HOME EQUITY: CURES, MODIFICATIONS AND DEVELOPMENTS

by

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HOME EQUITY: CURES, MODIFICATIONS AND DEVELOPMENTS

This paper is intended to provide an update regarding cures, modifications and certain developments pertaining to Texas home equity loans, including Texas home equity lines of credit ("HELOCs"). THIS PAPER IS NOT A DEFINITIVE EXPLANATION OF THE TEXAS HOME EQUITY LENDING LAW AND IT IS NOT INTENDED AND SHOULD NOT BE RELIED UPON AS LEGAL ADVICE REGARDING THE MEANING OF ANY PROVISION OF THE LAW.

I. CURES

In *Doody v. Ameriquest Mortgage Co.*,¹ the Texas Supreme Court found that Article XVI, Section 50(a)(6)(Q)(x) of the Texas Constitution² was a "cure provision" that permits lenders to cure failures to comply. This section was amended effective September 29, 2003 to provide clear guidelines regarding the timing and procedural requirements that lenders or holders must follow to cure violations.

A. Cure Authority

60-Day Period to Cure. Section 50(a)(6)(Q)(x) is a detailed cure provision. As amended, Section 50(a)(6)(Q)(x) states:

except as provided by Subparagraph (xi) of this paragraph, the lender or any holder of the note for the extension of credit shall forfeit all principal and interest of the extension of credit if the lender or holder fails to comply with the lender's or holder's obligations under the extension of credit and fails to correct the failure to comply not later than the 60th day after the date the lender or holder is notified by the borrower of the lender's failure to comply.

Accordingly, the obligation to cure is triggered upon notice by the borrower³ of a lender's failure to comply. To correct a violation, the lender or holder must take one or more of the specific actions set out in subsections (Q)(x)(a)-(f), as applicable. An overview⁴ follows.

Refund of Overcharges. If the owner has paid an amount to the lender or holder that either exceeds the 3% fee cap [Subsection (a)(6)(E)], is a prohibited prepayment penalty [Subsection (a)(6)(G)], or unauthorized interest [Subsection (a)(6)(O)], the lender or holder must pay to the owner an amount of money equal to any such overcharge.⁵

Acknowledgment of Partial Lien Invalidity. If the principal amount of the loan at closing exceeds the limitation under Subsection (a)(6)(B) of 80% of the fair market value of the homestead property (when added to the aggregate balances of all other valid encumbrances of record), the lender or holder must send the owner a written acknowledgment that the lien securing the equity

¹ 49 S.W.3d 342 (Tex. 2001).
² All references are to Article XVI of the Texas Constitution and are hereinafter omitted.
³ Section 50(a)(6)(Q)(x) uses the term "borrower". Subsections (Q)(x)(a)-(f) and (xi) use the terms "owner" and "borrower".
⁴ See Memorandum dated January 13, 2004 from Al Alsup, entitled "Home Equity Lending Update", which is available at www.loanlawyers.com.
⁵ Section 50(a)(6)(Q)(x)(a).
loan is valid only in the amount and to the extent that the loan amount does not exceed the 80% loan-to-value limitation.\(^6\)

If the loan purports to be secured by any real or personal property other than the homestead property as additional collateral prohibited by Subsection (a)(6)(H), the lender or holder must send the owner a written acknowledgment that the loan is not secured by any impermissible property.\(^7\)

If the loan purports to be secured by any homestead property designated for agricultural use prohibited by Subsection (a)(6)(I), the lender or holder must send the owner a written acknowledgment that the loan is not secured by any impermissible agricultural property.\(^8\)

**Modification of Prohibited Terms.** If the home equity loan contains any other amount, percentage, term, or other provision prohibited by Section 50 (\textit{e.g.}, recourse, impermissible non-judicial foreclosure provision, impermissible acceleration provision, impermissible repayments), the lender or holder must (i) send the owner a written notice modifying the loan to conform to an amount, percentage, term, or other provision permitted by Section 50, and (ii) adjust the account of the borrower to ensure that the borrower is not required to pay more than an amount permitted by the Texas Constitution and is not subject to any other term or provision prohibited by Section 50.\(^9\)

**Delivery of Signed Documents.** If the lender has (i) failed to provide the owner a copy of all documents signed by the owner related to the equity loan at the time of closing as required by Subsection (Q)(v), or (ii) failed to obtain the required signatures of the owner and/or the lender on the written acknowledgment of fair market value as required by Subsection (Q)(ix), the lender or holder must deliver the required documents to the owner.\(^10\)

**Acknowledgment of Abatement of Interest and Obligations.** If the lender has made an equity loan on a homestead property that already has an equity loan secured on the same property made under Subsection (a)(6) or a reverse mortgage secured on the same property made under Subsection (a)(7) in violation of Subsection (a)(6)(K), the lender or holder must send the owner a written acknowledgment that the accrual of interest and all of the owner's obligations under the loan are abated while any such prior (a)(6) or (a)(7) lien remains secured by the same homestead property.\(^11\)

**Payment of $1,000 Penalty and Offer of "No Cost" Refinancing.** If the lender when making an equity loan has failed to comply with any constitutional obligation that cannot be cured under any of the foregoing subsections (a) – (e),\(^12\) the lender or holder may cure the failure to comply by (i) a refund or credit to the owner of $1,000, and (ii) offering the owner the right to refinance the equity loan with the lender or holder for the remaining term of the loan at no cost to the owner on the same terms, including interest, as the original equity loan, with any modifications in terms necessary for the loan to comply with Section 50, or on such terms as the lender or

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\(^6\) Section 50(a)(6)(Q)(x)(b).
\(^7\) \textit{Id.}
\(^8\) \textit{Id.}
\(^9\) Section 50(a)(6)(Q)(x)(c).
\(^10\) Section 50(a)(6)(Q)(x)(d).
\(^11\) Section 50(a)(6)(Q)(x)(e).
\(^12\) This may include failure to provide the 50(g) notice under Section 50(a)(6)(M)(i), failure to provide the itemized fee disclosure under Section 50(a)(6)(M)(ii), or an impermissible closing location under Section 50(a)(6)(N).
holder and the owner otherwise agree that comply with Section 50.  Although the refinance of an equity loan before the first anniversary of the closing date of the loan is generally prohibited, Section 50(a)(6)(M)(iii) permits a refinancing made under the cure provisions of Section 50(a)(6)(Q)(x)(f).

**Practice Tip – Multiple Violations.** A lender may have multiple failures to comply rather than a single violation. We will discuss curing equity loans in which multiple violations are identified.

**Incurable Violations.** Two violations are excepted from the cure provision pursuant to Subsection (Q)(xi). A lender or holder of an equity loan would expressly forfeit all principal and interest of the loan if either:

- the loan is made by a lender that is not authorized by Subsection (a)(6)(P) to make home equity loans, or
- the lien was not created under a written agreement with the consent of each owner and each owner's spouse, unless each owner and owner's spouse who did not initially consent subsequently consents.

A matrix summarizing the cure provisions is attached as Exhibit "A".

**Practice Tip – Applicable Law.** Section 50(a)(6)(Q)(x) addresses curing failures to comply with obligations under the extension of credit established pursuant to the Texas Constitution. Certain failures to comply may also or only violate other laws -- Federal (e.g., Truth-in-Lending Act) or state (e.g., Chapter 342) -- or contractual terms. The ability to cure these other violations will depend upon the particular failure.

### B. Cure Interpretations

The Finance Commission and the Credit Union Commission (collectively, the "Commissions") have issued cure interpretations which address various issues including counting the 60-day cure period, methods of notification, and methods of curing a violation. An overview follows.

