

BILL ANALYSIS

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C.S.S.B. 42
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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 is already subject to an outstanding lien, often without notifying the buyer of the senior lien, or the existing lienholder of the sale. If the seller fails to pay the senior mortgagee, the mortgagee can foreclose on the property, and the buyer, who often lives on the property, would 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 also 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. 42 addresses a number of these issues. Specifically, 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 a constructive 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. 42 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. 42 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 and registration requirements; and authorizes an administrative penalty.

RULEMAKING AUTHORITY

Rulemaking authority is expressly granted to the Finance Commission of Texas in SECTION 3 (Sections 159.101, 159.108, 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-1) Provides that certain entities are exempt from this chapter (Residential Mortgage Loan Companies).

(b) Provides that in determining eligibility for an exemption under Subsection (a-1)(3), 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 Section 1.002(1) (relating to the definition of affiliate), Business Organizations Code, or if any of the owners have substantially common ownership, as determined by the savings and mortgage lending commissioner (commissioner).

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 are exempt from the licensing and other requirements of this chapter (Mortgage Bankers and Residential Mortgage Loan Originators).

(f) Provides that in determining eligibility for an exemption under Subsection (c)(2), 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 are affiliates, as defined by Section 1.002(1), Business Organizations Code, or if any of the owners have substantially common ownership, as determined by the commissioner.

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:

(1) made by or on behalf of an owner of unimproved residential real estate to a purchaser of that residential real estate if:

(A) the residential real estate purchased will not continue to be subject to any unreleased lien described by Subsection 159.001(7)(A) that secures a debt that is subject to a due-on-sale clause in connection with which the lien holder is authorized to foreclose the lien; or

(B) the residential real estate purchased will continue to be subject to an unreleased lien described by Paragraph (A) and the holder of that unreleased lien has consented to the sale of the residential real estate; or

(2) for a sale of residential real estate that is the wrap lender's homestead.

Sec. 159.003. EXEMPTIONS. (a) Provides that the following persons are exempt from this chapter:

(1) a federally insured bank, savings bank, savings and loan association, Farm Credit System Institution, or credit union;

(2) a subsidiary of a federally insured bank, savings bank, savings and loan association, Farm Credit System Institution, or credit union;

(3) the state or a governmental agency, political subdivision, or other instrumentality of the state, or an employee of the state or a governmental agency, political subdivision, or instrumentality of the state who is acting within the scope of the person's employment; or

(4) subject to Subsection (b), an owner of residential real estate if the owner does not in any 12-consecutive-month period make, or contract with another person to make, more than five wrap mortgage loans to purchasers of the property for all or part of the purchase price of the residential real estate against which the mortgage is secured.

(b) Provides that in determining eligibility for an exemption under Subsection (a)(4), two or more owners of residential real estate are considered a single owner for the purpose of computing the number of wrap mortgage loans made within the period specified by that subdivision if any of the owners are affiliates, as defined by Section 1.002(1), Business Organization Code, or if any of the owners have substantially common ownership, as determined by the commissioner.

SUBCHAPTER B. LICENSING OR REGISTRATION

Sec. 159.051. LICENSE OR REGISTRATION REQUIRED. Prohibits a person from originating or making a wrap mortgage loan unless the person is licensed or registered to originate or make residential mortgage loans under Chapter 156, 157, or 342 (Consumer Loans) or is exempt from licensing or registration as provided under an applicable provision of those chapters.

SUBCHAPTER C. TRANSACTION REQUIREMENTS; REMEDIES

Sec. 159.101. DISCLOSURE STATEMENT; OPTION TO RESCIND. (a) Requires a wrap lender to, 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:

(1) contains the information required for a written disclosure statement under Section 5.016 (Conveyance of Residential Property Encumbered by Lien), Property Code; and

(2) include a specified statement to the wrap borrower.

(b) Requires the disclosure statement required under Subsection (a) to be dated and signed by the wrap borrower when the wrap borrower receives the statement.

(c) Requires the Finance Commission of Texas (finance commission) by rule to adopt a model disclosure statement that satisfies the requirements of Subsection (a).

(d) Authorizes the wrap borrower, if the disclosure statement required under Subsection (a) and any disclosure required by Section 159.102 are received by the wrap borrower on or before the closing date of the wrap mortgage loan, to rescind the wrap mortgage loan agreement and any related purchase agreement or other agreement relating to the loan transaction not later than the seventh day after the date of receipt of the disclosure statement, regardless of whether the disclosure is timely made. Provides that, on rescission under this subsection, the wrap borrower is entitled to a return of any earnest money, escrow amounts, down payment,

or other fees or charges paid in connection with the mortgage loan, the related purchase transaction, and any other related transaction.

