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MEMORANDUM

TO: Clients and Friends of the Firm

FROM: J. Alton Alsup

DATE: November 17, 2003

SUBJECT: Our Firm's Comment on §153.13 of proposed new 7 T.A.C. Chapter 153 (the "Commentary") submitted for adoption by the Finance Commission and Credit Union Commission (the "Commissions")

Because of client concerns about compliance with the new pre-closing disclosure requirements of Section 50(a)(6)(M)(ii), our firm has appealed to the Commissions to adopt Commentary that provides interpretive guidance to the mortgage lending industry for establishing a uniform and efficient closing process for Texas home equity loans.

Our comments were restricted to proposed §153.13 of the Commentary that interprets the requirements of new Section 50(a)(6)(M)(ii), Article XVI, Texas Constitution, which defines a Texas home equity loan in part as an extension of credit that:

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

We informed the Commissions that our clients seek guidance on how mortgage lenders may comply with these new (M)(ii) preclosing disclosure requirements (i) without unnecessarily delaying home equity closings for days on end because of minor variances that routinely occur in the disclosed amounts of one or more itemized charges, often because of daily interest charges that accrue with the passage of time and (ii) without needlessly burdening homeowners by requiring because of compliance concerns that all homeowners personally appear at the title agency's office on three separate occasions just to close on a Texas home equity loan (i.e., first, to receive and acknowledge receipt of the subsection (M)(ii) preclosing disclosure; next, to consummate the transaction on the scheduled date of closing; and, finally, after the running of the three-business-day rescission period, to sign a confirmation of non-cancellation and receive the net loan proceeds). To that end, our firm has developed recommended procedures that (a) authorize the settlement agent in each case to close a home equity loan on the first business day after satisfying the (M)(ii) preclosing disclosure

requirements and (b) instructs the settlement agent to satisfy the (M)(ii) preclosing disclosure requirements by providing a copy of the final HUD-1 Settlement Statement to the owners of the homestead on any day preceding the scheduled date of closing, preferably via facsimile transmission to a fax number earlier authorized in writing by the borrower. We also informed the Commissions that we hope to soon provide mortgage lenders some assurance of their compliance with (M)(ii) preclosing disclosure requirements through proposed amendments to the Form T-42.1 Endorsement to the mortgagee's form of title insurance policy (T-2), which are under consideration by the Department of Insurance.

Because our clients understandably seek "safe harbor" interpretations by the Commissions that endorse these recommended procedures as satisfying subsection (M)(ii) preclosing disclosure requirements before adopting them, we urged the Commissions that it amend proposed §153.13 before adoption by the Commissions in the several respects that are discussed as Comments 1 – 5 in this memorandum to serve as an official interpretation of subsection (M)(ii) and provide "reliance on rule" protections under Section 50(u), Article XVI, Texas Constitution, for mortgage lenders who conform their practices to the interpretation, viz:

> **Comment 1. Clarify that "one business day" means the "first business day" and that the owner may receive the (M)(ii) disclosure on any calendar day.**

A "plain meaning" reading suggests the legislature intended Subsection (M)(ii) to require only a "one-day" preclosing disclosure of actual fees and charges so the homestead owner would have an opportunity to "sleep on it" before closing a home equity loan. The (M)(ii) legislative language unfortunately did not use parallel grammatical structure with that of Subsection (M)(i) that similarly provides" that a home equity loan may not be closed "before the 12th day after" [the later of the date of application or delivery of the subsection (g) promulgated notice]. Subsection (M)(ii), nevertheless should be interpreted to conform these provisions and clarify that an equity loan may be closed on or after the first business day after the date of receipt of the (M)(ii) preclosing disclosure just as it may be closed on or after the 12th day after the date of receipt of the (M)(i) promulgated notice. Because of the uncertainty in meaning and pending interpretive guidance, Fannie Mae in a cautionary policy adopted in its Announcement 03-10 dated October 15, 2003 is currently requiring that "at least one business day as so defined elapses after the day on which the notice is given and before the day on which the borrower signs the mortgage documents" — effectively requiring a two-business-day preclosing disclosure. This policy divides the practices of mortgage lenders delivering loans to Fannie Mae from institutions extending credit for their own account or for delivery to other investors who, on advice of counsel, interpret this provision to permit closing on the first business day after the date the preclosing disclosure is received by the owner. Divided interpretations of the meaning of Subsection (M)(ii) in this regard confuses lenders, settlement service providers, and consumers alike and is disruptive of otherwise uniform and efficient closing practices and procedures.