**Adequate Notice of Failure to Comply.** An interpretation, 7 T.A.C. § 153.91, sets forth the minimum information necessary to constitute adequate notice from a borrower to a lender that the lender has failed to comply with its obligations under the loan. The interpretation provides:

(a) A borrower notifies a lender or holder of its alleged failure to comply with an obligation by taking responsible steps to notify the lender or holder of the alleged failure to comply. The notification must include a reasonable:

1. identification of the borrower;
(2) identification of the loan; and
(3) description of the alleged failure to comply.

(b) A borrower is not required to cite in the notification the section of the Constitution that the lender or holder allegedly violated.

Three commentators expressed that the interpretation should require the notice to be in writing. The Commissions disagreed and noted in the preamble that the Texas Constitution does not require the notice to be in writing. The Commissions, however, did note the following: "If a borrower were to provide notice orally, the borrower would have the burden to prove when it was given, to whom, and the content of the notice."17

Practice Tip – Oral Notification. As noted, the Commissions have indicated that the rule does not limit a borrower to any specific method of delivery and, therefore, oral notification may suffice. Another interpretation, 7 T.A.C. § 153.93(a), expressly allows the borrower to notify the lender under Section 50(a)(6)(Q)(x), orally or in writing.18

Counting the 60-Day Cure Period. The next interpretation, 7 T.A.C. § 153.92, establishes that the 60-day cure period starts on the day following the day notice is received and ends at midnight on the 60th day unless the 60th day is a Sunday or federal legal public holiday, then the deadline is midnight on the following day that is not a Sunday or federal legal public holiday.20 The interpretation states:

(a) For purposes of Section 50(a)(6)(Q)(x), the day after the lender or holder receives the borrower's notification is day one of the 60-day period. All calendar days thereafter are counted up to day 60. If day 60 is a Sunday or federal legal public holiday, the period is extended to include the next day that is not a Sunday or federal legal public holiday.

(b) If the borrower provides the lender or holder inadequate notice, the 60-day period does not begin to run.21

Methods of Notification. Another interpretation, 7 T.A.C. § 153.93, establishes methods of service constituting a rebuttable presumption of service.22 The interpretation states:

(a) At closing, the lender or holder may make a reasonably conspicuous designation in writing of the location where the borrower may deliver a written or oral notice of a violation under 50(a)(6)(Q)(x). The designation may include a mailing address, physical address, and telephone number. In addition, the lender or holder may designate an email address or other point of contact for delivery of a notice.

(b) If the lender or holder chooses to change the designated delivery location as provided in subsection (a) of this section, the address change does not become

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19 7 T.A.C. § 153.93(a).
20 7 T.A.C. § 153.92(a).
21 7 T.A.C. § 153.92.
22 7 T.A.C. § 153.93.
effective until the lender or holder sends conspicuous written notice of the address change to the borrower.

(c) The borrower may always deliver written notice to the registered agent of the lender or holder even if the lender or holder has named a delivery location.

(d) If the lender or holder does not designate a location where the borrower may deliver a notice of violation, the borrower may deliver the notice to any physical address or mailing address of the lender or holder.

(e) Delivery of the notice by borrower to lender or holder's designated delivery location or registered agent by certified mail return receipt or other carrier delivery receipt, signed by the lender or holder, constitutes a rebuttable presumption of receipt by the lender or holder.

(f) If the borrower opts for a location or method of delivery other than set out in subsection (e), the borrower has the burden of proving that the location and method of delivery were reasonably calculated to put the lender or holder on notice of the default.23

Practice Tip – Delivery Designation. Pursuant to the interpretation, 7 T.A.C. § 153.93(d), if the lender or holder does not designate a location for delivery, the borrower may deliver the notice to any location of the lender or holder. Accordingly, lenders should specifically designate a location for delivery. Nevertheless, a borrower is not required to send the notice to the lender's designated location. See 7 T.A.C. § 153.93(f).

Development – Designated Notice Location. In the preamble, the Commissions note that "One commenter suggested that the language in 153.93(a) be changed to make it mandatory that the borrower deliver notice to the lender's designated notice location."24 The Commissions didn't adopt the comment and stated:

The Commissions do not believe that this provision should be mandatory. The Constitution does not prohibit, nor does it expressly permit, the parties to contractually determine the terms for delivery of the notice. If the borrower chooses another method of delivery, then the borrower would assume the burden of proving adequate delivery of a notice of violation.25

Thus, borrowers may ignore a designation and (1) give oral notice, and/or (2) notice to a different location. If they do, they will have to prove that the location and method of delivery were "reasonably calculated to put the lender or holder on notice of the default.”

Methods of Curing a Violation. An interpretation, 7 T.A.C. § 153.94, is intended to provide guidance on actions a lender or holder must take to effect a cure and provides:

23 7 T.A.C. § 153.93.
(a) The lender or holder may correct a failure to comply under Section 50(a)(6)(Q)(x)(a) – (e), on or before the 60th day after the lender or holder receives the notice from an owner, if the lender or holder delivers required documents, notices, acknowledgements, or pays funds by:

(1) placing in the mail, placing with other delivery carrier, or delivering in person the required documents, notices, acknowledgements, or funds;

(2) crediting the amount to borrower's account; or

(3) using any other delivery method that the borrower agrees to in writing after the lender or holder receives the notice.

(b) The lender or holder has the burden of proving compliance with this section.26

In addressing this interpretation, one commentator expressed that as the borrower is not required to provide an address with the notice, the lender should only be required to provide the cure to the last known address of the borrower and the lender should only be required to deliver the response to a notice to one borrower. The Commissions declined to make the suggested changes and provided the following reasoning:

The Commissions believe the lender should act reasonably and use best efforts to communicate to the appropriate location of the borrower and with the appropriate number of borrowers, so that the borrower or borrowers, if more than one, have the best opportunity to receive information related to a potential violation of their home equity loan.27

In the preamble, the Commissions also note "Section 153.94(a)(3) precludes the closing documents from dictating the method of delivery of cure documents or payments."28

Cured Failure. An interpretation, 7 T.A.C. § 153.95, clarifies the following:

(a) If the lender or holder timely corrects a violation of Section 50(a)(6)(Q)(x) as provided in Section 50(a)(6)(Q)(x), then the failure does not invalidate the lien.

(b) A lender or holder who complies with Section 50(a)(6)(Q)(x) to cure Section 50(a)(6)(Q)(x) before receiving notice of the violation from the borrower receives the same protection as if the lender had timely cured after receiving notice.

(c) A borrower's refusal to cooperate fully with an offer that complies with Section 50(a)(6)(Q)(x) to modify or refinance an equity loan does not invalidate the lender's protection for correcting a failure to comply.29

26 7 T.A.C. § 153.94.
28 29 Tex. Reg. 10258 (Nov. 5, 2004). In the preamble, the Commissions state "Under the proposed interpretation, the methods permitted in § 153.94(a)(1) and § 153.94(a)(2) are the only reasonable methods permitted without an agreement of the parties reached after the notice of violation is given." 29 Tex. Reg. 10258 (Nov. 5, 2004).
29 7 T.A.C. § 153.95.
Practice Tip – Curing a Failure Prior to Notice. A lender or holder may cure a failure prior to notice by a borrower. In the preamble, the Commissions state:

The Commissions believe that a lender or holder may use the cure provisions for violations they discover prior to being notified by the borrower. The lender or holder may offer to cure a violation they discover in the absence of a notice from a borrower. This offer to cure, in the absence of notice, does not begin the 60-day cure time period. The Commissions have added § 153.95(b) to address this.\(^\text{30}\)

Correcting Failures Under Section 50(a)(6)(Q)(x)(f). An interpretation, 7 T.A.C. § 153.96, provides guidance on subsection (Q)(x)(f), which is commonly known as the "catch all" provision. The interpretation sets forth guidance regarding actions a lender or holder must take during the cure period when the lender or holder cannot cure the failure under subsections (Q)(x)(a) - (e). The interpretation provides:

(a) To correct a failure to comply under Section 50(a)(6)(Q)(x)(f), on or before the 60th day after the lender or holder receives the notice from the borrower the lender or holder may:

(1) refund or credit the $1,000 to the account of the borrower; and

(2) make an offer to modify or an offer to refinance the extension of credit on the terms provided in Section 50(a)(6)(Q)(x)(f) by placing the offer in the mail, other delivery carrier, or delivering the offer in person to the owner.

