HOUSE COMMITTEE ON FINANCIAL INSTITUTIONS
TEXAS HOUSE OF REPRESENTATIVES
INTERIM REPORT 2000

A REPORT TO THE
HOUSE OF REPRESENTATIVES
77TH TEXAS LEGISLATURE

KIP AVERITT
CHAIRMAN

COMMITTEE CLERK
BRYAN MCMATH

Committee On
Financial Institutions

October 27, 2000

Kip Averitt
Chairman

P.O. Box 2910
Austin, Texas 78768-2910

The Honorable James E. "Pete" Laney
Speaker, Texas House of Representatives
Members of the Texas House of Representatives
Texas State Capitol, Rm. 2W.13
Austin, Texas 78701

Dear Mr. Speaker and Fellow Members:

The Committee on Financial Institutions of the Seventy-Sixth Legislature hereby submits its interim report including recommendations and drafted legislation for consideration by the Seventy-Seventh Legislature.

Respectfully submitted,

Kip Averitt, Chairman

Burt Solomons

Mary Denny

Harryette Ehrhardt

Gary Elkins

Kent Grusendorf

Kenny Marchant

Burt Solomons
Vice-Chairman

Members: Mary Denny, Harryette Ehrhardt, Gary Elkins, Kent Grusendorf, Kenny Marchant, Jim Pitts, Juan Solis

Jim Pitts

Juan Solis

Burt Solomons
Vice-Chairman

INTRODUCTION

At the beginning of the 76th Legislature, The Honorable James E. "Pete" Laney, Speaker of the Texas House of Representatives, appointed nine members to the House Committee on Financial Institutions (the "Committee"). The committee membership included the following appointees: Kip Averitt, Chair; Burt Solomons, Vice-Chair; Mary Denny; Harryette Ehrhardt; Gary Elkins; Kent Grusendorf; Kenny Marchant; Jim Pitts; and Juan Solis.

During the Interim, the Committee was assigned five charges by the Speaker:

1. Determine the extent to which personal customer and account information may be accessed or furnished to governmental institutions, other divisions or affiliates of a financial institution, and unrelated commercial or other enterprises. Assess the state's ability to assure customers the privacy of their information.

2. Research the practices commonly known as "payday loans" and "sale leasebacks" to determine the need to regulate such transactions.

3. Review the federal "financial services modernization" act (HR 10) to identify necessary changes to state laws and regulations governing insurance and financial institutions. This review is to be conducted jointly with the House Committee on Insurance.

4. Conduct a review of the home equity lending market, including lender activities and practices, to assess the extent to which the expectations of the 75th Legislature are being met.

5. Conduct active oversight of the agencies under the committee's jurisdiction.

The Committee met in two public hearings on April 6, and May 5, 2000 at which public testimony was presented on the five charges listed above. Additionally, at the direction of Senator David Sibley, Representative Kip Averitt and Representative John Smithee, the Department of Banking, in coordination with the Department of Insurance, the Savings and Loan Department, and the State Securities Board, conducted a study of the impact of financial services modernization on Texas law. This study resulted in a report entitled "Financial Services Modernization for Texas, Impact of the Gramm-Leach-Bliley Act of 1999" dated August 15, 2000, which outlines specific conclusions and legislative recommendations in response to the Gramm-Leach-Bliley Act ("GLBA").

The Committee would like to express its appreciation to Commissioner Randall James and staff at the Texas Department of Banking, Executive Director Jim Buie and staff at the Texas Bond Review Board, Commissioner Leslie Pettijohn and staff at the Texas Office of Consumer Credit Commissioner, especially Duane Waddill and Sealy Hutchings, Commissioner Denise Crawford and staff at the Texas State Securities Board, Commissioner Harold Feeney and staff of the Texas Credit Union Department, Commissioner Jose Montemayor and staff at the Texas Department of Insurance, Commissioner Jim Pledger and staff at the Texas Savings and Loan Department, and Executive Director Kim Edwards and staff at the Texas Public Finance Authority for their continued work to not only regulate their respective industries but also inform the Committee of important matters in their respective areas of authority as they pertain to the Committee's interim charges.

The Committee would also like to extend its appreciation to the members of the GLBA Task Force, namely Robert Bacon, Kevin Brady, Lynda Drake, Ryan Eckstein, Gayle Griffin, Don Hanson, Jack Hohengarten, Tim Irvine, Everette Jobe, Steve Martin, David Mattax, John Morgan, Tom Spradlin and David Weaver, for all their hard work in producing the "Financial Services Modernization for Texas" Report as directed by Senator David Sibley, Representative Kip Averitt, and Representative John Smithee.

Additionally, the Committee extends thanks to all industry and consumer representatives and other members of the financial industry who testified at the hearings and contributed to the interim study process, specifically Tom Bond, Mike Dunn, John Dwyer, Bo Gilbert, John Heasley, Jon Henneberger, Bradley Johnston, Sam Kelley, Jeff Kloster, John Martinez, David Mattax, Karen Neeley, Eric Norrington, Rob Norcross, David Pinkus, Mike Pollard, Elizabeth Rogers, Rob Schneider, Marybeth Stevens, Bill Stinson, and Bill White.

A special thanks is extended to Mr. Randy Batsell of Analytica, Inc., for his presentation on Home Equity Lending in Texas given before the Committee at the April 4, 2000, public hearing.

HOUSE COMMITTEE ON FINANCIAL INSTITUTIONS
INTERIM STUDY CHARGES

CHARGE Determine the extent to which personal customer and account information may be accessed or furnished to governmental institutions, other divisions or affiliates of a financial institution, and unrelated commercial or other enterprises. Assess the state's ability to assure customers the privacy of their information.

CHARGE Research the practices commonly known as "payday loans" and "sale leasebacks" to determine the need to regulate such transactions.

CHARGE Review the federal "financial services modernization" act (HR 10) to identify necessary changes to state laws and regulations governing insurance and financial institutions. This review is to be conducted jointly with the House Committee on Insurance.

CHARGE Conduct a review of the home equity lending market, including lender activities and practices, to assess the extent to which the expectations of the 75th Legislature are being met.

CHARGE Conduct active oversight of the agencies under the committee's jurisdiction.

PRIVACY OF CONSUMER FINANCIAL INFORMATION

BACKGROUND

Privacy of information, be it financial or otherwise, has become one of the most frequently discussed policy topics currently debated across the country. As a result of the growing attention being given to privacy, consumers are becoming increasingly concerned with the sharing of their personal information. A recent study by the National Consumers League shows that consumers rank “loss of personal privacy” second only to “education” as the major public policy issue they are the most concerned about. In response to a question regarding the protection of specific types of information online, respondents ranked credit card numbers, social security numbers and information about their financial assets as their top three concerns.[1] The combination of growing public concern over privacy and increased examples of information being shared in questionable ways has left legislatures across the country at the crossroads between consumer protection and industry practices. The proliferation of digital information sharing and the ease with which this information may be shared leaves consumers today faced with increasing vulnerability not only to annoying phone calls and junk mail, but more serious issues such as fraud and identity theft. Consumers today face more frequent opportunities to provide information about themselves. It is therefore imperative, through both public policy and private practice efforts, to ensure that consumers know not only what is being done with their information but also their rights to protect their personal privacy.

Discussions on privacy have ranged from the use of information by both governmental and private entities. In regards to personal financial information, the privacy landscape can be confusing in the very least. Distinctions have been made between consumers and customers to differentiate between people who have either temporary or established relationships with financial institutions. Categories of information, both public and non-public, have been identified to determine what information may or may not be shared, and if so, with whom. Furthermore, categories of entities, be they affiliates, exempted third parties or non-affiliated third parties, have been determined to dictate where such information may be disclosed. Additionally, the ideas of opting-in and opting-out have been suggested to provide the consumer a choice in the matter of whether or not they wish their information to be shared. Disclosure requirements have been established to ensure the consumer understands the privacy policies and notices of the various institutions.

Merriam-Webster’s Collegiate Dictionary defines privacy as “a. the quality or state of being apart from company or observation; b. freedom from unauthorized intrusion.”[2] Many consumers approach their idea of privacy from this starting point. As consumers form their own idea of a “right to privacy,” they imagine this right is the right to be left alone. These consumers value the confidentiality of their personal information and prefer that outside entities know as little as necessary about them. While there is national debate whether Americans have such a “right to privacy,” many of these same Americans maintain that information about themselves, be that public or private, still belongs to them regardless of where it is published. When personal information, be it public or private, is used in ways not initially intended when it was provided, consumers may feel betrayed or intruded upon, promoting distrust of the entities who collected and used the information in this fashion.

