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MEMORANDUM

TO: Clients and Friends of the Firm

FROM: Aaron Polasek

DATE: December 23, 2014

SUBJECT: Amendment to Texas Administrative Code Home Equity Interpretations

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On December 12, 2014, in response to the Texas Supreme Court's holdings in *Finance Commission of Texas v. Norwood*, 418 S.W.3d 566 (Tex. 2013)[1], the Finance Commission of Texas and the Texas Credit Union Commission (together, the "Commissions") filed with the Office of the Secretary of State for Texas an adoption of amendments to the affected provisions of the Texas Administrative Code (attached hereto). Specifically, and discussed in more detail below, the Commissions adopted amendments to 7 Texas Administrative Code §§ 153.1 (definition of interest), 153.5 (3% fee limits and certain charges, most notably discount points), 153.15 (location of closing and use of a power of attorney) and 153.51 (provision of the "12-day" disclosure if a power of attorney is being used).

7 TAC §153.1

The preamble to the operative definitions of this section was amended to clarify that the definitions of §153.1 apply to all of Chapter 153

§153.1(11) – the definition of "interest" has been amended to coincide with the definition provided by *Norwood*, such that for purposes of home equity lending, the term means the amount determined by multiplying the loan principal by the interest rate over a period of time.

7 TAC §153.5

The §153.5 amendments provide per diem interest (§153.5(3)(A)) and true discount points (§153.5(3)(B)) are not included in the 3% calculation, but charges to maintain (§153.5(9)) and charges to service (§153.5(12)) an equity loan, that are not interest, are fees subject to the 3% calculation if the charges are paid at the inception of the loan, or if the charges are customarily paid at the inception of the loan but are deferred for later payment after closing.

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[1] The lengthy procedural history of the *Norwood* case is the subject of three prior client memoranda issued by our firm on May 10, 2006, January 14, 2010 and June 25, 2013, all of which may be found on our website at www.loanlawyers.com

Specifically, and of note to our clients, §153.5(3)(B) clarifies that *legitimate* discount points are within the definition of interest and therefor excluded from the 3% calculation. Legitimate discount points are points that truly correspond to a reduced interest rate and are not necessary to originate, evaluate, maintain, record, insure or service the loan. According to the Commissions' commentary, an analysis of whether discount points are *legitimate* should include whether a borrower is able to choose between a loan without discount points and a loan that includes discount points with a corresponding reduced interest rate: "whether discount points are legitimate depends on whether they are truly an option available to the borrower." [39 TexReg 10408] If there is not a choice for the borrower between a loan without discount points and a loan with discount points and a corresponding lower interest rate, arguably any discount points charged were fees necessary to originate, evaluate, maintain, record, insure or service the loan (i.e. are not within the definition of "interest") because the loan would not have been originated without the imposition of the "discount points", and the points should be included in the 3% fee calculation. Lenders are expressly permitted to rely upon an established system of verifiable procedures to evidence that discount points offered are legitimate, and any such system may include documentation of options offered to the owner including an interest rate with discount points and a lower interest rate based on discount points.

7 TAC §153.15

Amendments to §153.15 clarify that a power of attorney to be utilized in a Texas home equity loan transaction must be signed at one of the three authorized places where a home equity loan can be closed: an office of the lender, an attorney's office or a title company. A lender is entitled to rely upon an established system of verifiable procedures to evidence compliance with the requirement, which system may include: a written statement in the power of attorney acknowledging the date and place at which the power of attorney was executed, an affidavit or written certification of a person who was present when the power of attorney was executed acknowledging the date and place of execution or a certificate of acknowledgement signed by a notary public that includes the date and place of execution. Whether a power of attorney is utilized or not, the closing of an equity loan must still occur at one of the three authorized locations. If a properly executed power of attorney is utilized, the 12-day disclosure may be provided by the lender to the attorney in fact instead of providing it to the owner/principal.

information is accurate and truthful in all respects and that the agency is able to meet its financial obligations as they become due; and

(4) such other information as the banking commissioner may require you to submit.

(b) Second, you must submit the following documents with your application:

(1) a copy of your agency's assumed name certificate if it is doing business or intends to do business in this state under a different name; financial disclosures that comply with this chapter;

(2) a list containing information on each pending lawsuit, civil or criminal (other than lawsuits filed on behalf of clients), involving your agency, including:

(A) the parties;

(B) a synopsis of the facts alleged by each party;

(C) the nature of the action;

(D) the court in which it is pending; and

(E) the amount in controversy;

(3) a list, containing the information required in paragraph (2) of this subsection, on each pending lawsuit involving an owner of a controlling interest in your agency that:

(A) is related to child support enforcement (other than lawsuits filed on behalf of clients); or

(B) may affect your agency.