We therefore urged that the §153.13 commentary be amended as follows to clarify that Subsection (M)(ii) permits a home equity loan to be closed on the first business day after any day on which the owner of the homestead receives the preclosing disclosure:

> ***§153.13. Preclosing Disclosures: Section 50(a)(6)(M)(ii).*** **An equity loan may not be closed before one business day after the date that the owner of the homestead receives a final itemized disclosure of the actual fees, points, interest, costs, and charges that will be charged at closing. An equity loan accordingly may be closed on the first business day after any calendar day on which the owner of the homestead receives the preclosing disclosure. If a bona fide emergency or another good cause exists and the lender obtains the written consent of the owner, the lender may provide the documentation to the owner or the lender may modify previously provided documentation on the date of closing.**

Comment 2. Revise proposed §153.13(1) to eliminate misguided interpretation that lenders must additionally disclose the Annual Percentage Rate (APR) in order to satisfy (M)(ii) preclosing disclosure requirements.

Proposed §153.13(1), if adopted in its present form, would require lenders (in order to get the "reliance on rule" protections of the interpretation) to additionally provide a final Truth in Lending Disclosure Statement with the final form of HUD-1 Settlement Statement to satisfy the (M)(ii) preclosing disclosure requirement. As proposed, the §153.13(1) interpretation reads in pertinent part:

> **(1) A lender may satisfy the disclosure requirement of this section by delivery to the borrower of a properly completed Department of Housing and Urban Development (HUD) disclosure Form HUD-1 or HUD-1A and delivery of a document providing the annual percentage rate as defined in 12 CFR 226.18.** [Emphasis Added]

The Wolens floor amendment to SJR 42 that was enacted as Section 50(a)(6)(M)(ii) effectively prohibits closing an equity loan before "one business day after the date that the owner of the homestead receives a final itemized disclosure of the actual fees, points, interest, costs, and charges that will be charged at closing." [Emphasis Added] Although "interest" is enumerated as one of the types of actual "charges" that must be disclosed, the preclosing disclosure requirements are clearly limited to only such "interest" as will be charged "at closing," such as per diem interest to the end of the month of the transaction and discount points comprising prepaid interest. Although the preclosing disclosure necessarily would include certain prepaid finance charges paid at closing that must be taken into account in the formula for computing the composite Annual Percentage Rate (APR), the APR itself is not interest charged "at closing" and is irrelevant to the (M)(ii) disclosure requirements.

Moreover, requiring that lenders also disclose the APR a day in advance of the scheduled closing date as proposed would both (i) conflict with the federal Truth in Lending Act's regulatory scheme and timing requirements and (ii) create another significant procedural hurdle for Texas mortgage lenders, mortgage brokers, and title settlement agents charged with compliance. Although the settlement agent routinely prepares the HUD-1 Settlement Statement (utilizing its own software program and variable "fees and charges" data provided by the lender in its written closing instructions), mortgage lenders must separately prepare and deliver the disclosures of the APR and other material Truth in Lending Act disclosures at closing as part of the loan closing document package typically prepared by the lender's Texas counsel and provided to the settlement agent only an hour or two before a scheduled closing. Under this proposed preclosing disclosure interpretation of §153.13(1), the lender's loan closing document package would have to be prepared at least two business days prior to the scheduled date of closing (or three business days under Fannie Mae's announced policy) so that the final APR disclosure may be transmitted to the settlement agent, combined with the final HUD-1 separately prepared by the settlement agent, and delivered by the settlement agent personally or via some authorized electronic means, such as facsimile transmission or e-mail, sometime during the business day preceding the scheduled date of closing (or two business days preceding the scheduled date of closing under Fannie Mae's announced policy). Moreover, while imposing this significant compliance burden, this extraneous disclosure of the APR provides no significant benefit to the consumer who at that stage of the closing process has already been provided an initial disclosure of the APR and other material Truth in Lending Act disclosures, which disclosure as a matter of industry practice is mailed to loan applicants within three business days after application.