Others groups choose to emphasize the information sharing aspect of privacy. In particular, industries that benefit from the sharing of consumer information would prefer that debates on privacy center on responsible practices and rules regulating how and where information may be shared. Industries argue that complete privacy is impractical in today's world, that information sharing is more of a benefit to consumers than most realize. The simple act of writing a check at a grocery store, they argue, involves considerable information sharing from the time the check is written to the time it is returned to the consumer after having been paid. In light of this example, industry groups say that total privacy, or total isolation, is nearly impossible, or at least undesirable. They claim consumers do not want complete privacy because of the many conveniences they enjoy today that they don't even realize. Even the annoying phone call during dinner, or the mailed solicitation, provides consumers with opportunities they might otherwise not be aware of, some of which they may even want to take advantage of, industries say.

One angle to approach privacy is to consider how particular information is shared, why this information is being shared, and whether or not these methods and means are acceptable. The real issue behind this approach is whether or not personal information is being collected, shared, and used to deny equal opportunity. Regarding personal financial information, is additional information (medical information, for example) being used in credit decisions? The example that someone would be denied a loan based on the fact that they have cancer is not an unimaginable situation now that banks will be affiliated with insurance companies. Or, turn it around, and consider insurance policies could be much more expensive or even unavailable to some people based on their spending habits. A consumer who just happens to rent jet skis with their credit card every weekend may end up paying considerably more for their health insurance that the consumer who buys books.

The fact that nine separate legislative committees of the Texas Legislature alone are studying various aspects of privacy identifies this as a major issue in the current legislative landscape. Policy summits in Austin and around the state have been held to inform legislators and legislative staff of the current industry trends to insure privacy. Information provided by these interested parties has outlined newly developed policies intended to ensure the privacy of customer information. Legislators themselves have been urged to proceed with caution and prudence to avoid any unforeseen and unintended consequences. Industry groups claim that recently passed federal regulations and rules have not even had time to be put into effect, much less work themselves out. But, despite all this talk, the fact remains that information is currently being collected, used and shared on individual consumers across the State of Texas and the United States, often without the knowledge, much less the consent, of those consumers.

In considering its position on privacy, Texas is faced with an overarching public policy issue on a national scale. Key federal regulations are currently in place establishing rules pertaining to the sharing of personal financial information. These regulations, two of which being the Fair Credit Reporting Act and the recently passed Gramm-Leach-Bliley Act, establish minimum regulations with which a company must comply when planning to collect and share information on a customer. While states have the opportunity to impose more stringent regulations on entities operating within their boundaries, the end result could prove worse than what currently stands. Potentially, companies could be forced to comply with 50 different privacy regulations in 50 different states, putting large, multi-state companies at a severe disadvantage because of the cost and effort necessary to comply. While this does not argue against discriminate regulations being needed in Texas regardless of the cost to companies or the decisions of other states, it is important to remember that these costs are often passed on to consumers in one form or another. Texas certainly would not want to burden companies to the point that this places undue burden on the people of the state, but the line must be drawn somewhere. The item to remember is the importance that the individual consumer be informed of their rights, regardless of the burden this may place on private companies.

CURRENT PRIVACY LAWS IN TEXAS

Texas Constitution and Statutes

Currently in the State of Texas, laws protecting the privacy of information held by both governmental and private institutions occur throughout our state statutes. While there is no single constitutional or statutory protection of an individual's "right to privacy," there are numerous statutes that deal with information sharing. This patchwork of laws not only restricts information from being shared, but also allows sharing in certain situations. In addition to state law, federal law also dictates how information flows and places certain restrictions on the process.[3]

In a report dated July 20, 2000, The Office of the Attorney General of Texas identified all occurrences of language and phrases relating to information deemed private or confidential. In all, over 700 constitutional and statutory citations were found, seventy-one of which occurred in the Finance Code alone, protecting information ranging from criminal records to financial statements of individuals filing applications for a state bank charter. Information was also provided by the Texas Department of Banking which identifies additional Finance Code statutes with respect to the Banking Department's areas of regulation. While many of these statues do not expressly identify a penalty for wrongful disclosure, the Public Information Act makes wrongful disclosure a misdemeanor and official misconduct.

One area of the Finance Code provides limited protection for consumers from disclosure of their financial records in the context of litigation. Section 59.006 Finance Code requires permission from nonparty customers before a financial institution discloses records in response to a court subpoena. Unfortunately, that same section exempts governmental requests for records from its requirements. In fact, Texas does not have a "Right to Financial Privacy Act" comparable to that found in federal law (See 12 U.S.C. §3401 *et seq*.). There is currently no state law governing the possible event of a Texas state agency obtaining financial information on a person in this state.

The Texas Insurance Code also provides some protections for Texas consumers in the context of financial institution sales of insurance. Article 21.21-9 requires financial institutions to provide an "opt-out" notice to customers before nonpublic information about such customers may be shared. Furthermore, article 21.48A of the Insurance Code prohibits the use of information from a policy of insurance found in a loan file to be shared with an insurance agent unless the customer has given expressed consent. For example, a mortgage loan customer could not be solicited for homeowners insurance as a result of the sharing of insurance information by the lender to an insurance agent. This is a limited "opt-in" requirement relating to real and personal property loan transactions.

FEDERAL PRIVACY LAW

Privacy Act of 1974

In 1974, Congress enacted the Privacy Act of 1974, codified as 5 U.S.C. § 552a. This is also known as the "Freedom of Information Act." It pertains to release of personal information by the government. Texas enacted comparable protections codified at section 552 Government Code.

Fair Credit Reporting Act

The Fair Credit Reporting Act ("FCRA") is another important piece of the privacy law puzzle. The FCRA, enforced by the Federal Trade Commission, is designed to promote the accuracy and privacy of information contained in credit reports. To accomplish this, the FCRA contains important protections and framework for the collection and dissemination of information about consumers. In 1996, amendments were made to the FCRA providing additional protections for consumers, one of which deals with information sharing among affiliates.

Companies that collect and sell information on consumers are termed "consumer reporting agencies" ("CRAs") by the FCRA. The most common type of consumer reporting agency is a credit bureau, which prepares and sells consumer reports on individual consumers. These reports contain information such as where a consumer works and lives, how they pay their bills and whether the person has ever been sued, arrested, or filed for bankruptcy[4]. The reports may also contain information on a consumer's credit worthiness, credit standing, credit capacity, character, general reputation, personal characteristics or mode of living. Interestingly, consumer reports are not used only to make credit decisions. In addition to evaluating a credit application, they may be used for employment screening, landlord reviews of tenants, collections, bad checks and various other transactions[5].

The FCRA regulates not only how credit reporting agencies collect and maintain consumer reports, but also the users of these reports. The three main users of consumer reports are lenders, insurance companies and employers. The FCRA designates that consumer reports can only be obtained and used for a legitimate purpose, such as determining a borrower's ability to repay a debt. Uses such as determining if someone is worthy of being sued is strictly forbidden as an illegitimate use of a consumer report.

The restrictions on uses of a consumer report also applies in part to sharing of information by affiliates. An affiliate is a company under common control with another company. Under FCRA, these affiliated companies are allowed to share certain information, such as transaction and experience data, without coming under the restrictions placed on consumer reporting agencies. Transaction and experience information could include whether a customer has ever been late on a payment, balances on accounts and purchase history on credit cards. If, however, a company intends to share information a customer provided on a loan application or information obtained in a credit report, FCRA requirements would apply. The company would be required to send a privacy notice explaining their sharing policy and a notice giving the customer an opportunity to opt-out before such sharing could occur. While FCRA does restrict information sharing among affiliates to a certain extent, the transaction and experience data can still be shared without the consumer even knowing about it, much less having the opportunity to restrict it from happening.

A real world example may help illustrate a fairly common practice among affiliates. Suppose "Bank A" is affiliated with a "Brokerage Firm B" that sells mutual funds. Bank A has a customer, "Mr. Buck", who currently owns several certificates of deposit of large dollar amounts in his financial portfolio. Bank A realizes Mr. Buck is a good candidate for buying a few mutual funds, and in Mr. Buck's "best interest" decides to send his name (and a list of other customers just like him) to Brokerage Firm B. Now, Brokerage Firm B takes this list and solicits these customers, encouraging them to buy some of the mutual funds the firm offers. Bank A can share all of this information with Brokerage Firm B without Mr. Buck or anyone else on that list ever being notified of Bank A's policies regarding the sharing of personal financial information or given an opportunity to not have this information shared. There is nothing in the FCRA that restricts the example as described above from happening.

