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December 6, 2021- **REV.** December 31, 2021

(Final Wrap Mortgage Loan Rules adopted – see page 5 of this Legislative Update.)

To: Clients and Friends

From: David F. Dulock

Subject: Texas Legislative Update V – Senate Bill 43 Adds Chapter 159, Finance Code, Financing Purchase of Residential Real Estate with Wrap Mortgage Loan

This legislative update addresses Senate Bill 43 from the 2021 Regular Legislative Session. Senate Bill 43 is effective January 1, 2022. Prior to this legislative update, we issued Legislative Update I, summarizing bills effective immediately; Legislative Update II, summarizing bills effective September 1, 2021; Legislative Update III, summarizing Proposed Constitutional Amendments SJR 35 and HJR 125; and Legislative Update IV, summarizing House Bill 2237's revisions to Chapter 53 of the Property Code. Legislative Updates I, II, III and IV may be found on the Resources page of the firm's website www.bmandg.com.

According to the Original Author's/Sponsor's Statement of Intent in the Bill Analysis, [Senate Bill 43](#) would close loopholes that have allowed evasion of registration or licensure; would provide that wrap payments are held in a constructive trust for the benefit of wrap borrowers; requires wrap lenders to properly disclose the nature and risks of wrap mortgage loans to their wrap borrowers; and offers wrap borrowers the right to rescind wrap mortgage loans when those disclosures are not made timely.

In addition to addressing wrap mortgage loans under new Chapter 159, Senate Bill 43 also amends Finance Code Sections 156.202, 157.0121 and 180.003, as follows:

Section 156.202 (Exemptions) is amended by amending Subdivision (a-1) (3) of Subsection (a-1) and adding Subsection (b), as follows:

Subsection (a-1) provides that the entities listed in subdivisions (a-1) (1), (2), (3) and (4) are exempt from Chapter 156 (Residential Mortgage Loan Companies). As amended, Subdivision (a-1) (3) provides that its exemption is subject to new Subsection (b) and applies to any owner of residential real estate who in any 12-consecutive-month period makes no more than three (instead of 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.

Subsection (b) provides that in determining eligibility for an exemption under subdivision (a-1) (3), two or more owners of residential real estate are considered a single owner 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 157.0121 (Exemptions from Residential Mortgage Loan Originator Requirements) is amended by amending Subsection (c) and adding Subsection (f) to provide similar exemption provisions for entity employees and owners as are provided for entities and owners in Subsections (a-1) and (b) of Section 156.202 above.

Section 180.003 (Exemption) is amended by amending Subsection (a) and adding Subsection (d) to provide similar exemption provisions for entities and owners as are provided for entities and owners in Subsections (a-1) and (b) of Section 156.202 above.

(7 pages)

Senate Bill 43 adds Chapter 159 (Wrap Mortgage Loan Financing) to the Finance Code, as follows:

SUBCHAPTER A. GENERAL PROVISIONS

Section 159.001 (Definitions) defines “commissioner,”(the TDSML commissioner); “finance commission,” (the Finance Commission of Texas); “residential mortgage loan,” (defined by §180.002); “residential real estate,” (defined by §180.002); “wrap borrower,”(person obligated on wrap mortgage loan); “wrap lender” (maker of a wrap mortgage loan; or residential real estate owner who contracts with wrap lender to make a wrap mortgage loan to a wrap borrower for purchase of the owner’s residential real estate); and “wrap mortgage loan,” which is a residential mortgage loan that:

- finances the purchase of residential real estate that:
 - will continue to be subject to a prior unreleased lien that:
 - secures an unpaid prior debt incurred by a person other than the wrap borrower; and
- obligates the wrap borrower to the wrap lender for payment of a debt the principal amount of which includes:
 - the outstanding balance of the prior debt; and
 - any remaining amount of the purchase price financed by the wrap lender.

Section 159.002 (Inapplicability of Chapter) provides that Chapter 159 does not apply to a wrap mortgage loan:

- made to a purchaser of unimproved residential real estate (*i.e.*, no dwelling has been constructed on subject real estate) by or on behalf of the owner if the unimproved residential real estate will not continue to be subject to a prior unreleased lien, described in Section 159.001 above, securing a debt subject to a due-on-sale clause by which the prior unreleased lien may be foreclosed; or
- the unimproved residential real estate will continue to be subject to a prior unreleased lien, described in Section 159.001 above, and the holder thereof has consented to the sale of the unimproved residential real estate; or
- for a sale of residential real estate that is the wrap lender’s homestead.