(b) To correct a failure to comply under Section 50(a)(6)(Q)(x)(f):

(1) the lender or holder has the option to either refund or credit $1,000; and

(2) the lender or holder and borrower may:

(A) modify the equity loan without completing the requirements of a refinance; or

(B) refinance with an extension of credit that complies with Section 50(a)(6).

(c) The lender or holder has the burden of proving compliance with this section.

(d) After the borrower accepts an offer to modify or refinance, the lender must make a good faith attempt to modify or refinance within a reasonable time not to exceed 90 days.\(^\text{31}\)


\(^{31}\) 7 T.A.C. § 153.96.
C. Judicial Decisions Regarding Cures

Cure Authority. In *Doody v. Ameriquest Mortgage Co.*,\(^{32}\) the Texas Supreme Court found that Section 50(a)(6)(Q)(x) is a cure provision that applies to all of Section 50(a) and, in addition to protecting the loan's principal and interest, operates as a cure provision that validates a lien securing an equity loan. The court concluded:

> We conclude that under the Texas Constitution, if a lender charges closing costs in excess of three percent, but refunds the overcharge within a reasonable time, bringing the costs within the range allowed by section 50(a)(6)(E), that cure also validates the lien under section 50(c). We reach this conclusion because we hold that section 50(a)(6)(Q)(x)'s cure provision applies to all the lender's obligations under the extension of credit. Upon the cure, the lender has established the terms and conditions the lender must satisfy to make a lien valid under section 50(c). Accordingly, the lien meets section 50(c)'s requirement that it is a lien that secures a debt described by this section.\(^{33}\)

The applicability of the cure provision and the effectiveness of a lender's cure efforts were at issue in *Adams v. Ameriquest Mortgage Co.*\(^{34}\) The facts follow. Larry and Tina Adams (the "Debtors") purchased their home in 1994 and granted a purchase money lien for a portion of the purchase price. In 2000, the Debtors refinanced their 1994 note with a home equity loan. On December 19, 2002, the Debtors refinanced the 2000 loan with a loan from Ameriquest Mortgage Co. ("Ameriquest"). The 2002 loan was not handled as a home equity loan as contemplated by Section 50(f) of the Texas Constitution. The Debtors argued that the 2002 loan is not a home equity loan as defined by Section 50(a)(6) and, therefore, the lien granted is invalid as an improper attempt to refinance a prior equity loan. Ameriquest contended that it saved its lien by curing the various defects in the 2002 loan that prevents it from being characterized as a home equity loan. In granting Ameriquest's summary judgment, the court found the following:

- The cure provision is applicable to a refinance of a prior home equity loan under Section 50(f);
- A lender is not limited in its cure power to only defects that the lender may unilaterally cure and a borrower may not refuse to comply with a reasonable offer to cure by the lender;
- Section 50(a)(6)(Q)(x) is applicable to cure "non-curable" defects (e.g., twelve day waiting period) through a reasonable offer to redo the transaction by the lender;
- Ameriquest received notice of the defective loan on the date recited in the certificate of service accompanying the adversary complaint and acted within a "reasonable time" given the circumstances of the case; and

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\(^{32}\) 49 S.W. 3d 342 (Tex. 2001).
\(^{33}\) *Id.* at 347.
• Ameriquest met its burden under the cure provision by its reasonable offer to cure.

The court also addressed which version of the Texas Constitution applies. The court states: "Section 50 of article XVI of the Texas Constitution was amended in 2003. The parties submit that the version of Section 50 prior to the amendment controls. The court agrees. 'The laws existing at the time a contract is made becomes a part of the contract and govern the transaction.' Wessely Energy Corp. v. Jennings, 736 S.W.2d 624, 626, (Tex. 1987)." 35

In In re Chambers, 36 the plaintiffs alleged numerous violations of the Texas Constitution with respect to a home equity loan. The memorandum opinion reflects the defendant sent a cure letter pursuant to, among other, the catch-all provision, Section 50(a)(6)(Q)(x)(f), as follows:

On February 1, 2006, within 60 days of receiving the Chambers' petition, the Defendant sent a letter to the Chambers addressing their allegations, attaching copies of the loan documents, and offering to cure the alleged defects in 2004 loan documents by providing a $1,000 credit to the loan for each violation and offering to refinance the loan on the same terms. The Defendant instructed the Chambers to contact the author of the letter, Royce Coleman, on or before March 8, 2006, if they desired to refinance their loan.

The plaintiffs asserted that Section 50(a)(6)(Q)(x)(f) is not the appropriate cure for the alleged violations. Apparently, the plaintiffs were arguing that the alleged defects were incurable since other cure provisions generally did not apply. The court noted:

• The Texas Supreme Court's language in Doody regarding the cure provision was unambiguous and unqualified – "section 50(a)(6)(Q)(x) is a cure provision that applies to all of section 50(a) . . . and also operates as a cure provision that validates a lien securing a section 50(a)(6) extension of credit." Doody 49 S.W. 3d at 345-346.

• Moreover, if a lender makes an offer to modify or refinance an equity loan that complies with § 50(a)(6)(Q)(x)(f), "a borrower's refusal to cooperate fully . . . does not invalidate the lender's protection for correcting a failure to comply." 7 Tex. Admin. Code § 153.95 (effective November 11, 2004). The Court, therefore, concludes that the Defendant's offer to cure the alleged violations of the Texas Constitution in connection with the 2004 home equity loan complied with § 50(a)(6)(Q)(x) and that the Chambers' failure to cooperate with the Defendant did not invalidate the Defendant's attempted cure.

The court remanded the case to state court for resolution of additional issues.

Adequate Notice of Failure to Comply. In Curry v. Bank of America, Nat'l Ass'n, 37 the borrowers brought an action against Bank of America claiming that their home equity loan was void for

35 Id. at fn. 1.
failure to comply with the Texas Constitution because the loan was closed at the borrowers’ place of business and all loan closing documents were not delivered to the borrowers. Prior to bringing the action, the borrowers sent a series of letters to the bank to notify it that the loan was constitutionally defective and to give the bank an opportunity to cure the defects. The letters contained a “preliminary determination” that the loan was invalid but did not contain specific facts or details in support of the determination.38 Noting that the borrowers had the burden of proving that they properly notified the bank of the constitutional defects, the court concluded that the borrowers failed to meet this burden because the notice contained only general allegations. The court held:

Although the home equity loan provisions are silent as to the extent of notice the borrower must give, we conclude the [borrowers] needed to do more than make a general allegation and had to describe how the loan is non-compliant... To determine how to cure its non-compliance, the lender must be aware of what that non-compliance is.39