<u>Comment 3</u>. Revise proposed §153.13(1) to expressly authorize electronic delivery of the preclosing disclosure to the owner of the homestead, or to any owner if more than one, as a means of satisfying subsection (M)(ii) preclosing disclosure requirements if the prior written consent of all owners to that means of delivery is first obtained and the actual receipt of the disclosure is acknowledged by all owners at closing.

Homeowners seeking a Texas home equity loan typically are now required to personally appear at the offices of the title insurance agency serving as settlement agent on a business day prior to the scheduled date of closing to receive, and acknowledge receipt of, the final HUD-1 Settlement Statement itemizing actual fees and charges to be charged at closing. This is a needlessly burdensome procedure that imposes a third separate occasion on which homeowners must now personally appear at the title company offices in order to close on a Texas home equity loan. Most often this additional appearance requires that one or more of the homeowners make special arrangements to absent themselves from work for the hour or two required to meet and travel to the designated title agency office for this purpose. Title agencies also are ill equipped to administer the additional "foot traffic" and process by which homeowners arrive at their offices unannounced and are corralled in the lobby while waiting to receive and acknowledge receipt of a copy of the final HUD-1 for a particular transaction, which in any case may not be available at that precise moment, and thereafter to respond to questions invariably posed by consumers seeking explanations of fees and charges itemized on the disclosure document.

This tiresome process begs for an alternative means of delivery that is fast, flexible, and less burdensome. Although delivery by certified mail is impractical because of the narrow window available between the time that actual fees and charges data are available and the scheduled closing date, electronic delivery via facsimile transmission or e-mail is commonplace today and within the capabilities of most homeowners to receive communications by such means. Mortgage lenders and secondary market investors of Texas home equity loans are reluctant to pioneer procedures that rely on an electronic means of delivery, however, in absence of interpretive guidance by the Commissions that validates delivery by such means as satisfying the (M)(ii) preclosing disclosure requirements.

Our recommended procedures for such an alternative means of delivery call for all owners of the homestead at the time of loan application (i) to elect as a matter of personal convenience to receive the final itemized disclosure of actual fees and charges at least one day in advance of the scheduled closing date for their home equity loan at one, or more, fax numbers designated by the homeowners; (ii) to acknowledge that successful transmission of the final itemized disclosure of actual fees and charges to the attention of *any owner* of the homestead at any of the fax numbers authorized by the owners will constitute effective receipt of the disclosure *by all owners* of the homestead; (iii) to acknowledge that if the fax transmission of the final itemized disclosure of actual fees and charges fails for any reason, whether because of service or technical failures or the error, omission, or negligence of any person, each owner of the homestead must personally appear at a designated office of the title insurance company or title agent serving as settlement agent for the home equity loan before the close of business on the business day immediately preceding the scheduled date of closing to receive and acknowledge receipt of the disclosure; and (iv) to acknowledge that if the owners fail for any reason to receive the final itemized disclosure of actual fees and charges either by facsimile transmission or by appearing in person on a day prior to the scheduled date of closing, the date of closing must be rescheduled for a later date that is at least one business day after the disclosure is received by Borrower.

We accordingly urged the Commissions that proposed §153.13(1) be amended as follows to (i) to eliminate the proposed interpretation that lenders must additionally disclose the Annual Percentage Rate (APR) in order to satisfy (M)(ii) preclosing disclosure requirements as discussed above in

Comment 2 and (ii) to expressly authorize electronic delivery of the preclosing disclosure to the owner of the homestead, or to any owner if more than one, as a means of satisfying subsection (M)(ii) preclosing disclosure requirements if the prior written consent of all owners to that means of delivery is first obtained and the actual receipt of the disclosure is acknowledged by all owners at closing:

> **(1) A lender may satisfy the disclosure requirement of this section by delivery to the borrower of a properly completed Department of Housing and Urban Development (HUD) disclosure Form HUD-1 or HUD-1A.** ~~**and delivery of a document providing the annual percentage rate as defined in 12 CFR 226.18.**~~ **Delivery of the final HUD-1 or HUD-1A settlement statement may be made by the title insurance company or title agent serving as settlement agent for the equity loan when acting pursuant to the lender's instructions. With the prior written consent of all owners of the homestead property, the preclosing disclosure may be made to the owner by facsimile transmission (fax) or electronic mail (e-mail), and delivery by either of these means to any owner will constitute effective delivery to all owners. An affidavit by the owner of the homestead at loan settlement acknowledging on oath timely receipt of the preclosing disclosure shall constitute prima facie evidence of compliance with the subsection (M)(ii) notice requirements.**
>
> **Comment 4. Revise proposed §153.13(4) to (i) eliminate an APR tolerance as a component of the *de minimus* variance test for good cause; and (ii) clarify that actual fees and charges charged at closing are not considered to be at variance with the preclosing disclosure if the total of all such actual fees and charges is less than the total of all such fees and charges itemized by the preclosing disclosure or is not more than the total amount permitted under the de minimus variance test.**