The FCRA does, however, restrict certain types of information from being shared, such as information provided on a loan application or from a credit report. In order to share this type of information with an affiliate, a company must provide its customer with an opportunity to opt-out. Back to the example, if Mr. Buck's last loan application with Bank A included that he has an account with another brokerage firm, this information could not be shared without first sending a privacy notice and opt-out form to Mr. Buck. Assuming he decides to opt-out, Brokerage Firm B would then rely on Mr. Buck to provide this information for himself. Additionally, any information from Mr. Buck's credit report likewise could not be shared. Brokerage Firm B would have to obtain their own credit report on Mr. Buck if they so chose, at a cost of around eight dollars. So, for a few bucks and a little cooperation, Bank A and Brokerage Firm B can basically circumvent any "affiliate information sharing restrictions" provided in FCRA with very little effort, keeping Mr. Buck in the dark about his so-called privacy rights.

The FCRA also contains certain provisions to ensure the accuracy of information contained in a consumer report. If an institution takes action against a consumer in response to a report supplied by a CRA (such as denial of an application for credit, insurance, or employment), the name, address and telephone number of the reporting CRA must be given to the consumer. While the consumer must then obtain a report on themselves to check the data for inaccuracies, in the event that a mistake has been made the consumer has an opportunity to have the information corrected. The consumer reporting agency must reinvestigate any item a consumer disputes as inaccurate within thirty days of a dispute. The reporting agency must forward any information sent by the consumer to the reporting institution and in the event an error is found, the providing institution must then notify all national credit reporting agencies of the correction. While this process is limited in the burden placed on the institutions to notify the consumers of the information sharing that takes place, and provides no opt-out opportunity to the consumer, the reality is that the reports would be unreliable if consumers had the opportunity to restrict the reporting of certain information. If a consumer could block the reporting of the fact that they write bad checks, then the consumer credit reports would become inaccurate and virtually useless.

One interesting opt-in provision contained in the FCRA is in the event an employer requests information

from a CRA on an employee. This is often done when a current or potential employee has or will have access to the finances of the company. An employer, or potential employer, must obtain the consent of the employee before the CRA can provide any information.
An additional opt-in requirement contained in the FCRA regards medical information. Consumer reports, in addition to personal and financial information, may include medical information. Neither creditors, employers, nor insurers may obtain a consumer report that contains medical information without the approval of the consumer.

In regards to general marketing of consumers based on information contained in a credit report, the consumer has "quasi" opt-out rights. While no notice of privacy policies or opt-out forms are required to be provided to the consumer, a company may use CRA file information as a basis for sending unsolicited credit and insurance offers to consumers. These offers must contain a toll-free number for the consumer to call to remove their name and address from the solicitation list. The company is required to remove the consumer from their list for a period of two years. If the consumer wishes to be removed from the lists permanently, a form must be obtained and filed with each CRA who has information on that customer.

The Gramm-Leach-Bliley Act

The Gramm-Leach-Bliley Act of 1999 ("GLBA" or "the Act") will impact the sharing of financial information by financial institutions more than any other piece of legislation passed in recent history. An entire section of the Act is dedicated to establishing rules relating to the sharing of personal information. Title V of the Act addresses the Disclosure of Nonpublic Personal Information. In short, section 503 provides that a financial institution must provide to its customers an annual notice detailing its privacy policies and practices. Section 502 requires financial institutions to fulfill certain disclosure and opt-out requirements to its customers before it may share nonpublic personal information with a non-affiliated third party.

The Act specifically establishes three main requirements in regards to privacy: 1. That the institution must provide to its customers a clear and conspicuous notice about its privacy policies and practices which describes the conditions under which nonpublic customer information may be disclosed to unaffiliated third parties and affiliates; 2. That this privacy notice must be provided annually and must again be clear, conspicuous and accurate; and, 3. The financial institutions must provide their customers an opportunity to "opt-out" of disclosures of their nonpublic personal information to non-affiliated third parties and provide a reasonable means to do so.

GLBA Privacy Rules

In order to implement Title V of GLBA, final regulations were passed in nearly identical form by financial institution regulatory agencies and the Federal Trade Commission. The federal agencies involved include the Office of the Comptroller of the Currency , the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation and the Office of Thrift Supervision, the National Credit Union Administration and the Securities and Exchange Commission. All agencies recently adopted their versions of these final rules pertaining to "Privacy of Consumer Financial Information" ("the Rules"). The Rules technically go into effect on November 13, 2000, but mandatory compliance is not required until July 1, 2001. The additional time period is intended to allow financial institutions an adequate duration to implement the rules internally, to notify their customers as required and to allow sufficient time for those customers choosing to opt-out to respond. Federal regulators will be monitoring progress, however, and expect financial institutions affected by GLBA to be making progress toward compliance well before the July, 2001 deadline.

In addition, Title V requires state insurance commissioners to adopt privacy regulations congruent with GLBA that apply to insurance companies. The National Association of Insurance Commissioners recently released their model regulations which are expected to be adopted by the Texas Department of Insurance. The regulations are significantly similar to the federal agencies' regulations, with the major exception that customers of insurance companies get an opt-in option regarding the sharing of medical and health information between affiliates. Thus, sensitive medical and health information may only be shared with the express consent of the consumer.

Financial Institutions

The Rules define a "financial institution" as any institution that is "significantly engaged in financial activities." Examples of traditional financial companies to which this definition will apply are banks, bank holding companies, financial holding companies, securities firms, insurance companies, insurance agencies, investment companies, thrifts, and credit unions. In addition, any business that is significantly involved in financial activities will also fall under GLBA privacy restrictions, including mortgage brokers, finance companies, check cashers, and pawnshops. Furthermore, the Act includes certain types of activities that are not typically considered to be "financial", such as tax preparation firms, financial data processors, and financial software companies. Moreover, any company that engages "significantly" in financial activities will be subject to the privacy restrictions with respect to the customers receiving the financial services.

Consumer/Customer Distinction

The GLBA distinguishes between "consumer" and "customer" for purposes of the notice requirements imposed by the Act. A "consumer" is defined as "an individual who obtains or has obtained a financial product or service from the bank that is to be used primarily for personal, family or household purposes."[6] A few examples of a "consumer" given in commentary to the Rules include a person who applies for a loan, a person who is shopping for the best rate on a mortgage loan or the lowest premium for an insurance policy, and a person whose loan is owned or serviced by an institution.

A customer is a consumer who has established a customer relationship. This is a continuing relationship between a consumer and a bank under which the bank provides one or more financial products or services to the consumer that are to be used primarily for personal, family, or household purposes. Examples of a "continuing" relationship include deposit account, loan, purchase of insurance product, lease of personal property, or investment services. By contrast, merely cashing a check or using an

ATM machine would not be "continuing" relationships. A person using an ATM, cashing a check, or purchasing travelers checks would all fall under the definition of "consumer" as defined by GLBA.

The main reason for the distinction between a "consumer" and a "customer" pertains to giving notice to the individuals by the institutions. If an institution does not collect and share information on a "consumer", it is not required to provide notice of its privacy policy to these individuals. If, however, it does collect information and wants to share it with non-affiliated third parties, the institution is required to provide the consumer with its privacy notice (which includes information on how the consumer may opt-out) just as if the "consumer" were an actual "customer".

Nonpublic Personal Information

In addition to distinctions between consumers and customers, the Act distinguishes between types of information. The term "nonpublic personal information" ("NPI") is used to identify any "personally identifiable financial information" a customer may provide to a financial institution except for information that is otherwise publicly available. A paper written by Covington & Burling on the final regulations for GLBA states that the information does not have to be "financial" in the traditional sense at all (i.e. account balances or payment information). It can include the fact that a consumer has a customer relationship with an institution and any information collected through the use of "cookies" from a World Wide Web site(or "website"). Furthermore, the paper points out that the exemption for publicly available information is virtually useless since almost all lists of public information of customers is derived in some way from NPI, like, for example, a list of customers with a particular payment history. The paper concludes that "NPI as a practical matter appears to include just about all personally identifiable information that a financial institution has in its possession pertaining to any of its retail consumers."[7]

A practical example of NPI is what is known as "transaction and experience data." Examples of this type of information for a typical consumer would include credit card payment information and charge history, electronic or automatic payments a consumer has set up for their checking account, and the companies to which checks were written. Detailed information such as a consumer's activity on a moment by moment basis causes a deeper level of concern regarding personal privacy. Whether or not an institution is sharing this information will vary by institution, but this type of specific information sharing is allowed among affiliates and potentially to non-affiliated third parties if the consumer decides not to opt-out.