Section 159.003 (Exemptions) provides that the following persons are exempt from Chapter 159:

- (1) a federally insured bank, savings bank, savings and loan association, Farm Credit System Institution or credit union, and a subsidiary of any of the above federally insured institutions;
- (2) the state of Texas or a governmental agency, political subdivision, or other instrumentality of the state;
- (3) an employee of the state or a governmental agency, political subdivision or other instrumentality of the state acting within the scope of his or her employment;
- (4) subject to (5) below, an owner of residential real estate who in any 12-consecutive-month period makes, or contracts with another person to make, no more than three wrap mortgage loans to purchasers for all or part of the purchase price of the residential real estate against which the wrap mortgage loan is secured; and

(5) in determining exemption eligibility under (4) above, two or more owners of residential real estate are considered a single owner 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.

SUBCHAPTER B. LICENSING OR REGISTRATION

Section 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 or is exempt from licensing or registration as provided under an applicable provision of those chapters.

SUBCHAPTER C. TRANSACTION REQUIREMENTS; REMEDIES

Section 159.101 (Disclosure Statement; Option to Rescind). Subsection (a) requires a wrap lender, on or before the seventh day before the wrap mortgage loan 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 Property Code Section 5.016 (Conveyance of Residential Property Encumbered by Lien), and (2) includes a “Notice Regarding Property Insurance” substantially similar to the Notice in subdivision (a)(2).

Subsection (b) requires the wrap borrower to sign and date the disclosure statement required under Subsection (a) when the wrap borrower receives the statement.

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

Subsection (d) provides that if the wrap borrower receives the disclosure statement required by Subsection (a) and any foreign language disclosure required by Section 159.102 on or before the wrap mortgage loan closing date, the wrap borrower may rescind the wrap mortgage loan and any related purchase agreement or other related agreement not later than the seventh day after receipt of the disclosure statement, regardless of whether the disclosure is timely made; and on rescission, 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 wrap mortgage loan, the related purchase transaction, and any other related transaction.

Section 159.102 (Foreign Language Requirement) requires the wrap lender to provide to the wrap borrower a copy of a written disclosure statement required under Section 159.101 above or Property Code Section 5.016 in a language other than English if the negotiations that precede the execution of the wrap mortgage loan are conducted primarily in that language.

Section 159.103 (Failure to Provide Disclosure: Tolling of Limitations) provides that if a wrap lender fails to provide the disclosure statement 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 a cause of action of the wrap borrower against the wrap lender arising out of the wrap lender’s violation of a Texas law in connection with the wrap mortgage loan transaction is tolled until the 120th day after the date the required disclosure statement is provided.

Section 159.104 (Failure to Provide Disclosure Before Closing; Right of Rescission).

Subsection (a) provides, subject to Subsection (b), that if a wrap mortgage loan is closed without the wrap lender providing the Section 159.101 disclosure statement or any required Section 159.102 disclosure, the wrap borrower may rescind the wrap mortgage loan and related purchase agreement at any time by providing the wrap lender a written notice of rescission.

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

Subsection (c) requires, in the event of the wrap borrower's rescission under Section 159.104, that the wrap lender return, no later than the 30th day thereafter, to the wrap borrower: (1) the wrap mortgage loan principal and interest payments made by the wrap borrower; (2) any money or property given as earnest money, 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.

Subsection (d) provides that on the date the wrap borrower receives all the returned money or property above, the wrap borrower must convey to the wrap lender or its designee the residential real estate purchased with the wrap mortgage loan and, not later than the 30th day thereafter, the wrap borrower must surrender possession of the residential real estate.

Subsection (e) provides that, notwithstanding Subsection (a) or (b), the wrap lender may avoid rescission if not later than the 30th day after the date the wrap lender receives the notice of rescission under Subsection (a), the wrap lender: (1) pays the outstanding balance due on the prior debt described in the wrap mortgage loan definition in Section 159.001; (2) pays any due and unpaid taxes or other government assessment on the residential real estate purchased with the wrap mortgage loan; (3) pays the wrap borrower, as damages for noncompliance, \$1,000 and any reasonable attorney's fees the wrap borrower incurred; and (4) provides the wrap borrower evidence of compliance with subdivisions (1) and (2).

Section 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.

Section 159.106 (Borrower's Right of Action). Subsection (a) authorizes a wrap borrower to bring an action to:

- (1) obtain declaratory or injunctive relief to enforce Subchapter C;
- (2) recover actual damages suffered by the wrap borrower because of a violation of Subchapter C; or
- (3) obtain other remedies available under Subchapter C or in an action under Section 17.50 (Relief for Consumers), Business & Commerce Code, as otherwise authorized under Subchapter C.

Subsection (b) authorizes a wrap borrower who prevails in such an action to recover court costs and reasonable attorney's fees.

Section 159.107 (Waiver or Avoidance Prohibited). Subsection (a) provides that a purported waiver of a wrap borrower right under Subchapter C or purported exemption of a person from liability for a Subchapter C violation is void.

Subsection (b) prohibits a person who is a party to a residential real estate transaction from evading the application of Subchapter C 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 E.

Section 159.108 (Rulemaking Authority) authorizes the finance commission to adopt and enforce rules necessary for the intent of or to ensure compliance with Subchapter C.

