HOME EQUITY LENDING

TEXAS COURT ENTERS JUDGMENT INVALIDATING PORTIONS OF THE TEXAS HOME EQUITY LENDING REGULATIONS

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After much delay, on May 1, 2006, the court entered a final judgment invalidating portions of the Texas Home Equity Regulations in the case of *Finance Commission of Texas v. ACORN,* Case No. 03-06-273-CV, in the Third District Court of Appeals, Austin, Texas ("ACORN"). Lenders who have relied upon the safe harbor provided by the Regulations now must re-examine their lending policies in light of this case. The State of Texas immediately appealed the judgment to the Court of Appeals in Austin, Texas, which stays the effect of the judgment for the present time.

ACORN (Association of Community Organizations for Reform Now) had challenged ten specific sections of the Home Equity Regulations. In a letter opinion issued on October 7, 2005, the court had sided with ACORN on eight of the ten challenged sections. Under the Texas Constitution, a Lender who acted in reliance upon a Regulation issued by the Finance Commission was provided a safe harbor, even if the Regulation was eventually withdrawn or overturned by a court. ***The Court of Appeals ruling, which also sides with ACORN, means that lenders may no longer be able to rely upon the Regulations if the judgment becomes final.***

ACORN addresses eight specific sections of the Regulations. The following are three of the most significant findings of the court:

What is "interest"? Closing costs, EXCLUDING interest paid by a consumer, are limited to 3% of the loan amount. The Finance Commission had previously adopted a definition of "interest" which is the same as that contained in the Texas Finance Code. Under that definition – the same used to test for usury – virtually every lender fee would be called "interest". For example, a loan origination fee would be interest and, therefore, excluded from the 3% fee cap in a home equity transaction. The ACORN court disagreed with this interpretation and struck down this regulatory definition, leaving us with the question, "What is interest"? While some cases have defined *bona fide* loan discount points as interest, the term "interest" – and therefore, our understanding of what is and is not included in the term – now remains largely undefined.

When do you start counting the 12 days? Many lenders take applications over the telephone. Understanding that the loan cannot close until 12 days after receipt of the Texas Extension of Credit Letter AND the application, the Regulations held that a telephone application could start this period running even if the lender received the written application (as often happened) only a day or two before closing. This Regulation was struck down in ACORN. Now we do not have a "state" definition of

"application", and lenders do not know if they should begin "counting" days from the borrower's original contact or from receipt of the written (and signed) loan application.

What happens if closing costs change? The Texas Constitution requires that the consumer be given a one-day period to review final costs and interest. The Finance Commission previously ruled that if closing costs decrease or increase less than 1/8th percent, does not need to start a new one-day review period. The ACORN case struck this rule down. Under ACORN, ***ANY*** change in closing costs of any amount would start a new one-day review period, thus delaying the closing.

The ACORN court stayed enforcement of its judgment for 30 days. The State of Texas appealed the ruling to the Court of Appeals in Austin, which stayed the judgment during the appeal process. ***While the case is on appeal, lenders can continue to rely upon the safe harbor and the Regulations as written.*** In a partial response to the Court ruling, the Finance Commission proposed certain amended Regulations designed to meet the objections of the ACORN court. These Regulations are still in the "comment" period and are not yet final. However, the Commission still does not address the largest of the issues raised in the ACORN case; namely, the definition of "interest."

For the present time, it's business as usual for home equity lenders. The "old" Regulations continue to provide a safe harbor for lenders. The new "proposed" Regulations will be addressed after their comment period passes. No matter how the Court of Appeals rules, a further appeal to the Texas Supreme Court is likely. ***This means that final disposition of the legality of the Regulations could be delayed as much as two or three years. In the interim, if new Regulations are adopted, replacing those which were ruled unconstitutional, there is a possibility that all or a portion of the ACORN decision could be rendered "moot."***

Stay tuned!

Originally published in the June 12, 2006
issue of Bankers Digest (www.bankersdigest.com)