

Texas Consumer & Commercial Law Update

Published by the Consumer Finance and Commercial Litigation Groups of McGlinchey Stafford PLLC

 Download a printable copy

Welcome

In this edition of the **Texas Consumer & Commercial Law Update**, we present an overview of predatory lending laws currently in effect in Texas. Prior to 2001, Texas had no laws specifically governing high-cost loans. However, beginning September 1, 2001, the Texas legislature imposed a number of restrictions on what it calls "high-cost home loans." Simply put, these are residential mortgage loans with interest rates or points and fees that exceed the threshold amounts for high rate/high fee loans under the federal Truth in Lending Act and Section 32 of Regulation Z. But in addition to this general high-cost loan legislation, Texas has additional restrictions on second mortgage loans with interest rates above ten percent. Even though these second mortgage loan restrictions are not "high cost" or "predatory loan" laws *per se*, and are not found in the same chapter of the Texas Finance Code as those laws adopted in 2001, lenders must consider them along with Texas' high-cost home loan laws since the restrictions come into play when the interest rate threshold is exceeded.

This Edition

Texas High-Cost Home Loan Law

Chapter 343 of the Texas Finance Code has a number of restrictions that apply to any "high-cost home loan," which is any loan that:

- is made to an individual for personal, family or household purposes;
- is secured by the borrower's principal residence – which is either a one-to-four family residential property or a manufactured home;
- is in a principal amount equal to or less than ½ of the maximum amount for Fannie Mae conventional first mortgages (for 2006 Fannie Mae's conventional maximum is \$417,000);
- is not an open-end or a reverse mortgage; and
- is a loan subject to Section 32 of Regulation Z, OR is a "residential mortgage loan" under Regulation Z with an APR that is more than 8 percent (for first lien loans) or 10 percent (for subordinate lien loans) above the T-bill rate for the same term to maturity as the loan, or with total points and fees that exceed 8 percent of the loan amount.

The Texas statute covers any residential mortgage loan that exceeds the high-cost thresholds of Section 32, INCLUDING any purchase money or initial construction mortgage loan that exceeds those thresholds. (Note that the federal law DOES NOT apply to purchase money loans.)

If a lender has made a loan that qualifies as a high-cost home loan in Texas, there are certain specific restrictions and requirements that apply to that loan which must be observed. These are:

- No Balloons – a high-cost home loan may not provide for a payment that is more than twice as large as the average of earlier scheduled monthly payments within the first sixty months of the loan.
- No Negative Amortization – a high-cost home loan may not provide for a payment schedule that may cause the principal balance to increase.
- Borrower's Payment Ability – the lender may not make high-cost home loans based on the collateral value of the property without regard for the borrower's repayment ability, including current and expected income, current obligations, employment status, and other financial resources.
- No Prepayment Penalty – a high-cost home loan may not contain a provision for a prepayment penalty.
- No Charge for Service Not Received – a lender on a high-cost home loan may not charge a borrower for a service or product if the borrower does not receive it.

[^ top](#)

Wait - No Disclosure Requirement?

When the Texas high-cost home loan law was passed in 2001, it contained a provision requiring that lenders give a special high-cost home loan notice, along with a statement regarding the value of mortgage counseling and a list of housing counseling agencies. The Office of Consumer Credit Commissioner provided the form of the notice that lenders were required to give. The notice was actually required on all loans with an interest rate over 12 percent, even if such loans did not exceed the high-cost home loan thresholds. However, the section of the Finance Code that mandated this disclosure requirement also contained an expiration date of September 1, 2003. The Texas Legislature later tried to repeal that expiration date and keep the disclosure provision in effect, but the repeal of the expiration was not set to take effect until after September 1, 2003 (oops). So the disclosure requirement expired on that date, and the Finance Commission later repealed the regulation that supplied the required disclosure form. The end result is that the Texas disclosures on high-cost home loans have been unnecessary since September 1, 2003. Since Texas law and federal law contain virtually the same test for determining whether a loan is covered by their high-cost loan laws, it is important to note that a federal disclosure may still be required on such loans.

[^ top](#)

...And One More Requirement Related to Low-Rate Home Loans

The Texas high-cost home loan law also contains a requirement that applies only to low-rate home loans. A "low-rate home loan" is described in the statute as a residential mortgage loan with an interest rate that is 2 percent or more below the T-bill rate for the same term to maturity as the loan (excluding introductory discounted rates and initial rates that automatically step up over time, in which case the fully indexed rate or fully stepped up rate is used to determine whether the loan is a low-rate loan). Any loan that qualifies as a low-rate home loan and which is made by a government or non-profit lender may not be replaced or consolidated before the seventh anniversary of the date of such loan unless the new loan has a lower rate and requires payment of a lesser amount of points and fees than the original loan, or unless it is a restructure to avoid foreclosure.