Cures – Amendments Not Retroactive. In Fix v. Flagstar Bank,40 the borrowers obtained a home equity loan and later refinanced the loan with a conventional loan. The second loan violated two provisions of the Texas Constitution: (1) it was executed within less than one year's time after the first loan was executed,41 and (2) it was in the form of a conventional loan, with provisions allowing for personal liability against the borrowers and nonjudicial foreclosure.42 The borrowers sent notice to the bank that the loan was constitutionally defective. Twenty-one days after receiving notice, the bank offered to cure the violations via a new home equity loan at a better rate at no cost to the borrowers and to pay the borrowers $1,000.43 The borrowers refused the offer and subsequently brought suit to compel forfeiture. The primary issue in the case was whether the 2003 amendments to the Texas Constitution applied retroactively. The 2003 amendments added specific ways by which a lender could cure constitutional violations and changed the time period to cure from "a reasonable time" to a sixty-day time period.44 After examining the literal language of the amendment and the legislative history, the court concluded that the 2003 amendments are not retroactive.45 Thus, the provisions prior to the 2003 amendments, which did not set forth specific cure provisions, would apply. Under the prior version, the court held that the bank's offer to cure occurred within a reasonable time period and was sufficient to cure the defects in the second loan.46

Contractual Breach v. Constitutional Violation. In Vincent v. Bank of America, N.A.,47 the borrowers obtained a home equity loan from the bank after signing a Federal Truth-in-Lending Disclosure and Loan Agreement. After the parties disputed how payments were being allocated between principal and interest, the borrowers sued the bank. They sought class certification, and forfeiture of the loan's principal and interest. The trial court denied class certification. After a trial, judgment was entered for the borrowers granting them injunctive and declaratory relief,

38 Id. at 348.
39 Id. at 353.
40 242 S.W.3d 147 (Tex. App.—Fort Worth 2007, pet. denied).
41 See Section 50(a)(6)(M)(iii).
42 See Sections 50(a)(6)(C) and (D).
43 242 S.W.3d at 152-153.
44 Id. at 155.
45 Id. at 157.
46 Id. at 158.
but refusing to declare the forfeiture requested. Most importantly, on appeal, it was held that no forfeiture is caused by a mere breach of contract not related to the specific duties mandated of a home equity loan under the Texas Constitution.\(^{48}\)

**Contractual Cure.** In *Foster v. Bank One Texas NA*,\(^{49}\) the borrower argued that the lien on his residence was invalid under Section 50(a)(6)(H) because it encumbered real property in excess of the permissible amount and granted Bank One a security interest in personal property. At the time the promissory note and lien for the loan were executed, homestead property was limited to one acre. The borrower's home was situated on 1.75 acres. Although this encumbrance would constitute a violation of Section 50(a)(6)(H), the loan documents provided that "notwithstanding any provision of this Homestead Lien Contract to the contrary in no event shall this Homestead Lien Contract require or permit any action which would be prohibited by Section 50(a)(6), Art. XVI, Texas Constitution, and all provisions of this Homestead Lien Contract shall be modified to fully comply with Section 50(a)(6), Art. XVI, Texas Constitution." The Fifth Circuit held that, to the extent the lien encumbered property in violation of Section 50(a)(6)(H), any defect was automatically cured by the terms of the loan documents.

**Equitable Subrogation.** In *LaSalle Bank Nat'l Ass'n v. White*,\(^{50}\) the Texas Supreme Court held that, to the extent the proceeds of a constitutionally invalid home equity loan are used to pay off constitutionally permissible pre-existing liens, the home equity mortgage is equitably subrogated to the prior lienholder's interests.

**II. MODIFICATIONS**

Section 50(a)(6) does not address modifications of Texas home equity loans. The Commissions, however, have issued an interpretation, 7 T.A.C. § 153.14(2), addressing the authority for modifications.

Section 50(a)(6)(M)(iii) provides a home equity loan may not be closed before one year after any prior home equity loan, regardless of whether the previous home equity loan was paid in full, subject to two exceptions.\(^{51}\) The Commissions have interpreted this provision not to prohibit modification of an equity loan before one year has passed since the loan's closing date.\(^{52}\) In particular, the interpretation states, in pertinent part, as follows:

Section 50(a)(6)(M)(iii) does not prohibit modification of an equity loan before one year has elapsed since the loan's closing date. A modification of a home equity loan occurs when one or more terms of an existing equity loan is modified, but the note is not satisfied and replaced. A home equity loan and a subsequent modification will be considered a single transaction. The home equity requirements of Section 50(a)(6) will be applied to the original loan and the subsequent modification as a single transaction.

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\(^{49}\) 54 Fed. Appx. 592 (5th Cir. 2002).

\(^{50}\) 246 S.W. 3d 616 (Tex. 2007).


\(^{52}\) 7 T.A.C. § 153.14(2); see also, Letter dated December 20, 2001 from the Texas Department of Banking, Texas Savings & Loan Department, Office of Consumer Credit Commissioner, and Texas Credit Union Department to Karen M. Neeley (the "Modification Letter"), a copy of which is attached as Exhibit "B".
(A) A modification of an equity loan must be agreed to in writing by the borrower and lender, unless otherwise required by law. An example of a modification that is not required to be in writing is the modification required under the Soldiers' and Sailors' Civil Relief Act.

(B) The advance of additional funds to a borrower is not permitted by modification of an equity loan.

(C) A modification of an equity loan may not provide for new terms that would not have been permitted by applicable law at the date of closing of the extension of credit.

(D) The 3% fee cap required by Section 50(a)(6)(E) applies to the original home equity loan and any subsequent modification as a single transaction.\(^53\)

The interpretation supports, subject to the listed conditions, the authority for modification of Texas home equity loans before one year has elapsed since the loan's closing date. Other laws also may apply to modifications.\(^54\)

The Modification Letter was issued December 20, 2001, prior to the grant of the Commissions' interpretive authority. In the letter, four state agencies recognized the authority for modifications of Texas home equity loans at any time, subject to certain conditions. (The Modification Letter does not create a safe harbor.) The Modification Letter states, among other things, the following:

- A lender may modify a home equity loan by reducing its interest rate and changing the payment amounts and/or the number of monthly payments without going through all of the steps of a loan refinancing. The lender and a borrower may agree to a modification at any time, even if it is within a year of closing this or another home equity loan secured by the same homestead.

- A loan modification is a transaction where an existing note is modified, but the note is not cancelled. In a modification, a lender and a borrower may agree to extend the term of the loan, change the interest rate, change the monthly payments, etc. If the existing note is cancelled and a new note is signed to replace it, the transaction is generally considered a loan refinance.

- A first or secondary home equity loan may be modified provided the modification is not contrary to any of the express requirements of the constitution. A modification to increase the principal amount advanced would be prohibited because it would have the effect of turning the home equity loan into a line of credit, which is expressly prohibited.

\(^{53}\) 7 T.A.C. § 153.14(2).

\(^{54}\) Other federal or Texas laws may apply. For example, Section 342.456 of the Texas Finance Code sets forth certain requirements for modifications for secondary mortgage loans.
• The below-signed regulators agree that a mutually agreed upon loan modification resulting in substantially equal post-modification monthly installments that differ from the pre-modification monthly installments would be acceptable.

As noted above, the agencies expressed their view that a lender and borrower may modify a home equity loan by reducing its interest rate and changing the payment amounts and/or the number of monthly payments. The Modification Letter was the basis for the interpretation, 7 T.A.C. § 153.14(2).

Nevertheless, questions remained regarding home equity loans modifications. In this context, the state agencies under the Finance Commission -- the Department of Banking, the Department of Savings & Mortgage Lending and the Office of Consumer Credit Commissioner -- and the state agency under the Credit Union Commission -- the Credit Union Department -- comprise what is known as the Joint Financial Regulatory Agencies Home Equity Work Group (the "Group"). On or about April 23, 2009, the Group released a Home Equity Modification Advisory Bulletin (the "Advisory Bulletin"), a copy of which is attached as Exhibit "C". Under "Permissible Modification," the Advisory Bulletin provides:

Borrower pays the lender whatever is necessary to bring the home equity loan current on or before the date that the home equity loan is modified. The modification schedules installments that are:

• substantially equal in amount,
• successive and periodic, and
• scheduled to equal or exceed the amount of accrued interest as of the date of the installment.