Clear and Conspicuous Disclosure

As required by Section 503 of GLBA, financial institutions will now be required to provide their customers with a copy of the institution's privacy notice. The notice must be reasonably understandable and designed to attract the attention of the customer. The Rules established to implement GLBA requirements state that overly detailed disclosures are neither required nor desirable due to the added burden they would place on institutions and the unlikelihood they would be read by consumers.[8]

Annual Notice

The initial privacy notice must be delivered to all customers by July 1, 2001, but will likely be delivered several months ahead of this date in order for financial institutions to be in full compliance by the July deadline. The notice must be provided thereafter on an annual basis. All customers of the institution must receive this initial and annual notice. Consumers, on the other hand, will only receive the notice if the institution plans to share the consumers NPI to a non-affiliated third party. The notice must outline the privacy policies of the institution and must include nine specific categories of information:

1. <u>Categories of NPI collected:</u> The notice will identify whether or not information is being collected from the customer themselves, the financial institution itself, affiliates of the financial institution, or from credit bureaus.

2. <u>Categories of NPI disclosed to others:</u> The notice will include a brief description of the types of information that may be disclosed to other entities. Examples of the types of information that may be collected include a customer's name, address, income, assets, payment history, parties to transactions, account balances, and the customer's creditworthiness and credit history. The notice is not required to include specific elements of information the institution plans to disclose.

3. <u>Categories of entities to whom NPI is disclosed:</u> The notice must include whether or not a financial institution plans to disclose information to affiliates and/or non-affiliated third parties. If the institution plans to share information, the notice must include the categories of entities the institution plans to share information with. These categories are identified as "financial service providers" (*e.g.*, mortgage brokers, insurance agents, etc.), "non-financial companies" (*e.g.*, retailers direct marketers, airlines, etc.) and "other organizations" (*e.g.*, non-profit organizations). The notice, however, is not required to name these entities, affiliates or non-affiliates, by name.

4. <u>Disclosures of NPI of former customers:</u> The notice must include a brief description of the institutions disclosure practices in regards to former customers.

5. <u>NPI disclosed under joint marketing/agency exception:</u> The notice must include a brief description of joint marketing disclosures the institution has with any other financial institutions.

6. <u>GLBA opt-out right:</u> The notice must include a declaration that the customer has the right to "opt-out" of disclosures of NPI to non-affiliated third parties. The opt-out must be available to consumers through reasonable means. Examples of reasonable means include a pre-printed form the customer may

return, a toll-free phone number the customer may call, or a website address the customer may use to opt-out electronically via the Internet. The customer may choose to opt-out at any time, and is not required to opt-out each year once they have initially elected to opt-out.

7. FCRA opt-out right: The notice must also disclose the consumer's right to opt-out of information sharing among affiliates under the FCRA. While the customer may not opt-out of the sharing of their transaction and experience data, this limited opt-out allows a consumer to restrict certain information from being shared, such as asset and income information provided by a consumer on a loan application.

8. Security and confidentiality practices and procedures: The notice must include a brief description of the institutions security and confidentiality policy, including general information on who has access to the consumer's NPI.

9. Disclosures covered by general exceptions: The notice must include that other disclosures are made to non-affiliated third parties "as permitted by law." These disclosures are permitted whether or not a consumer had chosen to opt-out. These excepted non-affiliated third parties are allowed to use the information provided to them only for the expressed purpose and must maintain the confidentiality of the information and may not re-disclose it to another entity unless they are also included in the allowed exemptions.[9]

Obviously, the customer must not elect to opt-out of having their nonpublic personal information shared in order for the institution to provide it to a non-affiliated third party. Furthermore, it is interesting to note that the privacy policy must contain the consumer's right to opt-out as established by GLBA and FCRA.

Delivery of Notice

While discussion has included mention of both a "privacy policy" and an "opt-out notice," the reality will most likely be that consumers receive a "privacy notice" containing both the institution's privacy policy and opt-out notice. Most likely, there will not be two separate documents provided to the consumer. The opt-out requirements as established in GLBA are satisfied by an institution that includes a toll-free number to call, a website address to be accessed electronically, or a reply card with check-off boxes to be returned via mail. Also, while some have envisioned a separate mailing being sent to consumers that contains only the institution's privacy notice, in all likelihood the notice will be included with the customer's financial statements in what is known as a "statement stuffer." This approach satisfies the requirements of delivery as established by GLBA.

Opt-out Status

Once a customer chooses to opt-out, this status remains indefinitely. While institutions are required to provide their privacy notice on an annual basis, the customers are not required to re-opt-out each year. If after choosing to opt-out, a customer decides to revoke this status, they may do so in writing, expressly stating their intention to have their NPI shared with non-affiliated third parties. But again, it is helpful to note that the options to opt-out provided by GLBA applies only to information shared with non-affiliated third parties. The options to opt-out provided by FCRA apply to certain information shared with affiliates. Besides the FCRA limitations, a customer is powerless to restrict their information being shared within an institution's affiliate structure and with exempted third parties. Consumers with a high sense of privacy awareness are left to shop around between institutions and compare the various privacy policies before establishing a customer relationship.

Where Information is Being Shared

There are four types of entities that a financial institution may want to share NPI with in the course of doing business. They are as follows:

1. Affiliates. The GLBA does not restrict information sharing within the affiliate structure. The FCRA has limited restrictions based on a customer's decision whether or not to opt-out. A brief description of affiliates to whom NPI may be disclosed is required in the privacy notice but these entities are not required to be identified by name. The privacy notice will most likely include all of this information in one comprehensive notice.

2. Joint Marketers. Typically, larger institutions do not have joint marketing agreements with other institutions, but smaller institutions very well may. Joint marketers are treated as affiliates if there is a contract between the two institutions that contains confidentiality requirements between the two entities. As in the case of affiliates, a brief description of joint marketing agreements must be included in the privacy notice. Joint marketing agreements are often found between a small bank and another entity that provides financial services, like a securities or mortgage broker firm. Joint marketing is in a sense a precursor to the newly allowed affiliations between banks, insurance companies and securities firms as found in GLBA.

3. Exempted Third Parties. An institution may disclose NPI to certain entities "as necessary to effect, administer, or enforce a transaction that a consumer requests or authorizes."[10] This would include any out-sourced services such as statement preparation and check printing a customer may receive in the normal course of opening an account. Typically, exempted third parties are data processing companies, but also include other companies for services such as underwriting, account bonuses, and fraud prevention.

4. Non-affiliated Third Parties. As the term suggests, non-affiliated third parties

are entities that do not otherwise have a business relationship with the institution. These entities typically purchase NPI from financial institutions for marketing and other purposes. The customer may restrict their NPI from being disclosed to non-affiliated third parties by exercising their right to opt-out as described above.

State Authority to Adopt Stricter Privacy Regulations

Title V of GLBA sets the minimum requirements for financial institutions regarding privacy of consumer financial information. In addition, it preserves the right of the states to enact stricter laws regarding this privacy. Texas has the right under GLBA to enact requirements necessary to ensure the privacy of this information. Possibilities include:

- opt-in requirements before information can be shared either within the affiliation structure or with outside non-affiliated third parties,

- detailed privacy policies identifying specifically the customer information that is being shared and the specific entities with whom it is being shared;

- opt-out option restricting information from being shared within the affiliate structure; or,

- restrictions against health information from being used in credit decisions or shared at all between affiliates (note: this restriction may indeed be part of TDI's forthcoming privacy regulation proposal).

While the Committee does not plan to recommend adoption of any of these options, it retains the right to study the implementation of GLBA privacy regulations and assess the need for possible additional restrictions in the future.

RECOMMENDATIONS

1. The State of Texas should pass legislation to codify in statute the privacy requirements pertaining to personal financial information as established in the Gramm-Leach-Bliley Act. State law should mirror Federal law to ensure local enforcement of these requirements. Regulatory authority should be given to the state agencies that currently regulate the various entities affected. If entities are currently unregulated determinations should be made as to the most appropriate regulatory agency as it pertains to financial privacy.

2. Additionally, due to the consensus that health and medical information is highly sensitive and should be vigorously protected, especially as it relates to credit decisions, the Committee chooses to defer judgement to the various House and Senate Committees that are currently studying health information privacy.

3. The Committee would also like to note its concern that consumers in the State of Texas need to know their rights. While it remains to be seen whether GLBA privacy requirements achieve this goal, the Committee reserves the right to act until the effectiveness of market implementation of GLBA requirements is determined. Future consideration may need to be given to the information contained in the privacy notice and whether more specific information may need to be included, specifically regarding the possible listing of affiliates by name. The Committee's primary concern is to ensure that consumer privacy rights are conspicuously disclosed.