(4) a list for the previous ten years of each judgment awarded against your agency or any owner of a controlling interest in the agency and a statement as to whether an appeal is pending;

(5) a surety bond in the amount of $50,000 that meets the requirements of§31.12;

(6) a franchise tax account status from the Texas Comptroller of Public Accounts if you are a Texas business corporation or a foreign business corporation;

(7) a copy of the findings from any supervisory enforcement actions taken against your agency by a governmental entity for the previous 5 years;

(8) a paper and electronic (Word) copy of the form contract your agency will use for an obligee to engage its services to enforce a child support obligation and the scores you calculated under§31.14(d) and the readability statistics you generated; and

(9) such other information as the banking commissioner may require you to submit.

(c) Third, you must submit a certified financial statement with your application containing the following:

(1) information that demonstrates the financial solvency of your agency;

(2) for your agency's most recent fiscal year:

(A) a balance sheet; and

(B) an income statement.

(3) if the end of your agency's most recent fiscal year was more than 120 days prior to submission of your application, an interim version of each document required under paragraph (2) of this subsection covering the period from the end of the most recent fiscal year to a date less than 120 days prior to submission;

(4) a written certification by your agency's chief financial officer or accountant that it is a true and correct statement of the agency's financial position; and

(5) any information the banking commissioner requests you to submit to demonstrate your agency's financial solvency, including an audited financial statement.

(d) Fourth, you must submit the following fees with your application:

(1) a nonrefundable filing fee of $500 for each location you want to register; and

(2) a $500 fee to cover the annual cost of regulation.

The agency certifies that legal counsel has reviewed the adoption and found it to be a valid exercise of the agency's legal authority.

Filed with the Office of the Secretary of State on December 12, 2014.

TRD-201405978
Catherine Reyer
General Counsel
Texas Department of Banking
Effective date: January 1, 2015
Proposal publication date: October 31, 2014
For further information, please call: (512) 475-1300

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SUBCHAPTER C. WHAT ARE MY AGENCY'S RESPONSIBILITIES AFTER REGISTRATION?

7 TAC §31.32

The amendments are adopted pursuant to Finance Code, §396.051, which authorizes the Finance Commission to adopt necessary rules to administer the chapter concerning private child support enforcement agencies.

The agency certifies that legal counsel has reviewed the adoption and found it to be a valid exercise of the agency's legal authority.

Filed with the Office of the Secretary of State on December 12, 2014.

TRD-201405981
Catherine Reyer
General Counsel
Texas Department of Banking
Effective date: January 1, 2015
Proposal publication date: October 31, 2014
For further information, please call: (512) 475-1300

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PART 8. JOINT FINANCIAL REGULATORY AGENCIES

CHAPTER 153. HOME EQUITY LENDING

7 TAC §§153.1, 153.5, 153.15, 153.51

The Finance Commission of Texas and the Texas Credit Union Commission ("commissions") adopt amendments to the following home equity lending interpretations: §153.1, concerning Definitions, §153.5, concerning Three percent fee limitation, §153.15, concerning Location of Closing, and §153.51, concerning Consumer Disclosure.

The commissions adopt the amendments without changes to the proposed text as published in the July 4, 2014, issue of the *Texas Register* (39 TexReg 5021).

The Texas Department of Banking, the Texas Department of Savings and Mortgage Lending, the Office of Consumer Credit Commissioner, and the Texas Credit Union Department ("agencies") received one written comment on the proposal from an individual. The comment includes three suggested revisions to the proposed amendments. The commenter's individual suggestions are discussed following the purpose of each provision discussed in the comment.

The amendments apply the administrative interpretation of the home equity lending provisions of Article XVI, Section 50 of the Texas Constitution ("Section 50") allowed by Section 50(u) and Texas Finance Code, §11.308 and §15.413.

The main purpose of the amendments is to implement the Texas Supreme Court's decision in *Finance Commission of Texas v. Norwood,* 418 S.W.3d 566 (Tex. 2013). In *Norwood,* the court held that portions of three interpretations adopted by the commissions were invalid: §§153.1, 153.5, and 153.15.

