NO. 03-06-00273-CV

In the Third Court of Appeals Austin, Texas

TEXAS BANKERS ASSOCIATION,
THE FINANCE COMMISSION OF TEXAS, AND
THE CREDIT UNION COMMISSION OF TEXAS

Appellants, Cross-Appellees

v.

ASSOCIATION OF COMMUNITY ORGANIZATIONS FOR REFORM NOW (ACORN),
VALERIE NORWOOD, ELISE SHOWS, MARY ANN ROBLES-VALDEZ, BOBBY MARTIN,
PAMELA COOPER, AND CARLOS RIVAS

Appellees, Cross-Appellants

On Appeal from the 126th Judicial District Court,
Travis County, Texas

AMICUS BRIEF OF INDEPENDENT BANKERS ASSOCIATION OF TEXAS

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IDENTITY OF INTEREST AND PAYMENT

Pursuant to TEX. R. APP. P. 11, the following brief is presented on behalf of the Independent Bankers Association of Texas ("IBAT"). IBAT is a trade association representing over 500 independent community commercial and savings banks domiciled in Texas.

Most IBAT members make home-equity loans. However, some IBAT member banks have been reluctant to provide home-equity loans to customers due to the continuing uncertainties regarding the requirements of such loans. Accordingly, both types of members are significantly interested in the outcome of this case.

The source of any fee paid for the preparation of this brief is IBAT. Copies of this brief have been served on all attorneys of record as reflected in the Certificate of Service.

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ARGUMENT

I. Background.

Until January 1998, Texas consumers were not permitted to access the equity in their homesteads by obtaining a home-equity loan from a lender. At that time, home-equity lending was authorized by an amendment, adding Article XVI, § 50(a)(6) to the Texas Constitution, which permits and sets out the requirements for a home-equity loan.

TEX. CONST. art. XVI, § 50(a)(6) (amended 2003). With over 20 individual requirements affecting loan validity, it was absolutely essential that lenders be able to strictly comply with the requirements. *Id*. Failure to do so invalidated the lien, a harsh consequence. *Id*.

The Finance Commission and the Credit Union Commission (the "Commissions") adopted an informal commentary providing a gloss to the Constitution. Office of the Consumer Credit Commissioner, Regulatory Commentary on Equity Lending Procedures (Oct. 1998). However, the commentary offered no "safe harbor" effect for lenders. *Id*. Thus, in 2003, the Constitution was amended again by adding Article XVI, § 50(u), authorizing the Legislature to identify one or more appropriate agencies to interpret the provisions relating to home-equity loans. TEX. CONST. art. XVI, § 50(u). The Legislature delegated that authority to the Commissions. TEX. CONST. art. XVI, § 50(u); *see also* TEX. FIN. CODE ANN. §§ 11.308, 15.413 (Vernon Supp. 2006). The Commissions issued interpretations, which were promulgated in accordance with the Texas Administrative Procedures Act. 29 Tex. Reg. 84 (2004); *see also* 7 TEX. ADMIN. CODE §§ 153.1-153.5, 153.7-153.18, 153.20, 153.22, 153.24-25, 153.41, and 153.51. Subsequently, this suit was brought, attacking certain aspects of the interpretations.

The purpose of this brief is to provide a community-bank perspective of practice and usage as it relates to mortgage lending in general and to home-equity lending in particular. Furthermore, IBAT will identify additional regulatory requirements that, we believe, affect the interpretations. The able briefing of the Texas Bankers Association and the Commissions will not be duplicated.

II. Interest vs. Fees.

The Appellees have argued that the phrase "any interest" does not include all interest as defined by the usury laws of the State of Texas, but rather only includes the note rate. By contrast, the Commissions' interpretation of "any interest" includes "interest as defined in the TEXAS FINANCE CODE § 301.002(a)(4) and as interpreted by the courts." 7 TEX. ADMIN. CODE § 153.1(11).

The practical question here is whether the term "interest" includes all forms of prepaid interest, such as origination fees. This is especially significant because the requirements for home-equity loans limit fees that are not interest to 3% of the principal. The fees that are capped are those that are necessary to "originate, evaluate, maintain, record, insure, or service the extension of credit." TEX. CONST. art. XVI, § 50(a)(6)(E).