PAYDAY LOANS AND SALE LEASEBACKS

BACKGROUND

76th Legislature

In the 76th Legislative Session, the issues of “payday loan” and “sale leaseback” transactions were brought to the attention of the Texas Legislature for the first time. During the 76th Session, the Committee held a hearing on March 29, 1999, and heard considerable testimony from proponents and opponents alike without reaching a conclusive legislative solution for the State of Texas. Prior to the 76th Session, no legislation had been filed to address these types of consumer products. As a result, many unauthorized lenders across the state were operating illegally, making usurious loans to consumers with annual interest rates potentially in excess of 800%. Furthermore, some of these illegitimate lenders had begun the practice of using local law enforcement and criminal justice systems as their collection agencies. When a customer refused to repay the initial loan amount, the operators would turn them in for writing a hot check. It was this practice that initially attracted the attention of local elected officials and got the ball rolling in the Texas Legislature. Due to the fact that no legislation was passed during the 76th Legislature, it is a ball that continues to this day.

In all, five bills were filed during the 76th Session in both the Texas House of Representatives and Texas Senate in an attempt to address the problem caused by illegal payday lending practices. In response to growing concern over collection practices, alleged lending abuses, and the burden these practices were putting on local criminal justice systems, Representatives Dale Tillery and Helen Giddings and Senator John Carona filed separate legislation in their respective chambers.[11] During debate of the various bills, considerable attention was given to the differences between “payday loans,” “sale leasebacks” and other variations of these types of consumer products. In order to differentiate between the various products, a closer examination of the transactions is necessary.

Payday Loans

A payday loan is a small consumer loan for a short period of time that is secured by the borrower’s personal check. It is typically intended to carry the borrower until their next pay check. Payday loans are known by many different names, including “cash advance loans,” “check advance loans,” “post-dated check loans,” “delayed deposit check loans,” and “deferred deposit” or “deferred presentment loans.” The loan, regardless of its name, is often in an amount from between $100 and 400 with a loan period from between 7 to 14 days. Interest paid can be as high as $33 per $100 borrowed, resulting in extremely high interest rates depending on the period of time until the loan is due.

A typical payday loan customer is both employed and has a current checking account, often with very few recent insufficient checks. Independent surveys report that the average annual household income of a payday loan customer is around $25,000. An industry survey found that the typical payday loan customer is 35 years old, averages $33,000 in household income, has been at their current job for four years, and that 35.8% of these customers own their own home.[12]

In obtaining a payday loan, the borrower is required to write a check as collateral on the loan. This is done in one of two ways, either by writing one check for the full amount of the loan ($133, assuming $33 of interest on a $100 loan), or by writing two checks, one for interest ($33, assuming previous example) and one for the principal of the loan ($100). In the former example, the lender would hold the single check until the loan period expired. In the latter example, the lender would most likely deposit the first check to cover the interest and hold the second check as security for the principal amount. Assuming the borrower chooses not to return to the lender before or at the time the loan period expires, the lender would then deposit the held check to cover the outstanding balance. The borrower may choose to return to the lender at or before the time the loan period expires to exchange cash for the held check, in essence repaying the loan directly rather than by the initial check.

In the event the borrower does return at the time the loan is due and is unable to repay the loan balance, the lender may extend the loan period if the borrower agrees to pay additional interest ($33 more, assuming example given above). The loan would therefore be extended for a period of time equal to the original loan period (for our example, let's assume a two-week period) and at the expiration of this second period, the borrower would again owe the unpaid original amount of $100. This practice of extending the period of time that the loan is due is called rolling a loan over, or simply a "rollover." If the borrower is unable to repay the amount due at the expiration of the loan period (again, 2 weeks), another rollover is offered, which the borrower can choose to accept and again pay the $33 interest payment for another period of two weeks, or allow the lender to deposit the original $100 check knowing there to be insufficient funds available in their checking account to cover the cost of that check. When the check is returned due to insufficient funds ("NSF"), some lenders have been known to turn the check over to their local criminal justice system for criminal prosecution, as described above. Apparently, this practice was of particular concern in Dallas and the surrounding communities, but eventually became a common problem throughout the State.

While the practice of using the local criminal justice system was a key reason leading to the filing of legislation related to payday loans, it represents only a part of the problem. The fact that many of these types of loans lead to numerous rollovers, creating a cycle of debt that low income consumers find difficult to escape from, leads consumer advocate group's reasons why Texas should not authorize payday lending. In states where payday loans are permitted, estimates put the average number of rollovers at between 10-12 per customer per year.[13] Another aspect that consumer groups point to is the practice of allowing a check to be held as collateral. This practice of literally allowing a check to be held allows lenders to figuratively hold the check over the head of the borrowers, creating a potentially threatening situation for the consumer. The potential use of the criminal justice system to collect the funds puts the consumer at a severe disadvantage and is coercive, opponents say. It is exactly these types of abusive lending practices that make payday loans undesirable since these consumers are already facing financial difficulty. Consumer groups argue that Texas should concentrate on enforcing current usury limits rather that consider legalizing such high rate lending products. Additionally, these groups point to currently available loan opportunities, such as signature loans, pawnshop loans, credit card cash advances and loans from friends and family, as adequate access to credit for these types of consumers.

Sale Leasebacks

"Sale leaseback" transactions are another type of consumer product that are often closely associated with payday loans. Proponents of sale leaseback transactions argue that this association between sale leasebacks and payday loans is unfounded due to their belief that a sale leaseback is not a loan. They point to the fact that a sale leaseback transaction is the sale of an item of personal property and subsequent leasing of the item back to the customer rather than an extension of credit. Proponents would also point out that there is no obligation to repay the amount given in the sale of the item. The piece of personal property, they say, may be returned to the operator in lieu of repayment of the original sale amount (or, in other words, the customer is not required to buy the item back). It is these two factors, proponents argue, that distinguish sale leaseback transactions as leases rather than loans.

In a sale leaseback, a customer in need of cash will conduct a transaction with a sale leaseback business in which a piece of personal property is sold to the business operator and then immediately leased back to the original owner. By presenting the serial number of a piece of personal property, a television for instance, a customer can obtain an agreed upon amount of cash by selling the TV to the business. Instead of being forced to surrender the TV as required in a pawn transaction, the customer then agrees to lease the item back from the operator for a specified period of time, often fifteen days. At the end of this period of time, the customer must pay additional money to the operator if they decide to continue to lease the TV for another fifteen days. Or, they can choose not to continue the lease, leaving the customer with two options. They may either return the TV to the operator or decide to keep the TV by buying it back for the same price as it was initially sold.

Typically, the sale price of the property item in a sale leaseback transaction will be from between $100 and $500. To obtain the product, a customer will approach a sale leaseback company not with their TV in hand, but rather with their checkbook and the serial number of the TV or any other household appliance of value. Upon describing the TV to the operator and deciding on a fair price, $200 for example, the customer receives $200 cash and signs a lease agreement which allows the customer to keep the TV at their home. Typical lease charges for the fifteen day period range from $30 to $33 per hundred dollars of item value, or $60-$66 for our $200 example. In addition to the lease charge, or administration fee as it is sometimes called, the customer must leave another check with the operator as a security deposit on the item. This security deposit is in the same amount as the sale price, or $200 in our example. The customer then leaves the business location with $200 cash, having left two checks for a total of $260-$266, the serial number of their TV, their signature and personal information on a lease agreement.

The serial number of the TV is included in the paperwork of the agreement, but rarely are customers required to prove that the item actually exists. This failure to verify collateral is another aspect that distinguishes sale leaseback transactions from another type of available credit in Texas, a common pawn loan. While sale leaseback operators argue they do not want to burden their customers with having to carry their heavy television sets into their stores, sensible business practice would seem to require that some proof be given that the item exists. This very well may be a personal business decision and outside the boundaries of public policy decisions, but it is also somewhat suggestive of the true nature of the transaction that is taking place.

Other Varieties of Payday Loans: Cash Back Ads and Catalog Sales

Other varieties of payday loans involve the use of catalog sales and newsletter advertising. In a newsletter advertising transaction the distinguishing factor is the requirement that the customer take out an advertisement in a newsletter produced by the business. This advertisement would likely be personal in nature and relatively short, often a few words or less. The transaction still involves the writing of multiple checks, one in exchange for cash and the other to purchase the ad. The businesses claim the transaction is strictly an advertisement and should therefore not be considered a loan. Similarly, catalog sale transactions involve the use of catalog gift items in addition to the checks and cash of a typical payday loan. In the catalog sale variety, a customer presents a check and receives cash back and a gift certificate good towards the purchase of gift items available through a catalog. Similar to payday loans, in order to get $100 cash back from the business a customer must present a check for $130, the difference ($30) in this instance being applied to the amount on the gift certificate. Also similar is the option to purchase additional advertisements and gift certificates rather than paying back the advanced cash, thus extending by an additional two weeks the time before the original check will be deposited.

