of proceeds of a sale of the homestead or its fixtures as part of the security for the loan. Provides that a provision of a deed of trust or other security agreement that secures a loan other than an equity loan and that makes the deed of trust or security agreement applicable to other indebtedness of the borrower does not apply to the collateral securing an equity loan of the borrower. Provides that this subsection does not affect the validity of the provision as applied to a loan other than an equity loan. Prohibits an equity loan from containing a provision that makes the lien on homestead property security for any other indebtedness of the borrower.

Art. 5A.12. **ACCELERATION PROHIBITED.** Set forth prohibitions against lenders accelerating the remaining payments of an equity loan. Provides exceptions.

Art. 5A.13. **NOTICE.** Sets forth the language required in the notice a lender is required to provide to a borrower in an equity loan. Requires the lender to provide the notice when the

lender receives an application for the loan.

Art. 5A.14. **WAITING PERIOD; RESCISSION.** Prohibits the closing of an equity loan within a certain period. Authorizes the owner of homestead property securing an equity loan to rescind the loan. Provides that compliance with all applicable state and federal laws regarding the right to rescind is considered compliance with this chapter regarding rescission. Provides that the right of rescission provided by this article applies to each equity loan made under this chapter, regardless of the purpose of the loan. Prohibits an owner of the homestead property securing an equity loan from waiving the right of rescission required by this article, regardless of whether applicable state or federal law provides for a waiver.

Art. 5A.15. **LOCATION OF CLOSING.** Prohibits the closing of an equity loan at the residence of the borrower. Requires an equity loan to be closed only at an office of the lender, a title company, or an attorney licensed to practice law in this state. Provides that a recital in the deed of trust or other security agreement securing an equity loan stating the location of the closing is conclusive evidence that the equity loan was closed at that location.

Art. 5A.16. **GENERAL PROVISIONS RELATING TO REVERSE MORTGAGES.** Provides that notwithstanding any other provision of this chapter, payment in whole or in part is permitted without penalty at any time during the term of a reverse mortgage. Provides that advances made under a reverse mortgage have priority over a lien filed for record. Authorizes a reverse mortgage to provide for an interest rate that is fixed or adjustable and also provide for interest that is contingent on appreciation in the fair market value of the homestead property. Prohibits the reduction in amount or number because of an adjustment in the interest rate, if a reverse mortgage provides for periodic advances to a borrower. Provides that a lender who fails to make loan advances as required in the loan documents, and who fails to cure the default as required in the documents, forfeits any right to collect all interest.

Art. 5A.17. **REPAYMENT OF REVERSE MORTGAGE.** Provides that a reverse mortgage becomes due and payable if certain specified conditions exist. Sets forth prohibitions in regard to the payment and due date of a reverse mortgage in the event of the homestead property owner's absence. Provides that the lender's right to collect reverse mortgage payments is subject to the applicable statute of limitations for a debt. Provides that the limitations period for the lien securing an equity loan is governed by Sections 16.035 and 16.036, Civil Practice and Remedies Code. Requires the lender, in the loan documents, to prominently disclose any interest or fee to be charged during the period that begins on the date the reverse mortgage becomes due and payable and ends when repayment is full.

Art. 5A.18. **INAPPLICABILITY OF OTHER STATUTES TO REVERSE MORTGAGE.** Authorizes the making or acquisition of a reverse mortgage loan without regard to specific provisions of any applicable state or federal statute and sets forth the provisions.

Art. 5A.19. **STATUS OF REVERSE MORTGAGE LOAN UNDER PUBLIC ASSISTANCE PROGRAM.** Provides that for the purposes of determining eligibility under any statute relating to payments, allowance, benefits, or services provided on a means-tested basis by this state, reverse mortgage loan advances made to a borrower are considered proceeds from a loan and not income; and undisbursed funds under a reverse mortgage are considered equity in a borrower's home and not proceeds from a loan.

Art. 5A.20. **REVERSE MORTGAGE LOAN INFORMATION AND COUNSELING.** Prohibits a lender from making a reverse mortgage commitment unless the loan applicant attests in writing that the applicant received from the lender, at the time the notice is required by Article 5A.13 of this title, a statement prepared by the consumer credit commissioner (commissioner) regarding the advisability and availability of independent information and counseling services on reverse mortgages. Requires the commissioner to develop the content and format of the statement and provide specific information to consumers regarding reverse mortgages.

Art. 5A.21. INTEREST. Authorizes a lender to contract for and receive an equity loan on any rate of interest that does not exceed the maximum rate authorized under Article 1.04 of this title or any other related state or federal statute. Requires interest to be accrued and earned by applying the simple annual interest rate or rates under the loan contract to the principal balance, which may include unpaid interest and additions to the principal authorized by the loan contract. Authorizes the lender, in determining the amount of interest accrued, to assume that the payments have been made as originally scheduled and ignore any difference created by late or early payments. Authorizes interest to accrue and be compounded during the term of the loan as provided by the reverse mortgage loan agreement, although payment of principal or interest is prohibited from being required under a reverse mortgage until the entire loan becomes due and payable.