To put this in context, it is helpful to review the requirements for safe and sound real estate lending as regulated by the FDIC Improvement Act. *See* FDIC Improvement Act of 1991, Pub. L. No. 102-242, 105 Stat 2236 (1991). As a result of that Act, the banking regulators adopted Interagency Guidelines For Real Estate Lending (the "Guidelines"). *See* 12 C.F.R. §§ 34 subpart D, 208, 365; *see also id.* at § 563.100-01. To comply with these Guidelines, a bank making a real-estate loan must obtain an appraisal or evaluation. *See, e.g.*, 12 C.F.R. §§ 34.43(a)(8), 564.3(a)(8). This requirement is also mandated by Title 11 of the Financial Institutions Reform Recovery and Enforcement Act of 1989. Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (codified as amended in scattered sections of 12 U.S.C. § 1811; Title XI, §§ 1107, 1113-14) (FIRREA). The Guidelines also require banks to have clear policies relating to

documentation. 12 C.F.R. § 34.62(b)(2)(iv). For banks, appropriate documentation of a real-estate mortgage includes a title policy, a title opinion, or some other assurance as to validity of title, and appropriate loan documentation as required by law and underwriting requirements. *See, e.g.*, 12 C.F.R. §§ 34 subpart D, 365.2(b)(1)(iv). The Department of Banking has promulgated loan worksheet number 10 on home-equity lending. *See* The Department of Banking, Loan Worksheet #10—Home Equity Lending, *available at* http://www.fc.state.tx.us/homeinfo/nrf14wk10.pdf. In addition to assuring compliance with the numerous provisions of the Constitution, this worksheet also requires examiners to determine whether the bank's documentation and funding system is adequate to insure full compliance with all aspects of the law prior to funding. *Id*.

Because of the strict oversight of banks by both their federal and state regulators, it is critical that banks obtain the documentation required by laws, regulations, and prudent lending practices in order to have a healthy loan portfolio. This inevitably results in the creation of certain fixed costs that are incurred in the making of bank loans. Because the amount of costs that can be paid directly by consumers is capped at three percent (3%), the bank must utilize a different revenue generator to assure that the cost of making a home-equity loan does not exceed the income. Thus, the interest rate is adjusted to assure an appropriate interest spread for prudent matching of interest expense and interest income, as well as to compensate for the overhead related to the transaction.

The interest may take the form of prepaid interest, more commonly referred to as an origination fee or points. Under the Texas definition of interest referenced above, these points are clearly interest for usury purposes. TEX. FIN. CODE ANN. §

301.002(a)(4) (Vernon Supp. 2002); *see also* 7 TEX. ADMIN. CODE § 153.1(11). They are also finance charges for purposes of the Truth-in-Lending disclosures, and they are interest for purposes of income tax calculations. *See* 12 C.F.R. § 226, Supp. I at 226.4(a), cmts. 1(ii)(B), 5(ii).

The consumer is not misled as to the cost of the loan with regard to the prepaid interest because the origination fee is clearly disclosed in the so-called "Fed box" as required by Regulation Z. 12 C.F.R. § 226.17(a)(1). The origination fee or points are part of the finance charge as defined by Regulation Z. *See id.* at § 226.4(b)(3). Furthermore, the origination fee is reflected in the itemization of the amount financed in the line captioned, "Prepaid Finance Charge." *See* Regulation Z, 12 C.F.R. §§ 226.4(b)(3), 226.18(c)(iv). In short, the customer is well informed as to the costs of the transaction.

Counsel for IBAT attended the oral argument in this matter and therefore is aware of certain questions asked by the Panel relating to origination fees, particularly in the context of lending practices in the 1980's. Counsel would respectfully point out that accounting standards and tax rules were revised in response to aggressive lending practices and now require banks to spread prepaid interest over the life of the loan rather taking that interest as income at loan closing. *See* FASB Statement, Statement of Financial Accounting Standards No. 91, Accounting for Nonrefundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases, *available at* http://www.fasb.org/st/status/statpg91.shtml. This change in both accounting and tax law resulted in a significant curtailment of abuse in this area.

Counsel is also aware that statements were made that most home-equity loans are first-lien transactions. IBAT has not found this to be true with regard to community banks. Many, if not most, home-equity loans made by the typical community institution is a second-lien transaction subject to the requirements of Chapter 342 of the Texas Finance Code if the interest rate exceeds 10%.

However, a certain number of loans made by community banks, as well as loans made by other financial institutions, may in fact constitute first-lien residential-mortgage transactions. In that event, the state usury law is pre-empted by federal law. *Cf.* 12 U.S.C. § 1735f-7a; *see also Hillsborough County, Fla. v. Auto. Med. Labs., Inc.*, 471 U.S. 707, 712, (1985) (federal law can preempt state law). Federal law expressly preempts the Texas Constitutional provisions and state statutes that limit the rate or amount of interest, discount points, or finance charges on first-lien, residential real-property loans. 12 U.S.C. § 1735f-7a(a)(1).