Interim Action

The Committee met in a public hearing on April 4, 2000, to address the current payday lending and sale leaseback situation in the State of Texas. The committee heard testimony from proponents, opponents and state regulators regarding the current practice of both payday lending and sale leasebacks in Texas and across the United States. Possible authorization of these products either by regulatory means was suggested by some, while others offered that the current legal structure was adequate and that the focus should be on enforcement of current laws rather than the passage of new ones.

Additionally, the Finance Commission of Texas adopted Rule 7 TAC §1.605 in June, 2000, authorizing certain small consumer loan companies to hold a check as collateral for a loan. In cases heard involving payday loan companies, the Attorney General's Office has focused on usury limits and operators making illegal loans while claiming the transactions are something other than loans. The Finance Commission rules are an effort to both clarify the legal option for making these types of loans as well as enhance enforcement actions allowing more aggressive pursuit of illegal lenders.

Federal Reserve Board, Regulation Z

On March 24, 2000, the Federal Reserve Board amended the commentary to Regulation Z ("Reg. Z"), which requires a lender to make certain disclosures to a customer regarding the cost of credit (including finance charges, the amount financed and the annual percentage rate), to include payday loans. The amended commentary clarified that a payday loan, or a cash advance made to a consumer in exchange for the consumer's personal check, is in fact an extension of credit and is subject to the disclosure requirements established in Reg. Z.[14] The primary significance of this clarification extends to several current cases where operators are claiming that the charges made for these transactions are “fees” for services rather than interest on loans. The Federal Reserve Board clarification establishes these types of transactions as loans.

LITIGATION

Payday Lending Cases

Since the conclusion of the 76th Legislature, the Texas Office of the Attorney General has been involved in several legal proceedings involving payday lenders. On December 17, 1999, Texas Attorney General John Cornyn announced the filing of a permanent injunction and a settlement of $1 million with Cash Today. The original suit filed against Cash Today alleged the company was engaged in unauthorized lending, unfair debt collection practices and was liable for usury, charging $33 per $100 loaned for a two week loan period amounting to an annual percentage rate ("APR") of 860% interest. Cash Today had required its customers to sign an agreement not to file bankruptcy, violating a customer right protected by both state and federal law. Cash Today further required the customer to agree not to list Cash Today as a creditor if they did, in fact, file for bankruptcy, essentially forcing the customer to perjure themselves.[15]

In testimony before the Committee, David Mattax of the Texas Attorney General's Office specified that Cash Today was conducting cash back advertising. Cash Today was charging its customers for placing an advertisement in a publication of one of its affiliates and claiming the money charged was an advertising fee rather than interest. In their investigations for the case, the Attorney General's Office discovered that many customers either did not know about the ads, or knew the advertisements were meaningless. In some instances, the customer did not place an advertisement and it was discovered that staff members of Cash Today actually placed the ads themselves.

In determining that these transactions were actually loans, the Attorney General's Office first determined the value of the advertisements sold. Since, as stated above, oftentimes the customers either did not know about the ads or knew the ads were meaningless, the advertisement was determined to be without value. Thus, since the "fee" charged could not have been charged for a valueless item, it was concluded that the charge was actually interest, and therefore the transactions were usurious loans. The concept of value of the item was a vital element in the determination in this case and is useful to remember when considering other transactions of this sort.

The Attorney General has filed additional lawsuits against other payday lending operations in Texas. Lawsuits against EZ Cash and Quick Cash, both located in the Rio Grande Valley, were originally filed on May 12, 1999 in Hidalgo County District Court, alleging both companies of making usurious loans and violating the Deceptive Trade Practices Act, the Texas Debt Collection Act, and the Texas Credit Code.[16] The Attorney General later secured temporary injunctions against the companies which will enjoin the defendants from making consumer loans or engaging in the business of deferred presentment transactions.[17] The lawsuits are currently pending before the Hidalgo County District Court and are set for trial on October 9, 2000.

Another case recently filed in Rusk County District Court alleges Advance Check Cashing of charging usurious rates on small consumer loans. In the suit, Advance Check Cashing allegedly charged a $28 "fee" on a $100 two week loan. According to the suit, no goods or services are provided for the $28 charge. Advance Check Cashing operates two locations in Texas, one in Henderson and one in Jacksonville, and is not licensed by the Office of Consumer Credit Commissioner. The suit asks for a temporary injunction against Advance Check Cashing.

Sale Leaseback Cases

In testimony before the Committee on April 6, 2000, Mr. John Dwyer, a lawyer from San Antonio with extensive experience in sale leaseback litigation, described a lawsuit from 1991 involving Personal Rental, a Houston based sale leaseback company. The State of Texas vs. Personal Rental was never published and as a result there is no official record of the decision, but in recounting the case Mr. Dwyer explained several important determinations that resulted from the proceeding. In the case, Personal Rental was being sued by the State of Texas for making usurious loans. Personal Rental argued that the transactions were not violations of the usury law because in their very nature they were not loans, due primarily to the fact that there was no absolute obligation to repay. The company would accept the return of the personal property involved in the transaction if the customer was unable to pay their biweekly rental fee. The jury in the case agreed that the transactions were not loans and Personal Rental was able to continue practicing as a sale leaseback company.

In his testimony, Mr. Dwyer also pointed out various Texas laws that would pertain to a case against a sale leaseback company that may have abused a customer. These laws were suggested by Mr. Dwyer as supposed consumer protections and in support of the idea that Texas does not need additional laws to regulate these types of transactions. The suggestion was made that there are already laws in Texas that apply to these types of transactions and additional laws are unnecessary. Mr. Dwyer summarized that the laws currently in place provide adequate legal framework to allow an abused consumer, alongside qualified legal counsel, to seek legal remedy in a court of law.

Mr. Dwyer identified that the Deceptive Trade Practices Act (Business and Commerce Code, Chapter 17) governs transactions that are false, misleading and deceptive and allows for an award of trebled damages (trebled damages = actual damages X 3). The determining factor in whether trebled damages or actual damages is awarded depends on whether someone misrepresented the transaction knowingly or not. If they were simply negligent (they didn't knowingly misrepresent), the award is limited to actual damages. If they are found to have knowingly misrepresented the information to the customer they may be liable for trebled damages.

Mr. Dwyer also mentioned usury penalties (Finance Code §349.002), stating that the usury laws in Texas allow for the forfeiture of principal as well as trebled damages. Interestingly, a sale leaseback transaction that has been executed properly contains no absolute obligation to repay and therefore would not fall under the usury provision. For a transaction to be considered usurious, it would have to be a loan as defined in the Texas Finance Code, §301.002(10) as "an advance of money that is made to or on behalf of an obligor, the principal amount of which the obligor has an obligation to pay the creditor." Since a properly executed sale leaseback transaction is not considered a loan by Mr.

Dwyer's arguments, it is unclear to the Committee how usury penalties would apply to a sale leaseback transaction lawsuit.

Finally, Mr. Dwyer identified the Debt Collection Act (Texas Finance Code, Chapter 392), which allow for attorney's fees and for punitive damages if a criminal act is involved. There is no limit to punitive damages in the Civil Practices and Remedies Code.

One practical problem that consumers who feel they may have been abused in a transaction of this type and would like to seek legal remedy is the fact that due to the small dollar amount of these transactions (typically in the $50 to $600 range), legal counsel willing to accept their case may prove difficult to find. Due to the practical reality of the expense involved in running a legal office, attorneys must weigh whether it makes economic sense to take a case of this amount. The customers, having already been in a financial situation difficult enough to force them to conduct a transaction of this type, are often destitute to begin with and the lawyer must rely on winning the case to be paid. Further consideration to whether they will be able to collect the award after a company has been proven deceptive might also dissuade an attorney from accepting the case. While it may not seem like a small amount of money to the abused consumer, the fact of the matter is that it is difficult for a lawyer to make much money on such a case.

CURRENTLY IN TEXAS

Finance Commission Rule 7 TAC §1.605

At the June 16, 2000, meeting of the Finance Commission of Texas, the Commission approved Rule 7 TAC §1.605 allowing a payday loan transactions to occur legally in the state of Texas according to legal parameters already existing in Subchapter F, Chapter 342 of the Finance Code. Subchapter F lenders, commonly known as "signature loan companies," currently lend amounts of up to $480 in Texas according to legal rates authorized in Texas Finance Code, §342.251-§342-258. The new rule allows these lenders to hold a check as collateral for a loan, essentially allowing payday loans in Texas. However, an important difference between the loans authorized by 7 TAC §1.605 and typical payday loans is the amount of interest charges. Texas lenders will be allowed to charge $11.87 on a $100 two week loan. Furthermore, in the event the borrower wishes to extend the loan another two weeks, Texas lenders will only be allowed to charge the difference in interest between a two week loan and a four week loan in the same dollar amount. For an initial loan of $100, this would amount to an allowable additional charge of $1.86 to extend the loan another two weeks. This is due to the rule stating that an acquisition charge (which compromises $10 of the initial $11.87 charge) is only allowed to be charged once per month.