[^ top](#)

Texas Second Mortgages Over 10 Percent

The other area of Texas law that is aimed at loans over a certain interest rate threshold involves junior lien mortgage loans that bear interest at rates above 10 percent. A number of specific restrictions and requirements apply to these loans, and there are separate licensing requirements for lenders who make (or brokers who arrange) these loans.

Chapter 342 of the Texas Finance Code is the operative statute impacting these loans. It applies to any loan made for personal, family or household purposes that is secured by a lien on real property that is already subject to one or more prior liens, with a maturity greater than 90 days and an interest rate greater than 10 percent. Anyone making or brokering these loans must hold a regulated loan license issued under Chapter 342 by the Texas Office of Consumer Credit Commissioner, unless the lender is a state or federal bank, savings bank, or savings and loan association.

The fees, costs and charges that may be collected on or before closing or which may be included in the principal of the loan are limited to:

- reasonable fees for title examination and abstract of title by a title company or search firm authorized to do business in Texas or an attorney who is not an employee of the lender;
- premiums or fees for title insurance or title search;
- reasonable fees charged for preparation of loan documents by an attorney who is not an employee of the lender;
- charges paid to public officials for filing, recording and releasing a security interest;
- the reasonable cost of an appraisal by an appraiser who is not a salaried employee of the lender;
- the reasonable cost of a credit report;
- reasonable fees for a survey prepared by a registered surveyor who is not a salaried employee of the lender;
- premiums for credit life, credit accident, or other insurance that protects the lender against default;
- reasonable fees incurred with a federally mandated program if required by a federal agency (i.e., flood determination);
- premiums for required property insurance;
- costs of a debt cancellation agreement; and
- an administrative fee not to exceed \$25 for a loan of more than \$1,000.

The loan contract may also provide for the payment of reasonable fees or charges paid for foreclosure and sale of the property, reasonable attorney fees paid for collection of a delinquent loan and court costs incurred in the collection and foreclosure of the loan. The lender may also assess and collect a fee as permitted by state law for the return of a dishonored check.

Other than these specific fees and charges, and lawful interest on the principal amount of the loan, a lender may not charge, contract for, or receive any fee, compensation, bonus, commission, discount or charge of any nature.

[^ top](#)

Plain Language Contracts ... and Spanish Language Disclosures

In addition to the restrictions on fees and charges, Texas law requires that any secondary mortgage loan with interest above 10 percent be written in plain language designed to be easily understood by the average consumer, and printed in an easily readable font and type size. The Texas Finance Commission has adopted rules governing the form of contracts which may be used. The rules include model plain-language contract forms for secondary mortgage loans. For adopted contract forms and related rules, see the Texas Consumer Credit Commission's website at http://www.occ.state.tx.us/pages/Legal/plain_lang/index.html.

Lenders are not required to use a model contract; however, they may not use a contract other than the adopted model forms unless such contract has been submitted to the Finance Commission. The lender may then use its own contract form unless and until the Finance Commission issues an order disapproving the contract.

In addition, if the terms of the loan were negotiated in Spanish, a summary of those terms and other pertinent information shall be provided to the borrower in Spanish in a form identical to the disclosures required for a closed-end transaction under Reg Z. The Texas Consumer Credit Commissioner has posted an approved form of the Spanish disclosure on its website at <http://www.occ.state.tx.us/pages/Legal/disclosures/SPAN342.htm>.

As evidence that the lender has provided the disclosure, the following statement should be added to the original promissory note or loan contract and should be signed or initialed by the borrower(s): "RECIBI LA FORMA INFORME DE PRESTAMO."

[^ top](#)

What Next?

While the trend toward predatory lending legislation continues with new laws regularly proposed in other states, Texas has seen no further effective predatory lending legislative activity since 2001. Legislation proposed in 2005 had little support in the Texas Legislature and failed to pass. And with the latest regulatory activity being the repeal of the high-cost home loan activity regulation, it appears that additional predatory lending laws remain a low priority among Texas lawmakers. However, with the potential for changes in the state's political landscape looming every two years, our best advice on this topic remains the same as ever – "stay tuned."

[^ top](#)

New Case Alerts

UPDATE: ACORN, et al. v. Finance Commission of Texas, et al.