This method may change the amount of the scheduled installment or it may change the remaining term of the loan or both.

The Advisory Bulletin expressly provides the statement is not meant to negate the applicability or legality of any other method of modifying a home equity loan. However, other actions beyond the foregoing such as capitalization of accrued interest and advances may raise constitutional concerns. The author is not aware of other statutes, interpretations, or judicial decisions currently providing further guidance on permissible modifications.

III. RECENT DEVELOPMENTS

An overview of certain developments pertaining to Texas home equity lending is set forth below.

On January 8, 2010, the Third Court of Appeals, in Texas Bankers Ass'n v. Ass'n of Community Orgs. For Reform Now (ACORN), reversed in part, and rendered judgment upholding three of

55 This guidance does not constitute an interpretation which only the Commissions can issue. Accordingly, the guidance does not qualify for the safe harbor under Section 50(u). A court, however, may view it as persuasive.

56 Texas Bankers Ass'n v. Ass'n of Community Orgs. For Reform Now (ACORN), __ S.W.3d ____, 2010 WL 45874 (Tex. App. – Austin 2010, pet. filed).
four interpretations\textsuperscript{57} that had been invalidated by the trial court. The court also affirmed the trial court's holding invalidating interpretations defining what constitutes "interest" and, therefore, is excluded from the three-percent fee cap.\textsuperscript{58} (See "Acorn Suit Challenging Interpretations").

On March 17, 2010, an Order Granting Joint Motion For Voluntary Dismissal was entered in \textit{Trahan v. Long Beach Mortgage Corp.}, No. 9:05CV29 (E.D. Tex. – Lufkin Division), a class-action lawsuit challenging variable rate home equity loans made prior to January 8, 2004, the effective date for the Commissions' interpretation, 7 T.A.C. § 153.16. In the suit, the plaintiffs had alleged their notes provide for a variable interest rate and, therefore, provided for payments that are not substantially equal. They had contended that this violates Section 50(a)(6)(L), the requirement that an equity loan is scheduled to be repaid in substantially equal successive periodic installments. The plaintiffs, individually and on behalf of the class, had alleged the notes are void and the lenders should forfeit all principal and interest on these notes.

On July 22, 2010, the Fifth Circuit Court of Appeals, in \textit{Cerda v. 2004-EQR1 L.L.C.},\textsuperscript{59} addressed the following issues:

- whether the district court incorrectly determined that the 12 day waiting period began to run when the borrowers submitted a telephonic application;
- whether a variable interest rate caused the loan payments not to be substantially equal; and
- whether discount points are properly characterized as fees that count against the three percent fee cap.

Based on the plain language of Section 50(a)(6)(M)(i), the court interpreted the term "application" to encompass oral applications, including telephonic applications such as the one submitted by the borrowers.\textsuperscript{60} The court accepted the defendants' interpretation of Sections 50(a)(6)(L) (substantially equal payment requirement) and 50(a)(6)(O)(variable interest rate authority) that the requirement of substantial equality exists to ensure that home equity loans are fully amortized and that balloon payments are prohibited.\textsuperscript{61}

The court recognized the conflicting interpretations of the terms "interest" and "fees" in Section 50(a)(6)(E) by the Waco court in \textit{Tarver}\textsuperscript{62} and the Third Court of Appeals in \textit{ACORN}.\textsuperscript{63} The court followed \textit{Tarver}, finding that decision better reasoned, more persuasive, and better supported by Texas law. The court held:

We are persuaded that the Texas Supreme Court, if faced with a choice between the approaches to defining "interest" in \textit{Tarver} and in \textit{ACORN}, would follow the \textit{Tarver} court's approach. The \textit{Tarver}
court's approach is supported by numerous current regulations as well as the REGULATORY COMMENTARY. It also has the advantage of providing lenders and borrowers with a consistent and straightforward definition of "interest," rather than one that varies depending on the nature of the underlying loan. While the ACORN court was appropriately concerned with ensuring that the 3% cap adequately protected consumers, we disagree that the Tarver approach "essentially renders this cap meaningless." Id. A broad definition of "interest" that includes discount points does not result in an absence of consumer protection: Characterizing discount points as interest rather than fees would not give lenders carte blanche to charge exorbitant fees through the guise of discount points precisely because the discount points would then be characterized as interest — and thus subject to the consumer protection provisions of the usury laws. Moreover, the ACORN court, while finding the usury definition of "interest" incompatible with the "plain language" of § 50(a)(6)(E), failed to suggest any viable alternative definition.64

IV.  ACORN SUIT CHALLENGING THE INTERPRETATIONS

ACORN Suit Challenging the Interpretations. On January 29, 2004, the Association for Community Organizations for Reform Now ("ACORN") and six individuals filed a petition against the Commissions in the District Court of Travis County (126th Judicial District) challenging the validity of certain interpretations adopted by the Commissions.65 The validity was challenged generally as follows: (A) some interpretations are new rules which the Commissions had no authority to enact; or (B) the Commissions exceeded their authority to interpret the Texas Constitution because some interpretations contradict the plain meaning and intent of the constitutional provisions, and some impose additional burdens and restrictions in excess of or in a manner inconsistent with the constitutional provisions. All parties moved for summary judgment, and a summary judgment hearing was held in October 2005.

On October 7, 2005, District Judge Scott Jenkins issued a letter in which he informed the parties how he intended to decide the cross motions for summary judgment. On April 29, 2006, Judge Jenkins issued a Final Summary Judgment and Temporary Stay Order (the "ACORN Order").

Trial Court Summary. The trial court granted in part and denied in the part the cross-motions for summary judgment, finding that seven of the nine interpretations challenged by ACORN were invalid. The ACORN Order is summarized below.

7 T.A.C. §§ 153.1(11) and 153.5(3), (4), (6), (8), (9), (12). Three Percent Fee Cap Rules. A challenged interpretation provides the charges an owner or an owner's spouse is required to pay that constitute interest under Texas law, for example per diem interest and points, are not fees subject to the three percent fee limitation. The plaintiffs contended that cases interpreting usury statutes are not controlling. Judge Jenkins ruled for the plaintiffs. Other cases and Judge Jenkins' October 7, 2005 letter reflect a position that discount points (i.e., points paid for

64 Id. at 796-796.
reducing the interest rate) are a form of interest and, therefore, not fees within the three percent limit.

7 T.A.C. § 153.12(2). Closing Date – Oral Application Rule. The plaintiffs challenged the interpretation providing that a loan application may be given orally and Judge Jenkins ruled for the plaintiffs. The ruling created concerns for lenders that take oral applications (e.g., via telephone) and may have required them to take written or electronic applications. The ruling also may have impacted the timing for a closing as an equity loan may not be closed before the 12th day after the later of (i) the date the owner submits an application, or (ii) the date the lender provides the owner with the Notice Concerning Extensions of Credit (the "Notice") prescribed by Section 50(g).

Development – Amendment and New Interpretations. Section 50(a)(6)(M)(i) was amended effective December 4, 2007 to provide an equity loan may not be closed before the 12th day after the later of (i) the date the owner submits a loan application, or (ii) the date the lender provides the owner with the Notice. The Notice was amended to delete the word "WRITTEN" and state "LOAN APPLICATION". The Commissions have adopted an amendment to the interpretation. The amendment, however, only addresses that a lender may provide one copy of the prescribed documents to married owners rather than a copy to each.66

7 T.A.C. § 153.13(4). Preclosing Disclosure – Fee Variance Rule. A lender cannot close an equity loan until one business day after providing an itemized disclosure of fees that will be charged at closing.67 A variance would mean a lender would need to redisclose and wait one business day to close. The Commissions adopted an interpretation permitting a de minimis variance and the plaintiffs challenged the interpretation. Judge Jenkins ruled for the plaintiffs.