In 1997, the Texas Constitution was amended to authorize home equity loans. After further amendments in 2003, the commissions were authorized to adopt interpretations of the constitution's home equity provisions, subject to the requirements of the Texas Administrative Procedure Act. The commissions adopted their interpretations in 2004. A group of homeowners sued the commissions, challenging several of the adopted interpretations. The case was ultimately appealed to the Texas Supreme Court and resulted in the court's decision in *Finance Commission of Texas v. Norwood.*

In *Norwood,* the court invalidated certain provisions interpreting Section 50(a)(6)(E), which provides that a home equity loan may not "require the owner or the owner's spouse to pay, in addition to any interest, fees to any person that are necessary to originate, evaluate, maintain, record, insure, or service the extension of credit that exceed, in the aggregate, three percent of the original principal amount of the extension of credit." The court invalidated §153.1(11) of the commissions' interpretations, which defined "interest" for purposes of the three percent limitation as "interest as defined in the Texas Finance Code §301.002(4) and as interpreted by the courts." The court held that interest means "the amount determined by multiplying the loan principal by the interest rate." 418 S.W.3d at 588. The court also invalidated paragraphs (3), (4), (6), (8), (9), and (12) of §153.5, which applied the commissions' original definition of "interest" to several specific types of charges for purposes of the three percent limitation. In a supplemental opinion, the court explained that interest includes per diem interest and legitimate discount points, and that these amounts are not included in the three percent limitation. 418 S.W.3d at 596.

The court also invalidated provisions interpreting Section 50(a)(6)(N), which provides that a home equity loan must be "closed only at the office of the lender, an attorney at law, or a title company." The court invalidated §153.15(2), which allowed a lender to accept a properly executed power of attorney authorizing someone to close a loan on a homeowner's behalf. It also invalidated §153.15(3), which allowed a lender to accept the homeowner's consent by mail. In the supplemental opinion, the court explained that "a power of attorney must be part of the closing to show the attorney-in-fact's authority to act." 418 S.W.3d at 596.

As stated earlier, the main purpose of the proposed amendments is to implement the Texas Supreme Court's decision in *Finance Commission of Texas v. Norwood.* The individual purposes of each amendment are provided below.

The amendment to the second sentence of §153.1 replaces the word "section" with "chapter" in order to clarify that the definitions listed in §153.1 apply to all of Chapter 153.

The amendment to §153.1(11) replaces the previous definition of "interest" with the definition used by the court. The phrase "over a period of time" is included in the amendment in order to clarify the time component in the definition. In addition, in its supplemental opinion, the court used the phrase "over a period of time" in applying the general definition of "interest." 418 S.W.3d at 596.

The amendment to §153.5(3)(A) specifies that per diem interest is interest and is not subject to the three percent limitation, in accordance with the court's supplemental opinion. *See* 418 S.W.3d at 596.

The amendment to §153.5(3)(B) specifies that legitimate discount points are interest and are not subject to the three percent limitation, in accordance with the court's supplemental opinion. *See* 418 S.W.3d at 596. The amendment also identifies the conditions that must be satisfied in order for discount points to be considered legitimate under the court's supplemental opinion, stating that the discount points cannot be "necessary to originate, evaluate, maintain, record, or service the loan." The amendment provides that a lender may rely on an established system to evidence that the discount points it offers are legitimate.

The commenter's first suggestion is that the commissions remove the phrase "and are not necessary to originate, evaluate, maintain, record, or service the loan" from §153.5(3)(B). The commenter states: "If a lender is charging a discount point, then it is a charge that the lender is making and collecting at closing in order to 'originate' the loan, the lender would not make the loan under the reduced interest rate, if the borrower did not pay the discount point. So every borrower who pays a discount point could argue that the payment of the discount point was 'necessary to originate . . . the loan' and they would be correct, or at least create a fact question."

The commissions disagree with this suggestion. In order for discount points to be legitimate, the borrower must be able to choose between a loan without discount points and a loan that includes discount points with a corresponding reduced interest rate. If the borrower can make this choice, then the discount points are not "necessary to originate, evaluate, maintain, record, or service the loan," because the borrower has the option of obtaining a loan without them. The court made this point in its supplemental opinion to *Norwood* when it stated: "We also agree with the Homeowners that true discount points are not fees 'necessary to originate, evaluate, maintain, record, insure, or service' but are an option available to the borrower and thus not subject to the 3% cap." 418 S.W.3d at 596. In other words, whether discount points are legitimate depends partly on whether they are truly an option available to the borrower. The

commissions disagree with the commenter's suggestion and believe that the proposed text is appropriate to maintain for this adoption.

The amendments to paragraphs (4), (6), (8), (9), and (12) of §153.5 add the phrase "as defined by §153.1(11) of this title" after "that are not interest" in provisions describing charges that are subject to the three percent limitation. Paragraphs (9) and (12), regarding charges to maintain and service the loan, are also amended to provide clarity and delete redundant text.

The amendment to §153.15(2) specifies that any power of attorney allowing an attorney-in-fact to execute closing documents must be signed at the office of the lender, an attorney at law, or a title company. It also provides that a lender may rely on an established system to evidence the date and place at which a power of attorney was signed. The amendment permits the use of an affidavit or written certification of a person who was present when the power of attorney was executed.