Proposed §153.13(4), if adopted in its current form, would create a two-part test for determining if any variance that occurs between actual fees and charges disclosed by the subsection (M)(ii) preclosing disclosure and actual fees and charges disclosed by the final HUD-1 Settlement Statement at closing is a mere *de minimus* variance. If meeting this test of a de minimus variance, the owner of the homestead at his or her option could consent to receive a modified preclosing disclosure on the date of closing under the "another good cause" standard set out in subsection (M)(ii), and upon the owner's receipt of the modified disclosure the preclosing disclosure requirements of subsection (M)(ii) would thereupon be deemed satisfied. As proposed, §153.13(4) reads as follows:

> **(4) A de minimus variance can be good cause at the owner's option. An owner who has received a preclosing disclosure may consent to receive a subsequent or modified preclosing disclosure on the date of closing under the good cause standard if:**
>
> > **(A) the annual percentage rate of interest on the subsequent disclosure is within .125% on regular transactions and .25% on irregular transactions, as defined in 12 C.F.R. 226.22, of the initial preclosing disclosure;**
> >
> > **(B) the actual disclosed fees, costs, points and charges on the date of closing do not vary from the initial preclosing disclosure by more than the greater of:**
> >
> > > **(i) $100 of the amount charged at closing or**
> > >
> > > **(ii) .125% of the principal amount of the equity loan at closing; or**
> >
> > **(C) one or more items described in subparagraphs (A) or (B) of this paragraph is less than the disclosed rate or amount on the initial preclosing disclosure.**

The first component of this two-part test, which if adopted would require that the annual percentage rate disclosed at closing be within a tolerance of 1/8% of the annual percentage rate disclosed by the

(M)(ii) preclosing disclosure, should be eliminated in its entirety because the annual percentage rate (APR) is not a required disclosure under the provisions of subsection (M)(ii) and is therefore an inappropriate component of a de minimus test to determine compliance with subsection (M)(ii) provisions. Subsection (M)(ii) is concerned only with actual fees and charges that will be imposed at loan closing and not with the annual percentage rate (APR) that is separately disclosed under Truth in Lending Act regulations. The APR is not a disclosure of interest charged at closing, but instead is a measure of the composite annual interest rate charged over the full term of the loan, giving effect to finance charges charged at closing and finance charges accruing after closing over the loan term, including contract interest and, if applicable, mortgage insurance. The reference to actual "points and interest" in subsection (M)(ii) means prepaid interest to be charged the borrower at closing in the nature of per diem interest and discount points and not the effective annual rate of interest.

We therefore urged the Commissions that the §153.13(4) commentary be amended as follows (i) to delete the APR variance component of the two-part test and (ii) to combine the second and third components of the test into a single de minimus variance test that would find good cause for an owner's consenting to receive a revised preclosing disclosure on the date of closing if the total of all actual fees and charges at closing are less than the total of all such fees and charges earlier disclosed, or do not exceed the total of all such fees and charges earlier disclosed by more than the greater of $100 or 1/8% of the principal loan amount. As amended, §153.13(4) could read substantially as follows:

(4) A de minimus variance can be good cause at the owner's option. An owner who has received a preclosing disclosure may consent to receive a subsequent or modified preclosing disclosure on the date of closing under the good cause standard if the total of actual disclosed fees, points, interest, costs, and charges that are charged to the owner on the date of closing:

~~(A) the annual percentage rate of interest on the subsequent disclosure is within .125% on regular transactions and .25% on irregular transactions, as defined in 12 C.F.R. 226.22, of the initial preclosing disclosure;~~

(A) is equal to or less than the total of all such disclosed fees, points, interest, costs, and charges itemized on the initial preclosing disclosure; or

~~(B) the actual disclosed fees, costs, points and charges on the date of closing do not vary from the initial preclosing disclosure by more than the greater of:~~

