

BILL ANALYSIS

Senate Research Center

S.B. 43
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Enrolled

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 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 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. 43 addresses a number of these issues. Specifically, the bill would close loopholes that have allowed bad actors to evade registration or licensure using so-called "de minimis" exceptions meant to exempt small businesses like "house flippers" from registering as financial services providers. 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. 43 requires wrap sellers to properly disclose the nature and risks of the wrap transaction to their buyers and offers consumers the right to rescind the transaction when those disclosures are not made timely.

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

S.B. 43 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 the following entities are exempt from Chapter 156 (Residential Mortgage Loan Companies):

(1) and (2) makes no changes to these subdivisions;

(3) subject to Subsection (b), any owner of residential real estate who in any 12-consecutive-month period makes no more than three, rather than five, residential 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; and

(4) Makes no changes to this subdivision.

(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 that subdivision if any of the owners are an entity or an affiliate of an entity, including a general partnership, limited partnership, limited liability company, or corporation, as defined by Section 1.002 (Definitions), Business Organizations Code.

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

(c) Provides that employees of the following entities, when acting for the benefit of those entities, are exempt from the licensing and other requirements of Chapter 157 (Mortgage Bankers and Residential Mortgage Loan Originators) applicable to residential mortgage loan originators:

(1) makes no changes to this subdivision;

(2) subject to Subsection (f), any owner of residential real estate who in any 12-consecutive-month period makes no more than three, rather than five, residential 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; and

(3) makes no changes to this subdivision.

(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 an entity or an affiliate of an entity, including a general partnership, limited partnership, limited liability company, or corporation, as defined by Section 1.002, Business Organizations Code.

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 Section 159.001(7)(A)

that secures a debt that is subject to a due-on-sale clause in connection with which the lienholder 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 three 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 mortgage loans made within the period specified by that subdivision if any of the owners are an entity or an affiliate of an entity, including a general partnership, limited partnership, limited liability company, or corporation, as defined by Section 1.002, Business Organizations Code.

SUBCHAPTER B. LICENSING OR REGISTRATION

Sec. 159.051. LICENSE OR REGISTRATION REQUIRED. Prohibits a person from originating 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, 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) includes a statement in a form substantially similar to a certain form.

(b) Requires the wrap borrower to sign and date the disclosure statement required under Subsection (a) 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) Provides certain circumstances and requirements under which the wrap borrower is authorized to rescind the wrap mortgage loan agreement and any related purchase agreement. Provides certain monetary return requirements for the wrap borrower in the event of a rescission.

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

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 that arises 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. FAILURE TO PROVIDE DISCLOSURE BEFORE CLOSING; RIGHT OF RESCISSION. (a) Authorizes the wrap borrower 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, 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.

(b) Authorizes the wrap borrower 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 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.

(c) Provides certain requirements for the wrap lender to return certain payments to the wrap borrower in the event of a rescission.

(d) Provides certain requirements for the wrap borrower to notify and return real estate to the wrap lender or wrap lender's designee in the event of a rescission.

(e) Provides that, notwithstanding Subsection (a) or (b), the wrap lender is authorized 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 closed 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.

(b) Authorizes a wrap borrower who prevails in such an action to recover court costs and reasonable attorneys fees.

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 (Deceptive Trade Practices), Business & Commerce Code, and is actionable under that 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 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 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 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 and for a reasonable cause, to 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 rules to:

(1) determine the information and records of the wrap lender to which the commissioner is authorized to demand access during an inspection or investigation; and

(2) establish what constitutes reasonable cause for an investigation.

(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 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 Texas. 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 Texas or other person authorized by law to serve citation or perfect service. Provides that the subpoena is authorized 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 an order requiring a person to obey a subpoena, testify, or produce documents relating to the matter if the person disobeys a subpoena or if the 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 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 an order to cease and desist from a particular action or an order to take affirmative action to a wrap lender or wrap mortgage loan originator 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 to set and give notice of a hearing before the commissioner or a hearings officer in the event a person against whom the order is made requests a hearing. Requires that the hearing 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 to institute in district court a suit for injunctive relief and to collect the administrative penalty in addition to any other remedy provided by law. 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 the following persons are exempt from Chapter 180 (Residential Mortgage Loan Originators):

(1)-(4) makes no changes to these subdivisions;

(5) subject to Subsection (d), an owner of residential real estate who in any 12-consecutive-month period makes no more than three, rather than five, residential 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; and

(6) subject to Subsection (d), an owner of a dwelling who in any 12-consecutive-month period makes no more than three, rather than five, residential mortgage loans to purchasers of the property for all or part of the purchase price of the dwelling against which the mortgage or security interest is secured.

(d) Provides that in determining eligibility for an exemption under Subsection (a)(5) or (6), 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 an entity or an affiliate of an entity, including a general partnership, limited partnership, limited liability company, or corporation, as defined by Section 1.002, Business Organizations Code.

SECTION 5. Effective date: January 1, 2022.