Development – New Interpretation. The Commissions repealed the interpretation in question, readopted a new one, and amended the readopted interpretation to correct an error.68 The Commissions have adopted additional amendments, but these amendments do not address the de minimis variance provision.69

7 T.A.C. §§ 153.15(2), (3). Location of Closing – Power of Attorney Rule. The challenged interpretation provides that a lender may accept a properly executed power of attorney allowing the attorney-in-fact to execute closing documents on the owner's behalf. Judge Jenkins ruled for the Commissions. This ruling supports the ability to use powers of attorney.

7 T.A.C. § 153.18(3). Limitation on Application of Proceeds – Debt Consolidation Rule. The plaintiffs challenged an interpretation providing that when an owner applies for a debt consolidation loan, it is the owner, not the lender, that is requiring that proceeds be applied to another debt. Judge Jenkins ruled for the plaintiffs.

Development – New Interpretation. The Commissions repealed the interpretation in question and readopted a new one.70

67 See 31 Tex. Reg. 5080 (June 30, 2006).
69 33 Tex. Reg. 9074 (Nov. 7, 2008).
70 See 31 Tex. Reg. 5080 (June 30, 2006).
7 T.A.C. § 153.20. No Blanks in the Equity Loan Agreement – Blank Spaces Rule. Blanks are prohibited and the challenged interpretation provides that the phrase "blanks that are left to be filled in" refers to omitted contract terms in the equity loan agreement. Judge Jenkins ruled for the plaintiffs. The plaintiffs contend the Texas Constitution places upon the lender the responsibility to ensure that no blanks are left in any document.

Development – New Interpretation. The Commissions repealed the interpretation in question and readopted a new one.  

7 T.A.C. § 153.22. Document Copy Rule. The plaintiffs challenged an interpretation pertaining to the documents the lender must provide the owner at closing. The interpretation provides "The lender is not required to give the owner copies of documents that were signed by the owner prior to closing, such as those signed during the application process." The plaintiffs contend documents signed before closing, such as various disclosures and the application for a home equity loan, are "related to the extension of credit," and, therefore, a lender is constitutionally required to give the owner copies of these documents. Judge Jenkins ruled for the plaintiffs.

Development – Amendment and New Interpretation. Section 50(a)(6)(Q)(v) was amended effective December 4, 2007 to clarify that the owner is to receive all executed documents signed by the owner at closing. The amendment also requires the owner to receive a copy of the final loan application. Section 50(a)(6)(Q)(v) now provides:

at the time the extension of credit is made, the owner of the homestead shall receive a copy of the final loan application and all executed documents signed by the owner at closing related to the extension of credit.

The Notice provides:

PROVIDE THAT YOU RECEIVE A COPY OF YOUR FINAL LOAN APPLICATION AND ALL EXECUTED DOCUMENTS YOU SIGN AT CLOSING;

In view of constitutional amendment, the Commissions have adopted amendments to 7 T.A.C. § 153.22.

7 T.A.C. §§ 153.51(1), (3). Customer Disclosure (Notice Concerning Extensions of Credit) – Disclosure Mailing Rule. The plaintiffs challenged the interpretation providing that a period of three calendar days, not including Sundays and federal legal public holidays, constitutes a reasonable presumption for sufficient mailing and delivery of the Notice. Judge Jenkins ruled for the Commissions and the ruling supports the interpretation’s validity.

71 See 31 Tex. Reg. 5
Development – New Interpretation. The Commissions have adopted an amendment to 7 T.A.C. § 153.51 to clarify a lender may rely on the Spanish translation of the Notice published on the Finance Commission's webpage.  

7 T.A.C. § 153.84(1). Restrictions on Devices and Methods to Obtain a HELOC Advance – Convenience Check Rule. The plaintiffs challenged the interpretation permitting, among other ways, convenience checks as a permitted method by which to access a HELOC. Judge Jenkins ruled for the plaintiffs and held all of subsection (1) invalid. Subsection (1) listed permissible methods (i.e., contacting the lender directly, telephonic funds transfers, and electronic funds transfers) and permissible devices (i.e., prearranged drafts, convenience checks, and written transfer instructions). The ruling created uncertainty regarding the permissible access methods and devices for Texas HELOCs.

Development – Amendment and New Interpretation. Section 50(t) was amended December 4, 2007 with respect to the issue of preprinted solicitation checks. The new language authorizes borrowers to use preprinted checks to obtain an advance, if these checks are requested by the borrower as follows:

(t) A home equity line of credit is a form of an open-end account that may be debited from time to time, under which credit may be extended from time to time and under which:

…

(3) the owner does not use a credit card, debit card, or similar device, or preprinted check unsolicited by the borrower, to obtain an advance;

The Notice also was amended. In view of these amendments, the Commissions have adopted amendments to 7 T.A.C. § 153.84 to implement the prohibition on the owner's use of preprinted checks unsolicited by the borrower to obtain a HELOC advance.

Third Court of Appeals. The Commissions, the plaintiffs, and the Texas Bankers Association ("TBA"), an intervenor, each filed a Notice of Appeal to challenge the trial court's decision. The Third Court of Appeals adopted the trial court's stay and extended that stay pending disposition of the appeal. While the appeal was pending, the Commissions repealed three of the seven interpretations that had been invalidated by the trial court. The Third Court of Appeals heard oral arguments on January 31, 2007.

On January 8, 2010, the Third Court of Appeals reversed, in part, and rendered judgment upholding three of the four remaining interpretations that had been invalidated by the trial court. The majority affirmed the trial court's holding invalidating one interpretation defining

73 33 Tex. Reg. 9074 (Nov. 7, 2008).
74 See 33 Tex. Reg. 5295 (July 4, 2008).
75 The interpretations: 7 T.A.C. § 153.13(4) pertaining to the preclosing disclosure-fee variance rule; 7 T.A.C. § 153.18(3) pertaining to limitation on application of proceeds – debt consolidation rule; and 7 T.A.C. § 153.20 pertaining to blanks.
what constitutes "interest" and therefore is excluded from the three-percent fee cap.\textsuperscript{77} The Commissions had defined interest as it had been defined by Texas courts and the Texas Finance Code: "compensation for the use, forbearance, or detention of money."\textsuperscript{78} The majority held that interpretation was "extremely broad," "would defeat the purpose of the constitutional provision imposing a fee cap in the first place" and is, therefore, "contrary to the intent and plain meaning of the constitution."\textsuperscript{79} Justice Puryear issued a Concurring and Dissenting Opinion stating that he believed that interpretation should likewise be upheld.\textsuperscript{80} Justice Puryear noted that "[i]t is hard to imagine a more reasonable manner in which the Commissions could have attempted to give effect . . . than using the very definition" the Legislature had used to define "interest."\textsuperscript{81}

A summary chart follows:

<table>
<thead>
<tr>
<th>Subject</th>
<th>Holding</th>
</tr>
</thead>
<tbody>
<tr>
<td>Three Percent Fee Cap Rules</td>
<td>Affirmed (Interpretations are invalid)</td>
</tr>
<tr>
<td>Oral Applications</td>
<td>Reversed</td>
</tr>
<tr>
<td>Convenience Checks</td>
<td>Reversed</td>
</tr>
<tr>
<td>Copies of Documents</td>
<td>Reversed</td>
</tr>
<tr>
<td>Closing Location – Powers of Attorney</td>
<td>Interpretation is valid.</td>
</tr>
<tr>
<td>Providing Written Notice – Disclosure Mailing</td>
<td>Interpretation is valid.</td>
</tr>
</tbody>
</table>

\textbf{Supreme Court}. The plaintiffs, the Commissions, and the TBA have all filed petitions for review in the Texas Supreme Court. The Commissions and the TBA are asking the court to uphold the Commissions' interpretation defining what constitutes "interest," as opposed to "fees" subject to the three-percent fee cap. The plaintiffs are asking the court to invalidate the Commissions' rules that allow a homeowner to a sign home equity loan documents using a power of attorney and that allow a lender to show that it provided the required disclosures about the terms of a loan through proof that it mailed the disclosure to the homeowner.

