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June 26, 2006

TO: Clients and Friends

FROM: David F. Dulock

SUBJECT: Home Equity Lending – Revisions to Interpretations §§153.13, 153.18, 153.20

The Finance Commission of Texas and the Texas Credit Union Commission ("Commissions") have jointly revised the following home equity Interpretations of §50(a)(6), Article XVI, Texas Constitution: §153.13 (*Preclosing Disclosures*), §153.18 (*Limitation on Application of Proceeds*), and §153.20 (*No Blanks in Any Instrument*). These revised Interpretations are published in the June 23, 2006 issue of the *Texas Register* (Vol. 31, No. 25) and become effective June 29, 2006.

The full text of revised §§153.13, 153.18, and 153.20 are printed below along with our comments contained at the end of each Interpretation:

"*§153.13. Preclosing Disclosures: Section 50(a)(6)(M)(ii).*

An equity loan may not be closed before one business day after the date that the owner of the homestead receives a final itemized disclosure of the actual fees, points, interest, costs, and charges that will be charged at closing. If a bona fide emergency or another good cause exists and the lender obtains the written consent of the owner, the lender may provide the documentation to the owner or the lender may modify previously provided documentation on the date of closing.

(1) A lender may satisfy the disclosure requirement of this section by delivery to the borrower of a properly completed Department of Housing and Urban Development (HUD) disclosure Form HUD-l or HUD-lA.

(2) Bona fide emergency.

(A) An owner may consent to receive the preclosing disclosure or a modification of the preclosing disclosure on the date of closing in the case of a bona fide emergency occurring before the date of the extension of credit. An equity loan secured by a homestead in an area designated by Federal Emergency Management Agency (FEMA) as a disaster area is an example of a bona fide emergency if the homestead was damaged during FEMA's declared incident period.

(B) To document a bona fide emergency modification, the lender should obtain a written statement from the owner that:

(i) describes the emergency;

(ii) specifically states that the owner consents to receive the preclosing disclosure or a modification of the preclosing disclosure on the date of closing;

(iii) bears the signature of all of the owners entitled to receive the preclosing disclosure; and

(iv) affirms the owner has received notice of the owner's right to receive a final itemized disclosure containing all actual fees, points, costs, and charges one day prior to closing.

(3) Good cause. An owner may consent to receive the preclosing disclosure or a modification of the preclosing disclosure on the date of closing if another good cause exists.

(A) Good cause to modify the preclosing disclosure or to receive a subsequent disclosure modifying the preclosing disclosure on the date of closing may only be established by the owner.

(i) The term "good cause" as used in this section means a legitimate or justifiable reason, such as financial impact or an adverse consequence.

(ii) At the owner's election, a good cause to modify the preclosing disclosure may be established if:

(I) the modification does not create a material adverse financial consequence to the owner; or

(II) a delay in the closing would create an adverse consequence to the owner;

(iii) The term "de minimis" as used in this section means a very small or insignificant amount.

(B) At the owner's election, a de minimis good cause standard may be presumed if:

(i) the total actual disclosed fees, costs, points, and charges on the date of closing do not exceed in the aggregate more than the greater of $100 or 0.125 percent of the principal amount of the loan (e.g. 0.125 percent on a $80,000 principal loan amount equals $100) from the initial preclosing disclosure; or [*should be* "**and**" - *see attached Legal Advisory from the Commissions*]

(ii) each itemized fee, cost, point, or charge does not exceed more than the greater of $100 or 0.125 percent of the principal amount of the loan than the amount disclosed in the initial preclosing disclosure.

(C) To document a good cause modification of the disclosure, the lender should obtain a written statement from the owner that:

(i) describes the good cause;

(ii) specifically states that the owner consents to receive the preclosing disclosure on the date of closing;

(iii) bears the signature of all of the owners entitled to receive the preclosing disclosure; and

(iv) affirms the owner has received notice of the owner's right to receive a final itemized disclosure containing all fees, costs, points, or charges one day prior to closing.

(4) An equity loan may be closed at any time during normal business hours on the next business day following the calendar day on which the owner receives the preclosing disclosure or any calendar day thereafter.

(5) The owner maintains the right of rescission under Section 50(a)(6)(Q)(viii) even if the owner exercises an emergency or good cause modification of the preclosing disclosure."