The rule requires additional consumer protections intended to discourage the abuses normally associated with payday loans. The minimum loan period is seven days. The check presented at the time of the loan is required to be made to the name of the lending company and must be dated the day the loan is made. A transaction document must be signed by both parties and must include both pertinent information to the transaction (name of lender, date, amount of check, total amount charged expressed in dollar amount and as an APR, and the earliest date the check may be deposited) as well as information how the borrower may contact the Office of Consumer Credit Commissioner. Furthermore, it must contain the following notice:

> *This cash advance is not intended to meet long-term financial needs. This loan should only be used to meet immediate short-term cash needs. Renewing the loan rather than paying the debt in full when due will require the payment of additional charges.*

Additionally, the rules expressly allow the borrower to prepay the loan and require the lender to refund any unearned finance charges at prepayment. The lender is restricted from depositing a borrower's check that has been held for over 31 days. This is intended to prevent collection abuses and to discourage lenders from threatening a borrower by holding a check over an extended period of time. The lender is required to post fees on the premises. In regards to renewals, the lender may only renew a loan if it is converted to a declining balance installment note, requiring the borrower to pay down the principal with each installment and make progress toward repaying the initial $100. In lieu of a renewal, the lender may extend the maturity date, or roll the loan over. Regardless of the number of rollovers a lender performs, there is still a limit on the amount of authorized charges, which must not exceed the amount that would have been charged initially for the extended period. For example, if a borrower agrees to extend their two week loan for another two weeks, the lender may only charge the difference between what the initial loan amount would have cost for a four week term. There is no limit on the number of times a loan may be rolled over, but the ten dollar acquisition charge may only be collected once per month. The lender may not simply double the total charge just because the loan term has been doubled. Additionally, this restriction in effect limits the number of loans a lender make to the same customer at one time. The same limit on total charges applies regardless of whether or not the lender takes out another loan with the same lender. Two separate $100 loans for two weeks would be limited by legal allowable charges on a $200 loan for the same amount of time. These limitations are intended to dissuade both the practice of "rollovers" and "multiple" loans frequently found in other states that have authorized these types of loans.

Finally, debt collection must be done legally according to the Texas Debt Collection Practices Act, Texas Finance Code, §392.001 *et seq*, and before making the loan, the lender must make a good faith estimate of the borrower's ability to repay. In addition to the Texas Constitution's Bill of Rights prohibition against imprisonment for debt[18], Subchapter D of the Debt Collection Practices Act prohibits certain debt collection methods. The prohibitions include "threatening that the debtor will be arrested for nonpayment of a consumer debt without proper court proceedings,"[19] and "threatening to file a charge, complaint, or criminal action against a debtor when the debtor has not violated a criminal law."[20]

Furthermore, there is an understanding between the parties that funds are not currently available to pay the debt or the customer would not have sought the loan in the first place. Since both lender and borrower know at the time the check is written that there is not sufficient cash in the account to cover the check it cannot be fraudulent. Only if one party does not know there is insufficient funds is it considered fraud. Writing a check as collateral for a loan is different from writing a bad check at the grocery store where the store owner assumes there is enough money for the check to clear.[21] While there may be instances where criminal prosecution is appropriate when a customer intends to defraud the lender by misrepresenting themselves, forging a check, or writing a check on a closed account for example, most payday loans would require no more collection action than normally allowed by law.

Payday Loan Industry in Texas

Currently, there are three ways that payday loans are being made in Texas. First, a lender may make a loan and charge no more than ten percent interest per year as authorized by Article 16, Section 11 in the Texas Constitution. No licensing is required as long as the lender abides by the ten percent limit on interest. Next, as described above, a lender that is licensed under Subchapter F, Chapter 342 of the Texas Finance Code may accept a check as collateral as authorized by Rule 7 TAC 1.605. Lenders must abide by the requirements established by 7 TAC 1.605 and are allowed to charge interest as authorized by Texas Finance Code §342.251-258. Lastly, a payday loan may be made in excess of the usury limits established by Texas Law under a practice known as "exportation of rates." In this practice, a national bank, acting through a local agent located in Texas, may offer payday loans charging interest rates in excess of those allowed by Texas law. The local agent serves to negotiate or arrange the loan on the out-of-state bank's behalf, but the loan is funded through the outside entity. Often the customer is given a plastic debit card once the loan is funded and may obtain cash through an ATM machine. While the lenders are required to comply with all state requirements, they may exceed state limits on APR[22]. In accordance with 7 TAC 1.605(b), anyone acting as an agent for an authorized lender in a payday loan transaction must be licensed with the Office of Consumer Credit Commissioner.

While no official numbers exist to suggest how many payday loans are currently being made in the State of Texas, a recent study sponsored by the Finance Commission on consumer lending provides an estimate on how many people currently have this type of loan product. The study found that 0.7% of respondents (the survey was limited to heads of household only) currently held a payday loan.[23] By using the Texas A&M University's Real Estate Center's estimate of 7.3 million households in Texas,[24] an estimate can be made that there are 51,100 payday loan customers currently in Texas. If one considers the fact that many of these customers are likely to have multiple loans, the actual number of loans currently on the street is considerably higher. However, based purely on the estimate above, an estimate of the Texas industry can be determined using the average loan amount from 1999 State of Colorado payday loan data. If a similar average loan average is assumed of $124.63 (not including the average finance charge of $22.56)[25], this estimates the Texas industry at currently over $6.3 million. While Finance Commission Rule 7 TAC §1.605 did indeed authorize "signature loan" companies to legally offer payday loan type products, this was only as of July 9, 2000. It is reasonable to assume that the majority of these loans were made prior to this date, most likely by illegal lenders at usurious rates.

An recent industry overview estimates that 17,000 payday lender locations will exist nationwide by the end of calendar year 2000. These lenders will make approximately $4.5 billion in loans in 2000, collecting $750 million in fees. Average customer data found a greater household income from $25,000-$45,000 per year, with the median income being $34,341 (median income in the United States is $38,724).

Sale Leaseback Industry in Texas

According to Consumer Credit Commissioner Leslie Pettijohn, companies across Texas are currently flocking to sale leaseback operations.[26] Given the attention directed at payday loans with the Attorney General's settlement with Cash Today and the threat of future litigation and possible regulation, the payday loan industry perceives sale leaseback operations as a "safe haven." Without regulation, it is impossible to determine the exact number of sale leaseback operators currently in Texas. However, a recently mandated study by the Texas Finance Commission on consumer lending in Texas found that 0.4% of respondents (respondents were required to be heads of household to qualify for survey results) were currently involved in a sale leaseback arrangement.[27] Again, by using the Texas A&M University's Real Estate Center's estimate of 7.3 million households in Texas,[28] this equates to approximately 29,600 heads of household currently involved in a sale leaseback contract. Using data from the Finance Commission Report on sale leaseback amounts ranging from $100-200, this translates to a present day industry of approximately $3 to $6 million. While this number is relatively small compared to other small loan products legally available in Texas, it does represent a significant industry currently operating in the State.