(Our Comment: In the December 31, 2021 issue of the Texas Register (pages 9238 – 9240), the finance commission adopted final Wrap Mortgage Loan Rules, which may be accessed by clicking on this [hyperlink](#). These final Wrap Mortgage Loan Rules are effective on January 8, 2022.)

SUBCHAPTER D. DUTIES OWED TO WRAP BORROWER

Section 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 wrap borrower.

Section 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 the prior debt described in the wrap mortgage loan definition in Section 159.001 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

Section 159.201 (Applicability of Subchapter) states that Subchapter E applies only to a wrap mortgage loan for purchase of residential real estate to be used as the wrap borrower's residence.

Section 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: (1) the amount of any payment made by the wrap borrower to the obligee of the prior debt described in the wrap mortgage loan definition in Section 159.001 to cure a default by the wrap lender caused by the lender's failure to make payments for which the lender is responsible under the terms of the wrap mortgage loan; or (2) any other amount for which the wrap lender is liable to the wrap borrower under the terms of the wrap mortgage loan.

SUBCHAPTER F. ENFORCEMENT OF CERTAIN REGISTRATION REQUIREMENTS

Section 159.251 (Applicability of Subchapter) states that Subchapter F applies only to a wrap lender required to register as a residential mortgage loan servicer under Chapter 158 (Residential Mortgage Loan Servicers).

Section 159.252. (Inspection; Investigation). Subsection (a) authorizes the TDSML commissioner to conduct an inspection of the wrap lender to determine whether the wrap lender is complying with Chapter 158 and applicable rules, which may include an inspection of the books, records, documents, operations, and facilities of the wrap lender. It also authorizes the commissioner to share evidence of criminal activity gathered during an inspection or investigation of the wrap lender with any state or federal law enforcement agency.

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

Subsection (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.

Subsection (d) requires the finance commission by rule to adopt guidelines governing inspections and investigations, including rules to determine the information and records of the wrap lender to which the commissioner may demand access during an inspection or investigation and to establish what constitutes reasonable cause for an investigation.

Subsection (e) provides that information the commissioner obtains during an inspection or investigation is confidential unless other law permits or requires disclosure of the information.

Subsection (f) authorizes the commissioner to share information gathered during an investigation with a state or federal agency; and 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.

Subsection (g) authorizes the commissioner to require reimbursement of expenses for the examiner for an on-site examination or inspection of the wrap lender if records are located out of state and are not made available for examination or inspection by the examiner in Texas; and, requires the finance commission by rule to set the maximum amount for the reimbursement of those expenses.

Section 159.253 (Issuance and Enforcement of Subpoena). Subsection (a) authorizes the commissioner, during an investigation conducted under Subchapter F, to issue a subpoena addressed to a Texas peace officer or other person authorized by law to serve citation or perfect service. The subpoena may require a person to give a deposition, produce documents, or both.

Subsection (b) provides that if the person to whom the subpoena is directed disobeys the

subpoena or refuses to testify in a deposition, the commissioner is authorized to petition a Travis County district court to issue an order requiring the person to obey the subpoena, testify, or produce documents relating to the investigation. The court is then required to promptly set for hearing an application to enforce the subpoena and to cause notice of the application and the hearing to be served on the person.

(Our Comment: Subchapter F does not apply to wrap lenders who are not required to register as a residential mortgage loan servicer under Chapter 158—see Section 159.251.)

SUBCHAPTER G. ENFORCEMENT OF CHAPTER

Section 159.301 (Cease and Desist Order). Subsection (a) authorizes the TDSML commissioner, if the commissioner has reasonable cause to believe that a wrap lender or wrap mortgage loan originator to whom Chapter 159 applies has violated or is about to violate Chapter 159, to issue without notice and hearing an order to cease and desist from a particular action or an order to take affirmative action, or both, to enforce compliance with Chapter 159.

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

Subsection (c) provides that if a hearing under Subsection (b) is not requested on or before the 30th day after the date the order is issued, the order is considered final and not appealable.

Subsection (d) authorizes the commissioner, after giving notice and opportunity for a hearing, to impose against a person who violates a cease and desist order an administrative penalty not to exceed \$1,000 for each day of the violation; authorizes the commissioner to file a suit in district court for injunctive relief and to collect the administrative penalty in addition to any other remedy provided by law; and provides that a bond is not required of the commissioner for injunctive relief granted.

No attempt was made by this legislative update to address all the bills effective on January 1, 2022, that could affect residential mortgage lending, lenders, or loan originators. This legislative update is simply an attempt to advise our clients of Senate Bill 43. This legislative update does not contain a complete description of Senate Bill 43, and you are advised to review the entirety of Senate Bill 43 if you believe it affects your business. You may request a copy of Senate Bill 43 from us, or you may click on the Senate Bill 43 hyperlink on page 1 of this legislative update.

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