The Texas Legislature is presumed to be aware of existing state and federal laws when it enacts legislation. TEX. GOV'T CODE § 311.023(3); *see also Fitzgerald v. Advanced Spine Fixation Sys., Inc.*, 996 S.W.2d 864, 868-69 (Tex. 1999). And the home-equity provision of the Constitution includes a so-called poison pill, which provides that if any part of the home-equity requirements are pre-empted by federal law, the entire home-equity authorization is null and void. TEX. CONST. art. XVI, § 50(j). Presumably, the Legislature would not have enacted the home-equity laws knowing that usury rates in Texas are pre-empted and intending for the entire home-equity provision to be null and void from enactment. See TEX. GOV'T CODE § 311.021(2); *see also Argonaut Ins. Co. v.*

Baker, 87 S.W.3d 526, 531 (Tex. 2004) (Legislature is presumed to have enacted a statute with complete knowledge of existing law and with reference to it); *see also Callaghan v. McGown,* 90 S.W. 319, 321 (Tex. Civ. App.—San Antonio, 1905, writ ref'd) ("it is always to be presumed the Legislature designed the statute to take effect, and not to be a nullity").

Finally, IBAT would respectfully urge that Appellees' suggestion—that the Court apply the "commonly understood" meaning of interest—would make inapplicable the usury definition. Certainly, lenders commonly understand that they cannot exceed the usury limits of the State of Texas for second-lien transactions that are not pre-empted. Therefore, it is anomalous to think that a second-lien home-equity transaction would be subject to an interest calculation for usury purposes that is significantly different from the interest calculation for purposes of determining compliance with the fee cap.

III. Oral Applications.

The text of the Constitution itself begins the twelve-day cooling-off period that is triggered upon submission of an application. TEX. CONST. art. XVI, § 50(g). The text does not provide for a "written" application; just simply an application. *Id*. Lenders understand the Constitution to be referring to an oral, written, or electronic application.

The context for requirements for mortgage applications is found in the Equal Credit Opportunity Act as implemented by Regulation B, 12 C.F.R. part 202. Regulation B, 12 C.F.R. § 202. That regulation expressly defines the term, "application," and explains in great detail what constitutes an application. 12 C.F.R. § 202.2(f). The commentary provides an additional clarification so that creditors of all sorts can

determine whether a communication between the creditor and a potential customer is an inquiry, an application, or a pre-qualification request. 12 C.F.R. § 202, Supp. I at 202.2(f), cmts. 3-5. In addition, the commentary to part 202.9, dealing with adverse actions, provides additional clarification as to when a pre-qualification request is actually an application triggering the potential requirement for adverse-action notices if the request is declined. 12 C.F.R. § 202.9, cmt. 5. In short, there are extensive, clear rules identifying when an application actually takes place.

It is also significant to note that Regulation B explicitly requires a written application only in the event of a transaction described by part 202.13(a). *See* Regulation B, 12 C.F.R. § 202.4(c). It is important to consider the commentary for part 202.13(a) to identify the transactions that trigger a written application. These are applications for a loan secured by the applicant's principal residence, and include purchase-money loans and the refinancing of purchase-money loans. The commentary explicitly states:

> Therefore, applications for credit secured by the applicant's principal residence but made primarily for a purpose other than the purchase or refinancing of the principal residence (such as loans for home improvement and debt consolidation) are not subject to the information–collection requirements. An application for an open-end equity loan of credit is not subject to this section unless it is readily apparent to the creditor when the application is taken that the primary purpose of the loan is for the purchase or refinancing of a principal dwelling.

12 C.F.R. § 202, Supp. I at 202.13(a), cmt. 5. Thus, an oral application is not required by federal law for a home-equity loan, except when it is a cash-out refinancing.

Since written applications are not required, it is not uncommon among certain lenders to initiate home-equity transactions by oral application. In this regard, IBAT has determined that some of the larger home-equity community lenders accept home-equity loan applications through a call center in order to maintain quality control over the process. The information from the applicant is captured by the loan processor in an on-line application, using a format similar to but less involved than what is required for the typical purchase-money transaction. The institution maintains a clear audit trail through the electronic application. In fact, the audit trail is necessary for prudent compliance with the real-estate lending guidelines referenced above.

While many community banks use written applications, it is not uncommon for oral applications to be used as described above. More significantly, oral applications are explicitly permitted by federal law and regulation.

IV. Document Provided at Closing.

Section 50(a)(6)(Q)(v) requires that the lender "at the time the extension of credit is made, provide the owner of the homestead a copy of all documents signed by the owner related to the extension of credit." TEX. CONST. art. XVI, § 50(a)(6)(Q)(v) (emphasis added). Presumably, the Legislature intended for the phrase "extension of credit" to have the same meaning each time it is used. *Whitworth v. Blumenthal*, 59 S.W.3d 393, 399 (Tex. App.—Dallas, 2001 pet. dism'd) (holding that a court presumes the Legislature intends the same words to have the same meaning throughout a statute). "Extension of credit" refers to the credit transaction or loan. Therefore, the documents that are related to the extension of credit are those that are part of the loan, not the

underwriting process. The extension of credit does not exist until the documents have been signed. Therefore, any item provided prior to that point could not be a part of the extension of credit but rather as a part of underwriting, a different process.