Our Comments: Existing §153.13 has been extensively revised and rearranged by revised §153.13: (**1**) The bona fide emergency/good cause documentation requirements are revised to include the owner's affirmation that the owner has received notice of the right to receive an accurate final itemization one day prior to closing. (**2**) The good cause standard is clarified and expanded. (**3**) The term "de minimis" is defined. (**4**) The numerical limits of the de minimis good cause standard are retained but the language revised to state that these limits apply to the total charges and to each charge individually in order to clarify that increase(s) in charge(s) cannot be offset by decrease(s) in other charge(s) in order to come within the de minimis good cause standard. (**5**) The decrease in charge(s) section of the de minimis good cause standard [see *existing §153.13(4)(B)*] is deleted. In the preamble to revised §153.13, the Commissions state: "*§153.13 would allow the lender to reduce fees or closing costs by any amount without postponing the date of closing.*" … "[A] *reduction in fees would not trigger the need for an owner's consent to forego a delay in the closing date"*, concluding, "*this is self-evident from the language of the interpretation.*" (**6**) Applying the legal doctrine of "de minimis non curat lex" (*the law does not concern itself with very small or trifling matters*), the Commissions explain in the preamble that an unanticipated "de minimis" charge added after the preclosing disclosure has been given would not require a redisclosure or delay in closing, stating that this doctrine *"protects the parties where the variance between the disclosures is minute. It seems unlikely that a law designed to protect an owner would require an owner to postpone a closing because of very small variances from previously disclosed costs, especially when the owner desires to proceed with closing. … Occasionally, unanticipated additional fees arise in an equity loan transaction shortly before closing. For example, the invoice for a courier or delivery fee may not arrive in time for the preclosing disclosure, and including the fee in the final documents could force a delay in closing the equity loan. This provision* [the de minimis standard in §153.13(3)(B)(i)-(ii)] *recognizes that postponing the date of closing may adversely affect the owner more than the amount of variance between disclosed and actual closing costs. It also allows the owner to decide if hardship would result from postponing the closing for de minimis variances in costs."* We do not agree with the Commissions' analysis in the preamble that unanticipated additional "de minimis" charges that arise after delivery of the preclosing disclosure are covered by the de minimis good cause standard of §153.13(3)(B)(i)-(ii). In this instance, we advise that lenders redisclose.

There are two errors in revised §153.13: (1) The word "or" between subsections (3)(B)(i) and (ii) should be "and." See the attached Legal Advisory from the Commissions for a full explanation. (2) Subsection (3)(C)(ii) should read *"specifically states that the owner consents to receive ~~the~~* [a subsequent or modified] *preclosing disclosure on the date of closing."* We had requested this change and the Commissions (in the preamble) agreed to make it *("The commissions agree with the commenter and modified the language of §153.13 as suggested. This modification clarifies the application of subsection (3)(C)(ii)… .)* Notwithstanding that agreement, §153.13(3)(C)(ii) as published does not contain the suggested change. We believe this is due to an inadvertent editing error.

"*§153.18. Limitation on Application of Proceeds: Section 50(a)(6)(Q)(i).*

An equity loan must be made on the condition that the owner of the homestead is not required to apply the proceeds of the extension of credit to repay another debt except debt secured by the homestead or debt to another lender.

(1) The lender may not require an owner to repay a debt owed to the lender, unless it is a debt secured by the homestead. The lender may require debt secured by the homestead or debt to another lender or creditor be paid out of the proceeds of an equity loan.

(2) An owner may apply for an equity loan for any purpose. An owner is not precluded from voluntarily using the proceeds of an equity loan to pay on a debt owed to the lender making the equity loan."

Our Comments: The changes to §153.18, while not extensive, are significant. First, the prohibitory statement in former subsection (2) [now subsection (1)] that, "[t]he lender may not otherwise specify or restrict the use of the proceeds" is deleted; thus, removing the former uncertainty whether a lender could make a home equity loan for home improvement purposes and require as a condition of the loan that the owner pay the contractor for the improvements. Second, with the deletion of subsection (3) [the "debt consolidation" interpretation], the risk to a home equity lender "voluntarily" receiving a payment on an unsecured debt owed to it by the owner without violating section 50(a)(6)(Q)(i) is increased because there is now no interpretative authority as to when such a payment is truly voluntary. Our recommendation, when the owner is paying off unsecured debt to the home equity lender with home equity funds, is that the closing agent not reflect these unsecured debt(s) on the HUD-1/1A Settlement Statement and to disburse the funds for this directly to the owner. Even in this instance, without the "debt consolidation" protection afforded by former §153.18(3), the voluntary nature of the payment will be a question of fact to be determined by a court proceeding.