In August 2010, the Texas Supreme Court requested that the parties file briefs on the merits. The parties' briefs will be filed through January 2011. The court will, thereafter, determine whether to grant the parties' petitions for review and accept review of the case.

\textsuperscript{77} \textit{Id. at }*3-4.  
\textsuperscript{78} See Tex. Fin. Code § 301.002(4).  
\textsuperscript{79} \textit{Texas Bankers Ass'n}, 2010 WL 45874 at *4.  
\textsuperscript{80} \textit{Id. at }*11-14.  
\textsuperscript{81} \textit{Id. at }*14.
Practice Tip – Online Resource. The Finance Commission has established helpful resource information online. The index page is entitled "Home Equity, Reverse Mortgage, & Home Improvement Lending in Texas Resources & Information" and a link follows: http://www.fc.state.tx.us/homeinfo/homeindex.htm.
**Exhibit "A"**

**Cure Matrix**

**Forfeiture Trigger:** If the lender or holder fails to comply with the lender's or holder's obligations under the extension of credit and fails to correct the failure to comply not later than the 60th day after the date the lender or holder is notified by the borrower of the lender's failure to comply. See Tex. Const. art. XVI, § 50(a)(6)(Q)(x).

<table>
<thead>
<tr>
<th>Section</th>
<th>Violation</th>
<th>Cure</th>
</tr>
</thead>
<tbody>
<tr>
<td>(a)(6)(Q)(x)(b)</td>
<td>Exceeds 80% FMV limit – (a)(6)(B)</td>
<td>Send written acknowledgment limiting to authorized percentage.</td>
</tr>
<tr>
<td>(a)(6)(Q)(x)(b)</td>
<td>Additional real or personal property taken – (a)(6)(H)</td>
<td>Send written acknowledgment that loan is not secured by impermissible property.</td>
</tr>
<tr>
<td>(a)(6)(Q)(x)(b)</td>
<td>Impermissible agricultural property – (a)(6)(I)</td>
<td>Send written acknowledgment that loan is not secured by impermissible property.</td>
</tr>
<tr>
<td>(a)(6)(Q)(x)(c)</td>
<td>Other – may include: recourse – (a)(6)(C); impermissible non-judicial foreclosure provision – (a)(6)(D); impermissible type of open-end credit – (a)(6)(F); impermissible acceleration provision – (a)(6)(J); impermissible repayments – (a)(6)(L); impermissible provision – (a)(6)(Q)(i), (ii), (iv); security instrument disclosure missing – (a)(6)(Q)(vi)</td>
<td>Send the owner a written notice modifying any other amount, percentage, term, or other provision prohibited by Section 50(a)(6) to a permitted amount, percentage, term, or other provision and adjust the account of the borrower to ensure that the borrower is not required to pay more than an amount permitted by Section 50(a)(6) and is not subject to any other term or provision prohibited by Section 50(a)(6).</td>
</tr>
<tr>
<td>(a)(6)(Q)(x)(d)</td>
<td>Failure to provide copies of final loan application and all executed documents signed by owner at closing – (a)(6)(Q)(v)</td>
<td>Deliver the required documents to the borrower.</td>
</tr>
<tr>
<td>(a)(6)(Q)(x)(d)</td>
<td>Failure to have appropriate signatures on FMV acknowledgment – (a)(6)(Q)(ix)</td>
<td>Obtain appropriate signatures.</td>
</tr>
</tbody>
</table>
**Section**

<table>
<thead>
<tr>
<th>(a)(6)(Q)(x)(e)</th>
<th>Another home equity loan or reverse mortgage secured by homestead – (a)(6)(K)</th>
</tr>
</thead>
<tbody>
<tr>
<td>(a)(6)(Q)(x)(f)</td>
<td>Violation not covered in (x)(a)-(e) – may include: failure to provide 50(g) notice – (a)(6)(M)(i); untimely or failure to provide loan application, if not previously provided, or itemized fee disclosure at least one business day prior to closing – (a)(6)(M)(ii); closed prior to one year of another HE loan – (a)(6)(M)(iii); impermissible closing location – (a)(6)(N); blanks – (a)(6)(Q)(iii)</td>
</tr>
</tbody>
</table>

**Cure**

- Send the owner a written acknowledgment that the accrual of interest and all of the owner's obligations under the extension of credit are abated while any prior lien prohibited under Paragraph (K) remains secured by the homestead.

- If the failure to comply cannot be cured under Subparagraphs (x)(a)-(e), curing the failure to comply by a refund or credit to the owner of $1,000 and offering the owner the right to refinance the extension of credit with the lender or holder for the remaining term of the loan at no cost to the owner on the same terms, including interest, as the original extension of credit with any modifications necessary to comply with Section 50(a)(6) or on terms on which the owner and the lender or holder otherwise agree that comply with Section 50(a)(6).

**Incurable Violations:** The lender or any holder of the note for the extension of credit shall forfeit all principal and interest of the extension of credit if:

- **(A)** the extension of credit is made by a person other than a person described under Paragraph (P) of Section 50(a)(6), or

- **(B)** if the lien was not created under a written agreement with the consent of each owner and each owner's spouse [see Section (a)(6)(A)], unless each owner and each owner's spouse who did not initially consent subsequently consents.

Exhibit "B"

Modification Letter
Opinion No. 01-14

December 20, 2001

Randall S. James, Commissioner, Texas Department of Banking

Leslie Pettijohn, Commissioner, Office of Consumer Credit Commissioner

James L. Pledger, Commissioner, Texas Savings & Loan Department

Harold E. Feeney, Commissioner, Texas Credit Union Department

By letter to Everette D. Jobe, General Counsel of the Texas Department of Banking dated October 3, 2001, you asked whether it is permissible to modify, rather than refinance, a home equity loan to reduce the interest rate and change the payments accordingly.

Summary:

A lender may modify a home equity loan by reducing its interest rate and changing the payment amounts and/or the number of monthly payments without going through all of the steps of a loan refinancing. The lender and a borrower may agree to a modification at any time, even if it is within a year of closing this or another home equity loan secured by the same homestead.

May a home equity loan be modified?

A loan modification is a transaction where an existing note is modified, but the note is not cancelled. In a modification, a lender and a borrower may agree to extend the term of the loan, change the interest rate, change the monthly payments, etc. If the existing note is cancelled and a new note is signed to replace it, the transaction is generally considered a loan refinancing. The permissibility of refinancing of home equity loans is discussed in the Regulatory Commentary on Equity Lending Procedures (October 7, 1998), jointly issued by the below-signed state regulatory agencies.

Section 50(a)(6) does not specifically allow or even mention modifications of home equity loans. Elsewhere, the constitution provides that a refinance secured by the homestead, any portion of which is a home equity loan, may not be secured by a valid lien against the homestead unless the refinance of the debt is a home equity loan. Thus, while the framers of these provisions of the constitution did include restrictions on refinancing a home equity loan, the constitutional provisions on home equity loans are silent on the application of common mortgage industry practices, such as modifications.