From a more pragmatic perspective, if every single piece of paper signed by the applicant as part of underwriting must be copied at closing and provided to the borrower, the borrower will likely receive multiple copies of several items. If every single item containing the borrower's signature must be copied, the borrower could receive multiple copies of:

- the application (which presumably has been provided at the time it was signed);
- the driver's license (which contains the applicant's signature on its face);
- verifications of employment and accounts;
- the income tax return (which on large transactions may be required to be signed by the applicant to verify its validity);

as well as the more typical documents that are a part of the transaction.

But many items that are signed as a part of the closing process have nothing to do with the extension of credit. They are documents required by the title company to protect it from unforeseen liens. These may include an occupancy affidavit, an affidavit of identity, a signature affidavit, a compliance agreement, a correction agreement and limited power of attorney, acknowledgment of receipt of privacy notice by various parties, and a mailing address verification form. While it is helpful for the borrower to have these documents, requiring a lender to provide copies of them as a condition to lien validity is quite another matter.

Furthermore, it is possible that a broker originated the home-equity loan and that another lender or service acquired it after closing. If the borrower later asks for copies of the documents not actually related to the extension of credit itself, but which may have been signed as a part of underwriting, it is quite likely that the current holder of the home-equity loan may not be able to produce those documents. Invalidating the lien because the lender cannot produce one of these documents is harsh. And we believe it is not what the Legislature intended.

V. Power of Attorney.

The home-equity provision of the Constitution explicitly provides that the owner is not to sign a confession of judgment or "power of attorney to the lender or to a third person to confess judgment or to appear for the owner in a judicial proceeding." TEX. CONST. art. XVI, § 50(a)(6)(Q)(iv). Because the Constitution has explicitly banned a power of attorney in this specific context, we believe that the power of attorney is permissible in other, normal settings. *See Mid-Century Ins. Co. of Tex. v. Kidd,* 997 S.W.2d 265, 273-74 (Tex. 1999) (applying the doctrine of *expressio unius est exclusio alterius*: an expression of one implies the exclusion of others); *see also Gables Realty Ltd. P'ship v. Travis Cent. Appraisal Dist.*, 81 S.W.3d 869, 873 (Tex. App.—Austin 2002, pet. denied) (presuming that words excluded from a statute are done so purposefully); *see also City of San Antonio v. City of Boerne*, 111 S.W.3d 22, 25 (Tex. 2005) (the Legislature's intent should be determined by reading the language in the statute as a whole and not just isolated parts).

Clearly, the Legislature knows how to describe scenarios in which a power of attorney is inappropriate and has done so in this section of the Constitution. *See* TEX. CONST. art. XVI, § 50(a)(6)(Q)(iv). If it intended for powers of attorney to be prohibited with regard to place of closing, then certainly the Legislature could have said so. It did not. *Brown v. De La Cruz*, 156 S.W.3d 560, 568 (Tex. 2004) (citing *PPG Indus., Inc. v. JMB/Houston Ctr. Partners Ltd. P'ship*, 146 S.W.3d 79, 84 (Tex. 2004)); *Cameron v. Terrell & Garrett, Inc.*, 618 S.W.2d 535, 540 (Tex. 1981) (presuming every word excluded from a statute was purposefully excluded).

From a practical perspective, it is vital that powers of attorney be permissible in closing home-equity loans. Clearly, only a properly executed power of attorney prepared in accordance with Texas law is acceptable. However, in the event the parties have provided such a power of attorney, closing should be permitted on the transaction. Otherwise, certain classes of potential borrowers are essentially barred from obtaining home-equity loans. Most significantly, persons who are disabled and unable to access a lawyer's office, a title company, or a lender's office, will face a significant barrier to obtaining home-equity loans.

CONCLUSION AND PRAYER

Certainty is vital in home-equity lending because the failure to comply with even the most minute of criteria invalidates a lien. The interpretations for home-equity loans should be considered in the context of the requirements for safe and prudent real-estate lending and the expertise provided by the Finance and Credit Union Commissions. The Commissions' rules are reasonable, consistent with the plain language of the

Constitution, and conform to normal and prudent banking practices. Therefore, they should be upheld as valid.

WHEREFORE, premises considered, IBAT respectfully requests that the trial court's judgment be reversed and rendered with respect to the following rule interpretations: 7 TAC §§ 153.1(11); 153.5(3)(4)(6)(8)(9) and (12); 7 TAC § 153.12; 7 TAC § 153.84; and 7 TAC § 153.22. Further, IBAT prays that, with respect to 7 TAC § 153.15 and 153.51, the trial court's judgment by affirmed.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing Amicus Brief of Independent Bankers Association of Texas has been forward to all counsel and parties of record, listed below, on the ___ day of April, 2007, by facsimile.

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