"*§153.20. No Blanks in Any Instrument: Section 50(a)(6)(Q)(iii).*

A home equity loan must be made on the condition that the owner of the homestead not sign any instrument in which blanks are left to be filled in.

(1) This Section of the Constitution prohibits the owner of the homestead from signing any instrument in which blanks are "left to be filled in". This Section is intended to prohibit a person other than the owner from completing one or more blanks in an instrument after the owner has signed the instrument and delivered it to the lender, thereby altering a party's obligation created in the instrument. Not all documents or records executed in connection with an equity loan are instruments, and not all blanks contained in an instrument are "blanks that are left to be filled in" as contemplated by this Section.

(2) As used in this Section, the term instrument means a document or record that creates or alters a legal obligation of a party. A disclosure required under state or federal law is not an instrument if the disclosure does not create or alter the obligation of a party.

(3) If at the time the owner signs an instrument, a blank is completed or box checked which indicates the owner's election to select one of multiple options offered (such as an election to select a fixed rate instead of an adjustable rate) and the owner therefore by implication has excluded the non-selected options, the instrument does not contain "blanks left to be filled in" when the non-selected option is left blank."

Our Comments: Revised §153.20 is more specific than the existing interpretation. We do not believe, however, it is a change in substance but only a more explicit interpretation of what documents and blanks are covered.

These revised Interpretations become effective June 29, 2006.

Legal Advisory—Recent Home Equity Lending Interpretations

From the Finance Commission and Credit Union Commission Agencies

The Finance Commission and the Credit Union Commission recently revised and re-adopted three home equity lending interpretations concerning the timing of preclosing disclosures (7 TAC §153.13), certain limitations on the use of loan proceeds (7 TAC §153.18), and the requirement that no instrument to be signed by the owner contain blanks "left to be filled in" (7 TAC §153.20). The new interpretations are published in the June 23, 2006 edition of the Texas Register (31 TexReg 5080), see Adoption of §§153.13, 153.18, 153.20.

Following adoption, we discovered a typographical error in §153.13 (the preclosing disclosure requirement) that could lead to mistaken conclusions regarding the intent of this interpretation. Specifically, the word "or" between §153.13(3)(B)(i) and (ii) should obviously have been the word "and." We wish to clearly point out that a literal reading of the word "or" in this context would conflict with the Texas Constitution. In brief, the requirements of both clauses (§153.13(3)(B)(i) and (ii)) must be met to establish the *de minimis* good cause standard that permits an owner to consent to delivery of a modified disclosure on the date of closing.

Texas Constitution, Article XVI, Section 50(a)(6)(M)(ii), requires a lender to provide an owner with a preclosing disclosure of fees, costs, points, and charges at least one day prior to closing a home equity loan. Initial delivery of or changes to a timely delivered disclosure are not permitted after that time unless good cause exists and the owner consents. Generally, revised §153.13 provides that good cause exists to deliver a modified disclosure on the date of closing if the variance in total costs is insignificant (a *de minimis* increase) under a specified formula (see §153.13(3)(B)(i)).

However, an insignificant change in total costs can be misleading if it conceals material but offsetting changes in individual fees, costs, points, and charges. Because variances of this nature demand more thoughtful analysis and consideration, the *de minimis* good cause standard requires the variance in any individual fee, cost, point, or charge to also be insignificant under the formula provided (see §153.13(3)(B)(ii)).

The obviously erroneous use of the term "or" in lieu of "and" between the two clauses that define the *de minimis* good cause standard does not mean that satisfying only one of these two conditions is sufficient to meet the *de minimis* good cause standard, and we will not endorse or support such a reading. We will seek formal correction of this typographical error at the earliest opportunity. Any questions or comments regarding this interpretation should be directed to Harold Feeney, Credit Union Commissioner, 914 East Anderson Lane, Austin, Texas 78752-1699, commissioner@tcud.state.tx.us, or to Sealy Hutchings, General Counsel, Office of Consumer Credit Commissioner, 2601 North Lamar Boulevard, Austin, Texas 78705-4207, sealy.hutchings@occc.state.tx.us.

Office of Consumer Credit Commissioner
Credit Union Department
Department of Savings and Mortgage Lending
Department of Banking