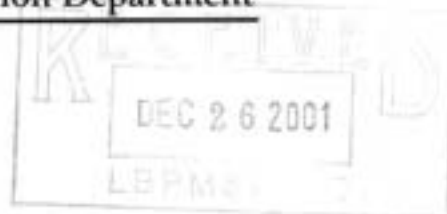

Texas Department of Banking
Texas Savings & Loan Department
Office of the Consumer Credit Commissioner
Texas Credit Union Department

December 20, 2001



VIA FACSIMILE (512) 322-0301
& Regular U.S. Mail

Karen M. Neeley
Long, Burner, Parks, McClellan & Delargy
A Professional Corporation
P.O. Box 2212
Austin, Texas 78768-2212

Re: Home Equity Modification Interpretation

Dear Ms. Neeley:

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 refinance. 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.¹ 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

¹ TEX. CONST. art. XVI, §50(f).

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.

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...each of which equals or exceeds the amount of accrued interest as of the date of the scheduled installment." 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 provision² 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.

²TEX. CONST. art. XVI, §50(a)(6).

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,⁷ federal credit savings associations,⁸ and federal credit unions⁹ 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,¹⁰ lenders may need to modify the rates on home equity loans to persons called to active military duty.¹¹

³ Finance Code § 341.101

⁴ Finance Code § 341.102(a).

⁵ Finance Code § 341.103(a).

⁶ Finance Code § 341.104(a).

⁷ Finance Code § 341.102(b).

⁸ Finance Code § 341.103(b).

⁹ Finance Code § 341.104(b).

¹⁰ 50 U.S.C. § 501 *et seq.*

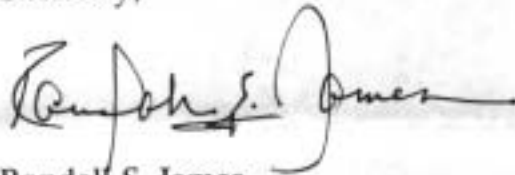
¹¹ 50 U.S.C. § 526 applies to a loan made prior to the time the person entered the service (or prior to active duty in the case of reservists and National Guardsmen). A serviceman who obtains a loan while already in the service is bound by the contract terms. The Act applies to all persons on active duty in the Army, Navy, Air Force, Marines, Coast Guard, Public Health Service, as well as members of the Guard or the Reserves who have commenced active service.

Ms. Karen Neeley

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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.

Sincerely,



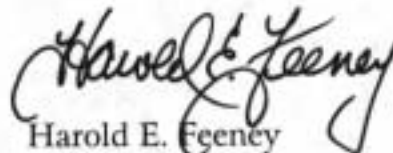
Randall S. James
Commissioner
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