

BILL ANALYSIS

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S.B. 1994
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AUTHOR'S / SPONSOR'S STATEMENT OF INTENT

Recent years have seen a spike in the prevalence of a particularly insidious category of mortgage fraud involving so-called "wrap" financing, in which a seller finances the sale of a residential property that already is subject to an outstanding lien, often without notifying the buyer of the senior lien, or the existing lienholder of the sale. If a seller fails to pay the senior mortgagee, the mortgagee can foreclose on the property, and the buyer will be ousted without ever having missed a payment to the wrap seller. Worse, if the seller never recorded the conveyance, it can be difficult to establish that the buyer has any interest in the property.

Such activities may already subject the seller to administrative penalties, civil liability, or criminal punishment, but significant obstacles under current law impede both the successful prosecution of bad actors and the recovery of civil damages on behalf of a victim. For example, licensing and registration requirements are ambiguous, making it difficult for regulators to intervene. Prosecution for fraud requires establishing intent beyond a reasonable doubt, which may cause some prosecutors to treat these as mere breach-of-contract cases. Finally, if the seller becomes insolvent, the buyer may not be able to recover damages, because the bank will have a prior interest in the real property, while the buyer will be in the position of an unsecured creditor vis-à-vis the insolvent seller.

S.B. 1994 addresses a number of these issues. For example, the bill would ensure that persons engaged in the type of wrap transaction most susceptible to abuse would have to register with the Texas Department of Savings and Mortgage Lending—there would be no "de minimis" exception as there is for other types of seller-financed transactions. What's more, the bill would provide that wrap payments are held in trust by the seller for the benefit of the buyer. This would ease prosecution of bad actors, as conversion of trust assets would itself be a crime, regardless of any larger intent to defraud. This also could ease recovery of damages, as the buyer would be entitled to recover the proceeds of converted trust assets. Finally, S.B. 1994 voids the lien of a wrap sale that was not closed in a title office and to which the senior mortgagee did not give written consent.

As proposed, S.B. 1994 amends current law relating to the financing of residential real estate purchases by means of a wrap mortgage loan and creates an offense.

RULEMAKING AUTHORITY

Rulemaking authority is expressly granted to the Finance Commission of Texas in SECTION 7 (Section 159.252, Finance Code) of this bill.

SECTION BY SECTION ANALYSIS

SECTION 1. Amends Section 156.002, Finance Code, by adding Subdivision (16) to define "wrap mortgage loan."

SECTION 2. Amends Section 156.202(a-1), Finance Code, to provide that certain entities are exempt from this chapter, including any owner of residential real estate who in any 12-consecutive-month period makes no more than five residential mortgage loans, none of which is a wrap mortgage loan, to certain purchasers.

SECTION 3. Amends Section 157.002, Finance Code, by adding Subdivision (7) to define "wrap mortgage loan."

SECTION 4. Amends Sections 157.0121(b) and (c), Finance Code, as follows:

(b) Provides that certain individuals are exempt from this chapter, including any owner of residential real estate who in any 12-consecutive-month period makes no more than five residential mortgage loans, none of which is a wrap mortgage loan, to certain purchasers.

(c) Provides that employees of certain entities, when acting for the benefit of those entities, are exempt from the licensing and other requirements of this chapter applicable to residential mortgage loan originators, including any owner of residential real estate who in any 12-consecutive-month period makes no more than five residential mortgage loans, none of which is a wrap mortgage loan, to certain purchasers.

SECTION 5. Amends Section 158.002, Finance Code, by adding Subdivisions (8) and (9) to define "wrap lender" and "wrap mortgage loan."

SECTION 6. Amends Section 158.052, Finance Code, by amending Subsection (a) and adding Subsection (d), as follows:

(a) Creates an exception as provided by Subsection (d).

(d) Provides that this chapter applies to a wrap lender who services a wrap mortgage loan.

SECTION 7. Amends Subtitle E, Title 3, Finance Code, by adding Chapter 159, as follows:

CHAPTER 19. WRAP MORTGAGE LOAN FINANCING

SUBCHAPTER A. GENERAL PROVISIONS

Sec. 159.001. DEFINITIONS. Defines "commissioner," "finance commission," "residential mortgage loan," "residential real estate," "wrap borrower," "wrap lender," and "wrap mortgage loan."