Art. 5A.22. CLOSED-END EQUITY LOANS. Requires each closed-end equity loan to be scheduled to be repaid in substantially equal successive monthly installments, except that the first installment is authorized to be scheduled beyond one month from the date of the loan but not beyond two months from the date of the loan. Requires the amount of each installment under the schedule of payments for a closed-end equity loan to equal or exceed the amount of interest scheduled to accrue as of the date of the installment or that would accrue as of the installment date through amortization of the loan on the date of the loan.

Art. 5A.23. CHARGES AND FEES. Sets forth the specific charges and fees a lender is authorized to collect with a contract for an equity loan.

Art. 5A.24. INSURANCE. Authorizes a lender to request or require a borrower to provide insurance and sets forth provisions regarding the amounts, terms, and conditions applicable.

Art. 5A.25. LENDER'S DUTY TO BORROWER. Requires the lender under an equity loan to deliver to the borrower a copy of the note or the contract for an open-end account, a copy of all other documents signed by the borrower or borrowers, and a written statement to include certain information. Authorizes the delivery of a copy of the note or other loan document to the borrower rather than the separate written statement, if the note or document contains information required by Subsection (a). Requires the lender to give a receipt to a person making a cash payment if requested by the borrower. Authorizes the collection of a prepayment fee, charge, or penalty on an equity loan except as prohibited by Articles 1.07 and 5A.16 of this title. Requires the holder to follow certain guidelines upon the termination and full payment of an equity loan.

Art. 5A.26. PROHIBITED PRACTICES. Prohibits a lender from accepting as security for a loan made under this chapter an assignment of wages, a confession of judgment or power of attorney running to the lender or to a third person to confess judgment or to appear for a borrower in a judicial proceeding, or an instrument in which blanks are left to be filled in after an equity loan is executed.

Art. 5A.27. OWNER ACKNOWLEDGMENT. Authorizes a lienholder or assignee for value to conclusively rely on an acknowledgment by the owner of homestead property and the owner's spouse, if the owner is married, of compliance with applicable requirements for an equity loan secured by a mortgage, trust deed, or other lien on a homestead.

Art. 5A.28. REPORT BY LENDERS. Requires a lender, before March 1 of each year, that makes an equity loan to submit to the director of the division of access to financial services a report of the lender's home equity loan activity during the calendar year preceding the year the report is submitted. Sets forth requirements for the report. Authorizes the director of the division of access to financial services to collect a reasonable filing fee. Authorizes the director to accept a copy of a report submitted by the lender to a federal agency instead of the report required under Subsection (a), if the report contains the required information. Provides that a lender that does not make a home equity loan during the period covered by a report is not required to submit the report.

Art. 5A.29. EQUITY LOAN RECOVERY FUND. Requires the commissioner to establish

and maintain an equity loan recovery fund. Requires money in the fund to be used for reimbursing aggrieved persons who suffer certain actual damages. Prohibits an action for judgment that subsequently results in an order for collection from being started later than two years after the date of accrual of the cause of action. Requires money received by the commissioner for deposit in the equity loan recovery fund to be held by the commissioner in trust for carrying out the purposes of the fund. Requires the Finance Commission of Texas (finance commission) to establish and collect reasonable and necessary fees from each authorized lender for each home equity loan originated by the lender to accomplish the purposes of this article. Requires collected fees to be deposited into the fund. Requires the finance commission to adopt rules necessary to implement this article.

SECTION 3. Amends Chapter 2, Title 79, V.T.C.S. (Article 5069-2.01 et seq., V.T.C.S.), by adding Articles 2.02E and 2.02F, as follows:

Art. 2.02E. DIVISION OF ACCESS TO FINANCIAL SERVICES. Provides that the division of access to financial services is created in the Office of Consumer Credit Commissioner to inform, monitor, and report on the availability and quality of home equity loans. Requires the division to be administered by a director appointed by the commissioner. Requires the director to adequately staff the division to carry out the division's functions under this article. Sets forth the required duties of the division. Authorizes the division to apply for and receive public and private grants and gifts as well as to contract with public and private entities to carry out studies and analyses under this article. Requires the consumer credit commissioner to establish and collect reasonable and necessary fees to accomplish the purposes of this article.

Art. 2.20F. STUDY AND REPORT; EQUITY LOANS. Requires the director of the division of access to financial services, after May 1, 2000, to conduct a study of equity lending under Chapter 5A of this title. Requires the director, before January 1, 2001, to submit a report on its study to the governor, lieutenant governor, and speaker of the house of representatives. Sets forth the required contents of the report. Provides that this section expires January 2, 2001.

SECTION 4. Amends Article 9.02, Insurance Code, by adding Subsection (r), to define "equity loan mortgagee policy."

SECTION 5. Amends Section 9.07, Insurance Code, by adding Subsection (g), to require the commissioner of insurance (COI) to promulgate an endorsement that must be attached to an equity loan mortgagee policy. Sets forth requirements for the endorsement. Authorizes COI to promulgate other policies and endorsements relating to an equity loan security interest in a homestead.

SECTION 6. Effective date: January 1, 1998, pending voter approval.

SECTION 7. Emergency clause.

SUMMARY OF COMMITTEE CHANGES

SECTION 2.

Page 5, after line 14, add Subdivision (4), regarding loans for purchase by the Federal National Mortgage Association or Federal Home Loan Mortgage Corporation. Makes conforming changes.