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

Sec. 159.103. 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 required.

Sec. 159.104. FAILURE TO PROVIDE DISCLOSURE BEFORE CLOSING; RIGHT OF RESCISSION. (a) Authorizes the wrap borrower, subject to Subsection (b), if a wrap mortgage loan is closed without the wrap lender providing the disclosure statement required by Section 159.101 or any disclosure required by Section 159.102, to rescind the wrap mortgage loan agreement and the related purchase agreement at any time by providing the wrap lender notice of rescission in writing.

(b) Authorizes the wrap borrower, if the wrap borrower receives a required disclosure statement under Section 159.101 or 159.102 after the date the wrap mortgage loan is closed but before the wrap borrower provides notice of rescission, to rescind the wrap mortgage loan agreement and the related purchase agreement in writing on or before the 21st day after the date of receipt of the disclosure statement.

(c) Requires the wrap lender, not later than the 30th day after the date the wrap borrower provides notice of rescission under this section, to return to the wrap borrower:

(1) all principal and interest payments made by the wrap borrower on the wrap mortgage loan;

(2) any money or property given as earnest money, a down payment, or otherwise in connection with the wrap mortgage loan or related purchase transaction; and

(3) any escrow amounts for the wrap mortgage loan or related purchase transaction.

(d) Requires the wrap borrower, on the date on which all of the returned money or property described by Subsection (c) is received by the wrap borrower, to convey to the wrap lender or the wrap lender's designee the residential real estate described by Section 159.001(7)(A). Requires the wrap borrower to surrender possession of the residential real estate not later than the 30th day after the date of the wrap borrower's receipt of the money or property returned as described by this subsection.

(e) Authorizes the wrap lender, notwithstanding Subsection (a) or (b), to avoid rescission if not later than the 30th day after the date of receipt of notice of rescission under Subsection (a), the wrap lender,:

(1) pays the outstanding balance due on any debt described by Section 159.001(7)(A)(ii);

(2) pays any due and unpaid taxes or other government assessment on the residential real estate described by Section 159.001(7)(A);

(3) pays to the wrap borrower as damages for noncompliance the sum of \$1,000 and any reasonable attorney's fees incurred by the wrap borrower; and

(4) provides to the wrap borrower evidence of compliance with Subdivisions (1) and (2).

Sec. 159.105. ENFORCEABILITY OF WRAP LIEN. Provides that a lien securing a wrap mortgage loan is void unless the wrap mortgage loan and the conveyance of the residential real estate securing the loan are signed by an attorney or a title company.

Sec. 159.106. BORROWER'S RIGHT OF ACTION. (a) Authorizes a wrap borrower to bring an action to:

(1) obtain declaratory or injunctive relief to enforce this subchapter;

(2) recover any actual damages suffered by the wrap borrower as a result of a violation of this subchapter; or

(3) obtain other remedies available under this subchapter or in an action under Section 17.50 (Relief For Consumers), Business & Commerce Code, as otherwise authorized under this subchapter.

Sec. 159.107. 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, Business & Commerce Code, and is actionable under this subchapter.

Sec. 159.108. RULEMAKING AUTHORITY. Authorizes the 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 obligations of the obligee under each debt described by Section 159.001(7)(A)(ii) and the payment of taxes and insurance for which the wrap lender has received any payments from the wrap borrower.

SUBCHAPTER E. WRAP BORROWER'S RIGHTS

Sec. 159.201. APPLICABILITY OF SUBCHAPTER. Provides that 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.

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

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 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, for reasonable cause, to at any time 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 for 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, during an investigation conducted under this subchapter, to 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, if a person disobeys a subpoena or if a person appearing in a deposition in connection with the investigation refuses to testify, to petition a district court in Travis County to issue an order requiring the person to obey the subpoena, testify, or produce documents relating to the matter. Requires the court to promptly set an application to enforce a subpoena issued under Subsection (a) for hearing and to 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 an order issued under Subsection (a) to 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 hearing officer. Requires the hearing to be governed by Chapter 2001 (Administrative Procedure), Government Code. Authorizes the commissioner by order to find a violation has occurred or not occurred, based on the findings of fact, conclusions of law, and recommendations of the hearings officer.

(c) Provides that if a hearing is not requested under Subsection (b) on or before 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 not to 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 (Residential Mortgage Loan Originators).

(d) Provides that in determining eligibility for an exemption under Subsection (a)(5) or (6), 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 are affiliates, as defined by Section 1.002(1), Business Organizations Code, or if any of the owners have substantially common ownership, as determined by the commissioner.

SECTION 5. Effective date: January 1, 2020.