SUBCHAPTER B. LICENSING

Sec. 159.051. LICENSE REQUIRED. (a) Prohibits an individual from making a wrap mortgage loan unless the individual meets certain criteria.

(b) Prohibits an entity from making a wrap mortgage loan unless the entity holds an active residential mortgage loan company license under Subchapter C (Residential Mortgage Loan Company Licenses and Registration), Chapter 156 (Residential Mortgage Loan Companies). Requires the entity to apply for and be issued a mortgage company license as provided by Section 156.2041 (Qualifications and Requirements for License: Mortgage Company).

(c) Provides that the requirement to obtain a license under Subsection (a) or (b) applies to an individual or entity making a wrap mortgage loan regardless of whether the person engages in a specific activity for which a license is required under Chapter 156 or 157 (Mortgage Bankers and Residential Mortgage Loan Originators) in connection with the making of the loan.

SUBCHAPTER C. DISCLOSURES AND CONSENT

Sec. 159.101. FOREIGN LANGUAGE REQUIREMENT; OFFENSE. (a) Requires the wrap lender to, if the negotiations that precede the execution of a wrap mortgage loan agreement are conducted primarily in a language other than English, provide a copy to the wrap borrower in that language of all written documents relating to the transaction, including certain documents.

(b) Provides that a person who violates this section commits an offense. Provides that an offense under this subsection is a Class A misdemeanor.

Sec. 159.102. ENFORCEABILITY OF WRAP LIEN. Provides that a lien securing a wrap mortgage loan is void and considered released without the necessity of a judicial determination unless certain criteria are met.

Sec. 159.103. FAILURE TO OBTAIN CONSENT AS DECEPTIVE TRADE PRACTICE. Provides that a wrap lender who makes a wrap mortgage loan without obtaining the written consent of a lienholder necessary under Section 159.102, or a person who knowingly assists a wrap lender in making a wrap mortgage loan without obtaining that consent, engages in a deceptive trade practice under Subchapter E (Deceptive Trade Practices and Consumer Protection), Chapter 17 (Deceptive Trade Practices), Business & Commerce Code, and that conduct is actionable under that subchapter.

Sec. 159.104. BUYER AS ATTORNEY IN FACT. (a) Provides that a wrap lender is considered to have given irrevocable consent to the wrap borrower as the lender's attorney in fact with respect to each unreleased lien on the property described by Section 159.001(7)(A) with respect to which the wrap lender was the grantor of the security interest or has assumed the debt secured by the lien.

(b) Authorizes the wrap borrower to, as the wrap lender's attorney in fact under this section, authorize certain activities and exercise certain powers.

Sec. 159.105. BORROWER'S RIGHT OF ACTION. (a) Authorizes a wrap borrower to bring certain actions.

(b) Authorizes a wrap borrower who prevails in an action under this section to recover court costs and reasonable attorney's fees.

Sec. 159.106. WAIVER OR AVOIDANCE PROHIBITED. (a) Provides that any purported waiver of a right of a wrap borrower under this subchapter or purported exemption of a person from liability for a violation of this subchapter is void.

(b) Prohibits a person who is a party to a residential real estate transaction from evading the application of this subchapter by any device, subterfuge, or pretense, and provides that any attempt to do so is void and a deceptive trade practice under Subchapter E, Chapter 17, Business & Commerce Code, and is actionable under that subchapter.

SUBCHAPTER D. DUTIES OWED TO WRAP BORROWER

Sec. 159.151. MONEY HELD IN TRUST. Provides that a person who collects or receives a payment from a wrap borrower under the terms of a wrap mortgage loan holds the money in trust for the benefit of the borrower.

Sec. 159.152. FIDUCIARY DUTY. Provides that, a person who collects or receives a payment from a wrap borrower under the terms of or in connection with a wrap mortgage loan owes a fiduciary duty to the wrap borrower to use the payment to satisfy the wrap lender's obligations under each debt described by Section 159.001(7)(A)(ii) and any other obligation affecting the residential real estate for which the wrap lender is responsible.

