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To Clients and Friends:

As we previously reported, the Texas Supreme Court on January 24, 2014 rendered its Supplemental Opinion on Motion for Rehearing (the "Supplemental Opinion") in the case of *Finance Com'n of Texas v. Norwood*. This Memo is to address a couple of the finer points addressed by the Supplemental Opinion.

In the Supplemental Opinion, the Court clarified its opinion that "per diem interest", though prepaid, is still interest and "legitimate discount points" are a substitute for interest. Both are therefore excludable from the 3% fees cap for a Texas home equity loan. It is our view that a lender should confirm that any discount points paid are "legitimate discount points" resulting in a reduced rate for the borrower and should have the borrower execute a discount points agreement acknowledging that the borrower had the option to either pay the par rate or buy down the rate by payment of legitimate discount points.

In the Supplemental Opinion in *Norwood*, the Supreme Court also reaffirmed its opinion that to use a power of attorney for a home equity loan, the power of attorney must be executed at the office of the lender, a title company, or an attorney.

Notably, the Supreme Court's Supplemental Opinion permits such locations to be *outside* the state of Texas. But note that, under applicable Texas Department of Insurance Rules, if a home equity loan is to be closed outside of Texas or at the lender's office or attorney's office inside or outside of Texas, then the title company will not issue the T-42.1 Endorsement without deleting paragraphs 1 (a) through (h).

Discount Points.

The Supreme Court stated:

> "Legitimate discount points to lower the loan interest rate, in effect, substitute for interest … true discount points are not fees 'necessary to originate, evaluate, maintain, record, insure, or service' but are an option available to the borrower and thus not subject to the 3% cap."

In our view, the key terms in this ruling are "Legitimate discount points"; "true discount points" and "an option available to the borrower". Neither Texas statutes nor Texas

case law defines "Legitimate" or "true" discount points. *Tarver v. Sebring Capital Credit Corp.*, 69 S.W.3d 708, (Tex. App.-Waco 2002, no pet.) did state that "Points are commonly charged as an added compensation to the lender in exchange for a lower interest rate."

Before Qualified Mortgages and Ability to Repay rules under Regulation Z came in to being, Fannie Mae defined "Bona fide discount points" as:

> Discount points will be determined to be bona fide if they: are knowingly paid by the borrower (which can be demonstrated by the discount points being fully disclosed to the borrower); and are funded through any source for the purpose of reducing the interest rate on the loan; and result in a meaningful reduction of the interest rate, provided that, prior to discount, the rate was consistent with current market rates based on the credit characteristics of the mortgage. A meaningful reduction is defined as a minimum of 25 basis points reduction in the interest rate for each discount point paid, provided all other terms of the mortgage remain the same.

Regulation Z, 12 CFR § 1026.32(b)(3) currently defines "bona fide discount points" as:

> The term bona fide discount point means an amount equal to 1 percent of the loan amount paid by the consumer that reduces the interest rate or time-price differential applicable to the transaction based on a calculation that is consistent with established industry practices for determining the amount of reduction in the interest rate or time-price differential appropriate for the amount of discount points paid by the consumer.

In our view, to fit squarely within the *Norwood* decision, discount points must be both optional and must be bona fide (they must reduce the rate below the par rate offered). Assuming the Borrower has the option to pay discount points to reduce the par rate, and the Borrower elects to do so, then lenders would be wise to use a discount points agreement wherein the Borrower acknowledges that the lender offered the borrower the option to (i) pay less at closing and close the loan at the stipulated par rate, or (ii) pay more at closing, in the form of discount points, to obtain a lower interest rate over the term of the and thereby reduce their monthly principal and interest payments. If the borrower opts to pay legitimate discount points to reduce the par rate, the Supreme Court has now made clear the discount points are not included in the home equity 3% fees cap.

Powers of Attorney.

In the Supplemental Opinion the Supreme Court reaffirmed that for an owner to use a power of attorney for a home equity loan, the power of attorney must be executed at the office of the lender, a title company, or an attorney.

If a lender permits the use of a power of attorney in connection with a home equity loan, then it would be wise to require evidence as to the location at which the principal actually executed the power of attorney. An affidavit of a third party who was present and witnessed the execution or an affidavit of the Notary should serve that purpose if the affidavit notes the

specific location of the execution and the location meets the constitutional requirements. Such an affidavit could be included as part of the form containing the power of attorney. Please note that the statement of the principal as to the location of execution is self serving and is probably not, alone, the best evidence of this fact.

The Supplemental Opinion also clarifies that a power of attorney for a home equity loan can be executed over seas in harm's way before a JAG lawyer. Therefore, a power of attorney to be used in connection with a home equity loan does not have to be executed in Texas, rather it can be executed at one of the three prescribed locations in Texas or outside of Texas.

Previously, many lenders, concerned that Texas law required the closing to occur in Texas, were hesitant to allow a borrower to close a home equity loan outside of Texas, even though the closing would be at the office of the lender, an attorney at law, or a title company.

Because the Supreme Court stated that the location for the execution of a power of attorney must occur at the same locations which the Constitution requires the home equity loan to be closed, this Supplemental Opinion clarifies that a home equity loan can be closed at one of the three prescribed locations in Texas or outside of Texas.

But beware of the Texas Title Insurance Regulations. The procedural rules under which a title company must operate provide that if a Texas home equity loan [a Texas (a)(6) loan] **is not closed at the "office of the title company", the title company must delete from the T-42.1 Endorsement paragraphs 1 (a) through (h).** [See Texas Title Insurance Regulations, Procedural Rule P-47A(4).]

"Office of the title company" is defined in The Texas Title Insurance Regulations as:

> "the leased or owned ***Texas* office** location**(s)** of: (a) a title insurance company; or, (b) a direct operation; or, (c) a title insurance agent; or, (d) an attorney conducting the attorney's business in the name of a title insurance company or direct operation or title insurance agent where the attorney and the attorney's bona fide employees who close transactions are licensed as escrow officers as provided in Article 9.42.C, Texas Insurance Code." [See Texas Title Insurance Regulations, Procedural Rule P-44(c)(1).]

Therefore, a title company will only issue a T-42.1 Endorsement on a home equity loan without deleting paragraphs 1 (a) through (h) if the loan closes at the *Texas* Office of the title company.