Inherent in an issue as complex as home equity lending are details that simply cannot be fully addressed within the text of the constitutional amendment. Different statutes and constitutional provisions govern the various aspects of credit transactions, specifically loans, including home equity loans. The home equity lending constitutional amendment and other laws affecting mortgage lending, particularly the Texas Finance Code, are separate and distinct layers of regulation, which may all, to some degree, apply to one or more aspects of a home equity loan. In reviewing home equity lending, these agencies must consider and administer all of these laws, as applicable, and not merely any one distinct layer. Section 50 addresses the elements necessary to create a valid lien on a homestead and the consumer protections the framers deemed necessary. Some of these protections may limit the ability of a lender to do things otherwise permissible in the context of a home loan that is not a home equity loan. To the extent that the provisions of the constitution can be reconciled with provisions of other Texas law applicable to mortgage lending, home equity lending will be governed by both.

A first or secondary home equity loan may be modified provided the modification is not contrary to any of the
express requirements of the constitution. For instance, the loan may not be modified to give the lender recourse for personal liability against any owner or the spouse of any owner. A modification to increase the principal amount advanced would be prohibited because it would have the effect of turning the home equity loan into a line of credit, which is expressly prohibited. These are examples, and there may be other instances where terms of a modification would be in conflict with the constitution.

A lender may unilaterally modify a home equity loan to comply with a legal requirement, but if an owner rejects the modification, the borrower has the right to pay off the existing balance of the loan at the rate and over the time period in effect prior to the proposed modification. The lender may not accelerate the loan solely on the basis of the rejection of the modification.

This opinion does not address the appropriateness of charging fees associated with a modification.

May a home equity loan be modified within one year of its anniversary date?

A home equity loan in Texas must "not be closed before the first anniversary of the closing date of any other home equity loan secured by the same homestead property" Tex. Const. art. XVI, §50(a)(6)(M)(ii). Does this provision prohibit modifying a home equity loan prior to its one-year anniversary date?

The constitutional amendment requires that an equity loan may not be closed before the first anniversary of the closing date of any other equity loan secured by the same homestead property. This provision requires that a refinancing of an equity loan may not be closed before one year has elapsed since the closing date of any other equity loan secured by the same homestead property. However, because modification of a home equity loan does not involve a closing and is legally different from a refinancing, a home equity loan may be modified before the first anniversary of the closing date of any other equity loan secured by the same homestead property.

The constitutional amendment requires that an equity loan may not be closed before the first anniversary of the closing date of any other equity loan secured by the same homestead property. This provision requires that a refinancing of an equity loan may not be closed before one year has elapsed since the closing date of any other equity loan secured by the same homestead property. However, because modification of a home equity loan does not involve a closing and is legally different from a refinancing, a home equity loan may be modified before the first anniversary of the closing date of any other equity loan secured by the same homestead property.

How does the requirement of substantially equal successive monthly installments affect modification?

A home equity loan must be scheduled "to be repaid in substantially equal successive monthly installments" Tex. Const. art. XVI, §50(a)(6)(L). However, in modifying a home equity loan, a lender may find it difficult to keep the monthly installments "substantially equal" to the loan's original monthly installments. In fact, a modified home equity loan with monthly installments substantially the same as originally contracted would likely circumvent the purposes and objectives of the Soldier's and Sailors Civil Relief Act of 1940 (the "SSCRA").

Because variable rate loans, which often have changing installments, are specifically permitted under subsection (a)(6)(O), the framers and ratifiers apparently intended to allow reasonable variation from subsection (a)(6)(L) in limited situations. The below-signed regulators agree that a mutually agreed upon loan modification resulting in substantially equal post-modification monthly installments that differ from the pre-modification monthly installments would be acceptable.

Authority of Responding Agencies
Because the constitutional provision for home equity lending provides no mechanism for agency interpretation, no state agency has authority to interpret it. This letter is not, therefore, an interpretation but a statement as to how the four agencies issuing this letter would, absent judicial precedent to the contrary, view home equity loan modifications.

The consumer credit commissioner has the powers and performs all duties relating to the issuance of a license under Finance Code, Title 4, Subtitle B and is responsible for the other administration of the subtitle except as provided by this Finance Code Chapter 341, Subchapter B.3 The banking commissioner has enforcement authority relating to the regulation of a state bank operating under Finance Code, Title 4, Subtitle B.4 Likewise, the savings and loan commissioner has enforcement authority relating to the regulation of state savings associations and state savings banks operating under Finance Code, Title 4, Subtitle B.5 and the credit union commissioner has enforcement authority relating to the regulation of state credit unions operating under Finance Code, Title 4, Subtitle B.6 The Comptroller of the Currency, the Office of Thrift Supervision, and the Supervisor of Federally Chartered Credit Unions may enforce Finance Code, Title 4, Subtitle B, relating respectively to the regulation of national banks, federal credit savings associations, and federal credit unions operating under Subtitle B.

The below-signed state regulatory agencies believe it is important to provide this guidance with respect to home equity loans to facilitate regulated lenders and investor's efforts, consistent with the intent of the Legislature, to meet the need of Texas consumers. This guidance is particularly momentous during this time when, pursuant to the SSCRA, lenders may need to modify the rates on home equity loans to persons called to active military duty.

The position on loan modification presented in this letter is the opinion of each of the state administrative agencies responsible for regulating certain entities making these loans. Lenders must be aware however that a court may or may not defer to this letter in resolving a dispute between a borrower and a lender.
Exhibit "C"

Advisory Bulletin
This statement on Article XVI Section 50(a)(6)(L) is not meant to negate the applicability or legality of any other method of modifying a home equity loan. This statement is solely meant to endorse the permissibility of the following method. Any modification must also comply with any applicable federal and state laws. This statement is not an interpretation of the Texas Constitution and is not being issued under Texas Finance Code, §11.308 and §15.413.

Permissible Modification
Borrower pays the lender whatever is necessary to bring the home equity loan current on or before the date that the home equity loan is modified. The modification schedules installments that are:

- substantially equal in amount,
- successive and periodic, and
- scheduled to equal or exceed the amount of accrued interest as of the date of the installment.

This method may change the amount of the scheduled installment or it may change the remaining term of the loan or both.

Constitutional Issues Associated with Modification
Subsection (L) provides the following limitations for any home equity loan made under Article XVI Section 50(a). Any modification must comply with these limitations:

(a) The homestead of a family, or of a single adult person, shall be, and is hereby protected from forced sale, for the payment of all debts except for:
   (6) an extension of credit that:
(L) is scheduled to be repaid:
(i) in substantially equal successive periodic installments, not more often than every 14 days and not less often than monthly, beginning no later than two months from the date the extension of credit is made, each of which equals or exceeds the amount of accrued interest as of the date of the scheduled installment;

Amount of Each Installment
Each installment must equal or exceed the amount of accrued interest. The issue of whether the scheduled installment equals or exceeds the amount of accrued interest may be addressed by having the owner bring the loan current either before the modification is signed or when it is signed. This could also be accomplished by having the lender waive the accrued interest as of the date the home equity loan is modified. Additionally, the first scheduled installment may not be scheduled so far in the future that it violates this provision. This will generally mean that the first payment will be scheduled within 60 days of the modification.

Substantially Equal Successive Periodic Installments
The constitutional language requires that the loan be scheduled to be repaid in substantially equal successive periodic installments. Therefore, the parties should be able to modify a home equity loan by providing a new schedule of installments so long as the schedule provides for successive periodic installments, not more often than every 14 days and not less often than monthly.

First Installment Due Date
The parties may schedule the modification so that the first payment is due more than two months after the modification. The constitution limits the first payment of a home equity loan to begin "no later than two months from the date the extension of credit is made." This provision applies to the original closing or refinancing of the loan. The date of the modification is not the date that the original extension of credit is made. A modification simply changes certain terms of an existing obligation. As referenced above, most of the time the terms of the loan will require the first payment to be scheduled within two months so that the first installment after the modification will equal or exceed the amount of accrued interest.