Sec. 159.153. DECEPTIVE TRADE PRACTICE. Provides that, in addition to any other penalties or remedies provided by law, a breach of a duty created by this subchapter is a deceptive trade practice under Subchapter E, Chapter 17, Business & Commerce Code, and is actionable under that subchapter.

SUBCHAPTER E. WRAP BORROWER'S RIGHTS

Sec. 159.201. APPLICABILITY OF SUBCHAPTER. (a) Provides that, subject to Subsection (b), this subchapter applies only to a wrap mortgage loan for a purchase of residential real estate to be used as the wrap borrower's residence.

(b) Provides that this subchapter does not apply to a wrap mortgage loan for a sale of residential real estate that is the wrap lender's homestead.

Sec. 159.202. WRAP BORROWER'S RIGHT TO DEDUCT. Authorizes the wrap borrower to, without taking judicial action, deduct certain amounts from any amount owed to the wrap lender under the terms of the wrap mortgage loan.

SUBCHAPTER F. ENFORCEMENT OF CERTAIN REGISTRATION REQUIREMENTS

Sec. 159.251. APPLICABILITY OF SUBCHAPTER. Provides that this subchapter applies only to a wrap lender who is required to register as a residential mortgage loan servicer under Chapter 158(Residential Mortgage Loan Servicers).

Sec. 159.252. INSPECTION; INVESTIGATION. (a) Authorizes the savings and mortgage lending commissioner (commissioner) to conduct an inspection of a wrap lender registered under Chapter 158 as the commissioner determines necessary to determine whether the wrap lender is complying with that chapter and applicable rules. Authorizes the inspection to include an inspection of the books, records, documents, operations, and facilities of the wrap lender. Authorizes the commissioner to share evidence of criminal activity gathered during an inspection or investigation with any state or federal law enforcement agency.

(b) Authorizes the commissioner at any time to, for reasonable cause, investigate a wrap lender registered under Chapter 158 to determine whether the lender is complying with that chapter and applicable rules.

(c) Authorizes the commissioner to conduct an undercover or covert investigation only if the commissioner, after due consideration of the circumstances, determines that the investigation is necessary to prevent immediate harm and to carry out the purposes of Chapter 158.

(d) Requires the Finance Commission of Texas (finance commission), by rule, to provide guidelines to govern an inspection or investigation under this section, including certain rules.

(e) Provides that information obtained by the commissioner during an inspection or investigation under this section is confidential unless disclosure of the information is permitted or required by other law.

(f) Authorizes the commissioner to share information gathered during an investigation under this section with a state or federal agency. Authorizes the commissioner to share information gathered during an inspection with a state or federal agency only if the commissioner determines there is a valid reason for the sharing.

(g) Authorizes the commissioner to require reimbursement of expenses for each examiner for an on-site examination or inspection of a registered wrap lender under this section if records are located out of state and are not made available for examination or inspection by the examiner in this state. Requires the finance commission, by rule, to set the maximum amount for the reimbursement of expenses authorized under this subsection.

Sec. 159.253. ISSUANCE AND ENFORCEMENT OF SUBPOENA. (a) Authorizes the commissioner to, during an investigation conducted under this subchapter, issue a subpoena that is addressed to a peace officer of this state or other person authorized by

law to serve citation or perfect service. Authorizes the subpoena to require a person to give a deposition, produce documents, or both.

(b) Authorizes the commissioner to petition a district court in Travis County to issue a certain order, if a person disobeys a subpoena or if a person appearing in a deposition in connection with the investigation refuses to testify. Requires the court to promptly set an application to enforce a subpoena issued under Subsection (a) for hearing and cause notice of the application and the hearing to be served on the person to whom the subpoena is directed.

SECTION 8. Amends Section 180.002, Finance Code, by adding Subdivision (24) to define "wrap mortgage loan."

SECTION 9. Amends Section 180.003(a), Finance Code, to provide that certain people are exempt from this chapter, including an owner of residential real estate and an owner of a dwelling who in any 12-consecutive-month period makes no more than five residential mortgage loans, none of which is a wrap mortgage loan, to certain purchasers.

SECTION 10. Effective date: September 1, 2017.