

BILL ANALYSIS

Senate Research Center
85R28176 AJA-F

C.S.S.B. 1994
By: Zaffirini et al.
Business & Commerce
5/4/2017
Committee Report (Substituted)

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. (Original Author's / Sponsor's Statement of Intent)

C.S.S.B. 1994 amends current law relating to residential mortgage loans, including the financing of residential real estate purchases by means of a wrap mortgage loan, provides licensing requirements, and authorizes an administrative penalty.

RULEMAKING AUTHORITY

Rulemaking authority is expressly granted to the Finance Commission of Texas in SECTION 3 (Sections 159.107 and 159.252, Finance Code) of this bill.

SECTION BY SECTION ANALYSIS

SECTION 1. Amends Section 156.202, Finance Code, by amending Subsection (a-1) and adding Subsection (b), as follows:

- (a) Provides that certain entities are exempt from this chapter, including, subject to Subsection (b), any owner of residential real estate who in any 12-consecutive-month period makes no more than five residential mortgage loans to certain purchasers.

(b) Provides that, in determining eligibility for an exemption under Subsection (a-1)(3) (relating to exempting a certain owner of residential real estate from Chapter 156 (Residential Mortgage Loan Companies)), two or more owners of residential real estate are considered a single owner for the purpose of computing the number of mortgage loans made within the period specified by that subdivision if any of the owners meet certain conditions.

SECTION 2. Amends Section 157.0121, Finance Code, by amending Subsection (c) and adding Subsection (f), as follows:

(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, subject to Subsection (f), any owner of residential real estate who in any 12-consecutive-month period makes no more than five residential mortgage loans to certain purchasers.

(f) Provides that, in determining eligibility for an exemption under Subsection (c)(2) (relating to any owner of residential real estate who in any 12-consecutive-month period makes no more than five residential mortgage loans to certain purchasers), two or more owners of residential real estate are considered a single owner for the purpose of computing the number of mortgage loans made within the period specified by that subdivision if any of the owners meet certain conditions.

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

CHAPTER 159. 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."

Sec. 159.002. INAPPLICABILITY OF CHAPTER. (a) Defines "unimproved residential real estate."

(b) Provides that, notwithstanding any other provision of this chapter, this chapter does not apply to a wrap mortgage loan made by or on behalf of an owner of unimproved residential real estate to a purchaser of that residential real estate if certain conditions are met.

Sec. 159.003. EXEMPTIONS. (a) Provides that certain entities and persons are exempt from this chapter.

(b) Provides that, in determining eligibility for an exemption under Subsection (a)(5) (relating to an owner of residential real estate who in any 12-consecutive-month period makes no more than five wrap mortgage loans to certain purchasers), two or more owners of residential real estate are considered a single owner for the purpose of computing the number of mortgage wrap loans made within the period specified by that subdivision if any of the owners meet certain conditions.

SUBCHAPTER B. LICENSING

Sec. 159.051. LICENSE REQUIRED. (a) Prohibits a person from originating or making a wrap mortgage loan unless the person meets certain criteria.

(b) Provides that the requirement to hold a license under Subsection (a) applies to a person originating or 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 originating or making of the loan.

SUBCHAPTER C. TRANSACTION REQUIREMENTS; REMEDIES

Sec. 159.101. DISCLOSURE STATEMENT. (a) Requires a certain wrap lender, on or before the seventh day before the wrap mortgage loan agreement is entered into, to provide to the wrap borrower a separate written disclosure statement in at least 12-point type that contains the information required for a written disclosure statement under Section 5.016 (Conveyance of Residential Property Encumbered by Lien), Property Code.

(b) Requires that the wrap lender's disclosure statement to the wrap borrower include a statement in a form substantially similar to a certain statement, regardless of whether the wrap lender provides a written disclosure statement under Subsection (a) or under Section 5.016, Property Code. Sets forth the statement's content.

Sec. 159.102. FOREIGN LANGUAGE REQUIREMENT. Requires the wrap lender to provide a copy of the required disclosure statement in that language to the wrap borrower, regardless of whether the wrap lender provides a written disclosure statement under Section 159.101 or under Section 5.016, Property Code, if the negotiations that precede the execution of a wrap mortgage loan agreement are conducted primarily in a language other than English.

Sec. 159.203. FAILURE TO PROVIDE DISCLOSURE: TOLLING OF LIMITATIONS. Provides that, if a wrap lender fails to provide the disclosure statement as required by Section 159.101 or fails to provide the disclosure statement in the language required by Section 159.102, the limitations period applicable to any cause of action of the wrap borrower against the wrap lender arising out of the wrap lender's violation of a law of this state in connection with the wrap mortgage loan transaction is tolled until the 120th day after the date the required disclosure statement is provided.

Sec. 159.104. ENFORCEABILITY OF WRAP LIEN. Provides that a lien securing a wrap mortgage loan is void unless certain criteria are met.

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 (Deceptive Trade Practices and Consumer Protection), Chapter 17 (Deceptive Trade Practices), Business & Commerce Code, and is actionable under that subchapter.

Sec. 159.107. RULEMAKING AUTHORITY. Authorizes the Finance Commission of Texas (finance commission), to adopt and enforce rules necessary for the intent of or to ensure compliance with this 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) (relating to the definition of "wrap mortgage loan" to mean a residential mortgage loan securing a certain debt) and any other obligation affecting the residential real estate for which the wrap lender is responsible.

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, 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.

SUBCHAPTER G. ENFORCEMENT OF CHAPTER

Sec. 159.301. CEASE AND DESIST ORDER. (a) Authorizes the commissioner, if the commissioner has reasonable cause to believe that a wrap lender or wrap mortgage loan originator to whom this chapter applies has violated or is about to violate this chapter, to issue without notice and hearing an order to cease and desist from continuing a particular action or an order to take affirmative action, or both, to enforce compliance with this chapter.

(b) Requires that an order issued under Subsection (a) contain a reasonably detailed statement of the facts on which the order is made. Requires the commissioner, if a person against whom the order is made requests a hearing, to set and give notice of a hearing before the commissioner or a hearings officer. Requires the hearing to be governed by Chapter 2001 (Administrative Procedure), Government Code. Authorizes the commissioner, based on the findings of fact, conclusions of law, and recommendations of the hearings officer, by order, to find a violation has occurred or not occurred.

(c) Provides that, if a hearing is not requested under Subsection (b) not later than the 30th day after the date on which an order is made, the order is considered final and not appealable.

(d) Authorizes the commissioner, after giving notice and an opportunity for hearing, to impose against a person who violates a cease and desist order an administrative penalty in an amount no the exceed \$1,000 for each day of the violation. Authorizes the commissioner, in addition to any other remedy provided by law, to institute in district court a suit for injunctive relief and to collect the administrative penalty. Provides that a bond is not required of the commissioner with respect to injunctive relief granted under this subsection.

SECTION 4. Amends Section 180.003, Finance Code, by amending Subsection (a) and adding Subsection (d), as follows:

(a) Provides that certain persons are exempt from this chapter, including, subject to Subsection (d), 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 to certain purchasers.

(d) Provides that, in determining eligibility for an exemption under Subsection (a)(5) (relating to any owner of residential real estate who in any 12-consecutive-month period makes no more than five residential mortgage loans to certain purchasers) or (6) (relating to any owner of dwelling who in any 12-consecutive-month period makes no more than five residential mortgage loans to certain purchasers), two or more owners of residential real estate or a dwelling, as applicable, are considered a single owner for the purpose of computing the number of mortgage loans made within the period specified by those subdivisions if any of the owners meet certain conditions.

SECTION 5. Effective date: September 1, 2017.