(B) does not exceed the total of all such disclosed fees, points, interest, costs, and charges as itemized on the initial preclosing disclosure by more than the greater of:

(i) $100 of the amount charged at closing or

(ii) .125% of the principal amount of the equity loan at closing; ~~or~~

~~(C) one or more items described in subparagraphs (A) or (B) of this paragraph is less than the disclosed rate or amount on the initial preclosing disclosure.~~

Comment 5. Add a new §153.13(5) to proposed Commentary to (ii) clarify that "fees . . . and charges" for purposes of the subsection (M)(ii) preclosing disclosure mean only such fees and charges that will be charged to the owner and do not include fees to be paid by the lender outside of closing; (i) clarify that such "fees . . . and charges" do not include amounts required to payoff and discharge existing liens on the homestead or unsecured debts to other creditors that are to be consolidated by the home equity loan;

and (iii) to clarify that per diem interest charges are considered accurate, even if the closing should be postponed to a later date, if the per diem charges were accurate based on information available to the lender at the time the preclosing disclosure was received by the owner.

Under current industry practices, scheduled equity loan closings often must be reset to a later business day at great inconvenience to lenders, title companies, and consumers alike when the amount of one or more fees and charges actually charged at closing varies in any amount from itemized fees and charges on the preclosing disclosure. Often the only variance is in charges paid by the lender to third parties outside of closing or in the amount of the payoff of an existing lien on the homestead property or the precise amounts of unsecured debts that the owner intends to payoff with equity loan proceeds to consolidate the owner's debts. Payoffs particularly change each day with the passage of time as they accrue interest. However, these are the owner's own existing debts and the owner uniquely has personal knowledge of the amounts owed and the terms of repayment, including daily accrued interest charges. The Commentary should clarify that payoffs of the owner's existing debts in this manner are not "fees . . . and charges" of the type contemplated by subsection (M)(ii) that must be disclosed in advance of the date of closing. Similarly, fees paid by the lender outside of closing, although disclosed on the HUD-1 Settlement Statement in accordance with RESPA requirements, by definition are not "fees . . . and charges" of the type contemplated by subsection (M)(ii) in that they are neither paid by the owner nor paid at closing.

We also urged that a special tolerance rule be recognized by the Commissions for the accuracy of disclosure of per diem interest to be charged to the borrower at closing from the date of closing to the first day of the succeeding month that is patterned on the tolerance rule for the accuracy of per diem interest disclosures under the Truth in Lending Act set forth in Regulation Z, §226.17(c)(ii), which reads as follows:

> (ii) For a transaction in which a portion of the interest is determined on a per diem basis and collected at consummation, any disclosure affected by the per diem interest shall be considered accurate if the disclosure is based on the information known to the creditor at the time that the disclosure documents are prepared for consummation of the transaction.

This special tolerance rule permits mortgage loans for which the APR has already been given in accordance with the requirements of the Truth in Lending Act to be reset to a later closing date without the creditors having to recalculate and re-disclose the APR affected by the change in per diem interest. Under the rule, for example, if the closing were scheduled for a Monday and per diem interest is accurately calculated and disclosed assuming a Monday closing, the per diem interest is still regarded as accurate for Truth in Lending disclosure purposes even if the loan closing date is delayed until Wednesday or Thursday of that week. Establishing a similar tolerance rule for per diem interest that must be disclosed under subsection (M)(ii) would avoid the absurd consequence of having to reschedule equity loan closings when all parties are ready and eager to close merely because of an impermissible variance in per diem interest disclosures.

Accordingly, a new §153.13(5) could read substantially as follows:

> **"Fees . . . and charges" for this purpose do not include amounts paid by the lender to third-party service providers outside of closing or amounts required to be paid by the owner to other creditors to payoff and discharge existing liens on the homestead or unsecured debts that are to be consolidated by the equity loan. Preclosing disclosures of per diem interest charged at closing shall be considered**

accurate if the amount disclosed is accurate based on the information known to the lender at the time the preclosing disclosure document is prepared for closing of the equity loan .

The proposed Commentary was filed with the Office of the Secretary of State on October 24, 2003 (TRD-200307197) and published for comment in the Texas Register on November 7, 2003 (Volume 28, Number 45, Pages 9595-9984). The earliest date on which the Commentary can be adopted as an interpretive rule is December 7, 2003.