In a previous edition of the Texas Consumer & Commercial Law Update, we included a summary of the district court's ruling in *ACORN, et al. v. Finance Commission of Texas, et al.* That ruling invalidated several of the Finance Commission's interpretive regulations relating to home equity lending in Texas, including the interpretation expressing that points are interest and are not fees that are subject to the three percent cap on fees required to be paid by the owner. The district court's ruling has since been appealed to the Texas Court of Appeals. The immediate effect of the appeal is to supercede the judgment of the trial court, and indeed any enforcement of that judgment has been stayed at least until July 14, 2006. Consequently, the district court's order is as yet ineffective, and the affected regulations continue in effect, pending a determination of the appeal. We will continue to monitor the progress of this case in the appellate court and keep you informed as to further developments.

In Re Dornier Aviation (North America), Inc. v. Hainan Airlines Co. Ltd., 2005 WL 3783829 (Bk. E.D. Va.).

A bankruptcy court has ruled on an unsettled question of Texas law regarding the contractual limitation of remedies. §2.719 of the Tex. Bus. & Comm. C. (verbatim from the UCC) governs the manner in which the contracting parties may limit the remedies of an aggrieved party. Subsection b and c appear to conflict with each other in that (b) states where an exclusive (contractual) remedy fails of "its essential purpose," then the parties may resort to the remedies available under Article 2. Subsection (c) states that consequential damages may be limited or excluded (except in cases involving personal injury). Naturally, a great deal of debate arose regarding how to apply and harmonize these two rather vaguely worded sections and a split in the case law appeared, in which some courts hold that (b) trumps (c) (i.e., voiding an attempted damage waiver/exclusion) or the two subsections can be read independently. The Virginia bankruptcy court concluded that, based upon a plain reading of the UCC and the policy behind §2.719, the Texas Supreme Court would construe the two subsections independently. According to this court's interpretation, the analysis under (b) must be done in light of the party's performance of the contract while (c) requires the court to look at the contract at the point in time of formation to determine whether the waiver is unconscionable.

[^ top](#)

New Legislation

7 TAC §§153.13, 153.18, 153.20

The Finance Commission of Texas has repealed and revised three sections of the interpretive rules applying to home equity loans in Texas. The revisions affect three sections of Title 7 of the Texas Administrative Code: §153.13 concerning Preclosing Disclosures, §153.18 concerning the Application of Loan Proceeds, and §153.20 concerning Blank Spaces in Loan Instruments. The revision of §153.13 clarifies the terms "bona fide emergency" and "other good cause" in a way that preserves the constitutional protections for the owner without subjecting the owner to unnecessary regulatory burdens. The revision of §153.18 removes the existing provision that when an owner applies for a home equity debt consolidation loan with the existing lender, the owner makes a voluntary choice to use proceeds from that loan to pay off debt to the home equity lender; the question of whether the act of the owner is voluntary is now to be a question of fact. And the revision of §153.20 clarifies that in the constitutional requirement that an owner not sign any instrument containing any blanks left to be filled in, the phrase "blanks left to be filled in" means something more than the requirement that an owner not sign an instrument which contains blanks. To view the text of the revised sections as adopted, please click [here](#).

[^ top](#)

News and Events

Update: Debt Elimination Scam

In a matter related to our Spring Edition which focused on "debt elimination" scams, the Texas Attorney General announced that he has obtained an order closing down a scheme that was focused on Hurricane Katrina victims. Bankopp.com promoted a plan whereby unsuspecting debtors would pay it \$5,000 for a seminar that would allow them to eradicate debt by using an unidentified lender. It turns out that the money was being sent to an account in Panama. For further information, please click [here](#).

[^ top](#)

Ask the Editors

Ronald Bendalin
Member
Dallas

David Pederson
Of Counsel
Dallas

Jennifer Davis
Member
Houston

David Smith
Of Counsel
Houston

*Board Certified in Consumer and Commercial Law by the Texas Board of Legal Specialization

McGLINCHEY STAFFORD PLLC

Houston Office • 1001 McKinney, Suite 1500 • Houston, TX 77002 • (713) 520-1900

Dallas Office • 2711 N. Haskell Ave. Suite 2700, LB 25 • Dallas, TX 75204 • (214) 257-1700

www.mcglinchey.com

HOUSTON • DALLAS • CLEVELAND • ALBANY • NEW ORLEANS • BATON ROUGE • MONROE • JACKSON

Case Alerts

Update: ACORN, et al. v. Finance Commission of Texas, et al.

In Re Dornier Aviation (North America), Inc. v. Hainan Airlines Co. Ltd.

Legislation

Home Equity Lending Revisions

News & Events

Update: Debt Elimination Scam

Resources

CAFA Law Blog

MSYB Law - One stop resource for mortgage and consumer lenders

Previous Editions - Home Equity Lending Debt Elimination Scams

Next Edition

Suits, Secrets and Signatures: Recent Updates in Commercial Law

Questions and Suggestions