The commenter's second suggestion is that the commissions amend the provision in §153.12(2)(B) allowing a lender to evidence compliance with the requirements for powers of attorney. As proposed, the provision allows a lender to evidence compliance through "an affidavit or written certification of a person who was present when the power of attorney was executed, acknowledging the date and place at which the power of attorney was executed." The commenter suggests that the commissions add the phrase "or of a person with personal (or actual) knowledge of where the power of attorney was executed," in order to allow certifications by persons who were not present but who possess personal or actual knowledge. The commenter states: "It would seem that anyone with personal knowledge of where the POA was executed should be authorized to execute an Affidavit. For example, Texas Estates Code Section 751.055, provides that the agent with personal knowledge may execute an affidavit as to certain facts. If the agent knows that the principal executed the POA at an attorney's office and has personal knowledge that it was executed there (for example, they drove their father to the attorney's office, but was not in the room when it was executed), then why shouldn't a person with personal knowledge of the facts also be permitted (and expressly authorized by the rule) to give an affidavit as to that fact?"

The commissions disagree with this suggestion. The commenter suggests that a person can have personal knowledge that the power of attorney was signed at a particular place and time, even though the person was not present when it was signed. It is unclear how a person can have personal knowledge in this situation. In the commenter's example, where the child drops the parent off at the attorney's office, it appears that the child's affidavit would be based on a hearsay allegation that the parent signed the power of attorney inside the office. An affidavit not based on personal knowledge is generally insufficient to support a claim. *Marks v. St. Luke's Episcopal Hosp.*, 319 S.W.3d 658, 666 (Tex. 2010). An affidavit based on hearsay is insufficient. *Stanford v. Johnson*, 577 S.W.2d 791, 793 (Tex. Civ. App.--Corpus Christi 1979, no writ). Also, Texas Estates Code, §751.055 does not support the type of affidavit suggested by the commenter. That section deals with an affidavit signed by an attorney-in-fact, stating that the attorney-in-fact did not have knowledge about the termination of a power of attorney at the time it was terminated or revoked. This matter is within the personal knowledge of the attorney-in-fact.

The commissions disagree with the suggestion that a person can have personal knowledge of the time and place that a power of attorney was signed without being present. The commissions believe that it is appropriate to maintain the proposed text, which allows a certification by a person who was present. This does not mean that §153.12(2) provides the only methods through which a lender can evidence compliance. The provision is not intended to provide a comprehensive list of all methods by which a lender may evidence compliance. This is why the section uses the phrase "may include one or more of the following." It would be outside the intended scope of the amendments to provide a comprehensive statement of the circumstances in which a lender can (or should) use powers of attorney, or a statement of the conditions that must be satisfied in every power of attorney relating to a home equity loan.

The amendment to §153.15(3) specifies that the required consent form must be signed at the office of the lender, an attorney at law, or a title company. The amendment also specifies that the consent may be signed by an attorney-in-fact described by paragraph (2).

In §153.51, new paragraph (5) specifies that if a power of attorney described by §153.15(2) has been executed, then the attorney-in-fact may accept the disclosures required under Section 50(g).

The commenter's third suggestion is that the commissions make conforming changes to §152.15, regarding Place for Execution of Contract for Work and Material. The commenter suggests that this change would be appropriate because "a POA could also be used to close these loans and presumably would (or should) be subject to the same requirements."

The commissions decline to adopt this suggestion. This suggestion is outside the intended scope of the amendments, which are intended to address home equity loans, rather than work and material loans. Work and material loans were not addressed in *Norwood*. In addition, because §152.15 is outside the subject matter included in the proposal, adopting this change would require a separate rulemaking action with a new publication for comment. *See State Bd. of Ins. v. Deffebach*, 631 S.W.2d 794, 801 (Tex. App.--Austin 1982, writ ref'd n.r.e.).

The amendments are adopted under Article XVI, Section 50(u) of the Texas Constitution and Texas Finance Code, §11.308 and §15.413, which authorize the commissions to adopt interpretations of Article XVI, Section 50(a)(5)-(7), (e)-(p), (t), and (u) of the Texas Constitution.

The constitutional provisions affected by the adopted amendments are contained in Article XVI, Section 50 of the Texas Constitution.

The agency certifies that legal counsel has reviewed the adoption and found it to be a valid exercise of the agency's legal authority.

Filed with the Office of the Secretary of State on December 12, 2014.

TRD-201406000
Leslie L. Pettijohn
Consumer Credit Commissioner
Joint Financial Regulatory Agencies
Effective date: January 1, 2015
Proposal publication date: July 4, 2014
For further information, please call: (512) 936-7621

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