REGULATION

Payday Loan Regulation Across the United States

Currently across the United States, twenty-three states (and the District of Columbia) have what amounts to a "payday lender act," effectively legalizing the practice of payday lending. An additional nineteen states, including Texas, have usury rates that apply to small loans and consequently payday lenders. The remaining eight states have no small loan rate or usury limit.[29]

Of states that do authorize payday lending, Colorado is one of the few that collects data on the lenders. The Administrator of the Uniform Consumer Credit Code found that Colorado had 206 deferred deposit lenders reporting data as of December 31, 1999. These lenders made 596,814 deferred deposit loans totaling $86,392,248 in 1999. Of these, 48,802 were outstanding as of December 31, 1999 for a total outstanding debt of $5,949,193. Assuming comparable loan totals for Texas, this would fit into the lending market above pawnshops, which are estimated by the OCCC to have loaned approximately $60 million in 1999[30], and below Subchapter F lenders, who reported loan totals of $353,929,666 for 1999[31]. The Colorado figures also report an average loan amount of $124.63 with an average finance charge of $22.56. The average APR in Colorado was 496.82% with an average loan term of 16.7 days. Interestingly, 52% of lenders reported that they do make multiple loans, while of the 48% that said they don't make multiples, 120,078 loans were reported to have been rolled over. 20.12% of loans were reported to have been refinanced as a percentage of total loans made.[32]

In considering possible regulation of payday lenders in Texas, the Community Financial Services Association of America ("CFSA") proposed the following "Best Practices" by which all payday lenders should abide by:

- Full disclosure: A member will comply with all full disclosure requirements;
- Compliance: A member will not charge fees in excess of legal limits;
- Truthful advertising: A member will not advertise a payday loan in a misleading or deceptive way;
- Encourage consumer responsibility: A member will inform customers that payday loans are intended for short term cash flow needs not designed for longer term financial solutions;
- Limit/prohibit roll-overs: Where allowed by law, a member will allow roll-overs but will not allow customers to roll over a transaction more than four times;;
- Right to rescind: A member will give its customers the right to rescind, at no cost, on or before the close of the following business day;
- Appropriate collection practices: A member must use professional, fair and lawful collection practices as contained in the Fair Debt Collection Practices Act;
- No criminal action: A member may not threaten or pursue criminal prosecution if a customer's check is returned due to insufficient funds;
- Self-policing of the industry: A member will participate in the self-policing of the

industry and is required to report any violations of law to CFSA; and,

- Support balanced legislation: A member will work with state legislators and regulators to support responsible payday loan regulation.

While these best practices are from an industry point of view, they do address many important concerns in the payday loan industry and should be considered in the event payday loan legislation appears during the next legislative session.

Sale Leaseback Regulation

Proponents point out that most people believe that sale leaseback transactions are unregulated. While Texas has no law that specifically regulates sale leaseback transactions, proponents note several federal regulations and resulting state statutes that govern leases. According to proponents, Uniform Commerce Code Article 2A (Texas Business & Commerce Code Chapter 2A) regulates leases and therefore sale leasebacks. While technically this is true if one agrees that a sale leaseback is indeed a lease, these provisions are generally intended for commercial lease agreements rather than consumer leases. Proponents also point to the Truth in Leasing Disclosures[33] (Fed. Reg. M) that all lease companies must comply with. These regulations specifically define a "consumer lease" as "a lease... for a period exceeding four months."[34] Thus, if a particular sale leaseback transaction was not made with a contract for a period of at least four months and a day, Regulation M disclosures would technically not apply.

An Opinion Letter recently released by the Attorney General of the State of Louisiana addresses the question of whether a sale leaseback company is subject to licensure and regulation by the Office of Financial Institutions of Louisiana. Specifically, the question addressed "a company engaged in the business of buying and leasing back movable property to a customer for a period of fifteen days."[35] The letter states, "while the documents are drawn to say that this is intended to be a lease, a more careful review of the substance of the documents makes them appear far more akin to a consumer credit transaction or small loan." The letter concludes that the company would indeed be subject to licensure by the Office of Financial Institutions.

RECOMMENDATIONS

The House Committee on Financial Institutions recommends the following in response to the Interim Charge relating to Payday Lending and Sale Leaseback transactions:

1. The Committee recommends that small consumer loans commonly known as payday loans be subject to licensure and regulation in the State of Texas, either by codification of Rule 7 TAC §1.605 adopted by the Texas Finance Commission, or by passage of separate legislation authorizing an additional rate structure for loans obtained through the practice of using a check as collateral.

2. The Committee makes no recommendation on the best course of action regarding sale leaseback transactions.

FINANCIAL SERVICES MODERNIZATION ACT

BACKGROUND

In November 1999, Congress passed into law the Gramm-Leach-Bliley Act ("GLBA" or "the Act"), otherwise known as the Financial Services Modernization Act. Since 1934, federal law had prohibited affiliations between commercial banks and securities firms. Likewise, federal law had separated banks and insurance companies since 1955. Under Gramm-Leach-Bliley, banks, insurance companies, and securities firms may engage in common ownership through affiliations or holding company structures.

GLBA eliminates pre-existing federal and state laws that prevent common ownership of entities that engage in insurance, securities, and banking activities. Additionally, GLBA pre-empts state agent licensing laws that prohibit or interfere with a depository institution's ability to sell insurance. The Act also directs the states to develop uniform insurance agent licensing laws or face losing licensing authority to a national self-regulatory body known as the National Association of Registered Agents and Brokers ("NARAB"). Finally, GLBA establishes the concept of "functional regulation," whereby the combined activities of these companies will be regulated by the appropriate regulatory agency. Functional regulation also outlines the process by which conflicts among regulators will be resolved and attempts to insure against overburdening the institutions with duplicative regulation, both by federal and state regulators.

The Texas Department of Banking ("DOB"), in consultation with the Texas Department of Insurance ("TDI"), the Texas Savings and Loan Department ("TSLD") and the State Securities Board ("SSB"), released a report entitled, "Financial Services Modernization for Texas, Impact of the Gramm-Leach-Bliley Act of 1999" ("Agency Report") on August 15, 2000. The joint study analyzes the impact that GLBA will have on Texas and suggests an appropriate course of action for the Texas Legislature to consider in aligning our State laws with these newly created federal regulations. For a more detailed explanation and analysis, please consult the actual Agency Report, which may be obtained through the Texas Department of Banking or online at www.banking.state.tx.us. The following section is a summary of the recommendations of this report.

GLBA AND TEXAS LAW

State Law Pre-empted by GLBA

There are no laws in the State of Texas that would prevent or restrict banks, insurance companies or security firms from affiliating among one another as allowed by GLBA. The Act specifically pre-empts any state law that restricts the allowable affiliations under GLBA and any state law that restricts financial activities as permitted by GLBA. GLBA pre-emptions apply to “depository institutions,” “insurers,” and their “affiliates.”

> **Terms as defined by GLBA**
>
> A “depository institution” is a bank or savings institution, or a foreign bank with U.S. operations (includes a national bank, federal savings bank, federal savings association, state savings bank, state savings association, state bank organized in the District of Columbia, state commercial bank, banking association, trust company, savings bank, savings association, industrial bank, another bank accepting deposits, and a foreign bank that maintains a branch, agency, or commercial lending company in the U.S.).
>
> An “insurer” is “any person engaged in the business of insurance” (includes insurance companies, agents, adjusters, and risk managers).
>
> An “affiliate” is any person or entity controlling, controlled by, or under common control with a company.

State law in Texas is presently consistent with GLBA to the extent that it does not directly prohibit the types of affiliations contemplated by the Act. However, GLBA may pre-empt or impair certain Insurance Code provisions, specifically with regard to agent licensing and the allowable time for TDI to review proposed affiliations.

Sufficient flexibility exists in the Finance Code to allow for this change in law relating to the regulation of depository institutions, as established by the Texas Banking Act of 1995 (74th Texas Legislature). However, there are some inconsistencies between the “ATM Fee Reform Act of 1999" enacted by GLBA and current ATM fee disclosure requirements in Texas law. In addition, state law regarding trust companies that are not in the business of receiving deposits is inconsistent with the Act.

CHANGES TO CONFORM TEXAS LAW WITH GLBA

As previously noted, Texas state agencies with regulatory authority over financial institutions as defined by GLBA issued a report on August 15, 2000, to address necessary changes to Texas law to fully conform with GLBA. What follows is a brief summary of the recommendations made in this report. While this summary will highlight the essential changes needed, a more in-depth explanation can be found in the Agency Report.

Insurance Agent Licensing

Under GLBA, if a majority of the states and U.S. territories (29) fail either to adopt uniform agent licensing requirements or to institute reciprocal agent licensing before November 12, 2002, non-resident agent licensing authority will be stripped from the states and vested in a new self-regulatory organization known as the National Association of Registered Agents and Brokers ("NARAB").[36] In the Agency Report, TDI strongly expressed the importance of maintaining state control of the agent licensing function: "The number of disciplinary actions taken by TDI and other insurance regulators against agents every year underscores the public policy concerns that would arise under NARAB."

Texas law does not currently provide for uniform or reciprocal agent licensing consistent with the requirements of GLBA to circumvent the establishment of NARAB. In 1999, the 76th Legislature passed S.B. 956 to provide for reciprocal licensing between Texas and other states. The bill also contained many uniform provisions of a model agent licensing law subsequently adopted by the National Association of Insurance Commissioners ("NAIC"). However, the Governor vetoed S.B. 956 because of an unrelated amendment tacked on late in the process. The 77th Legislature, therefore, should pass a revised version of S.B. 956 that fully implements GLBA.

TDI has been working with other insurance regulators through the NAIC to design effective uniform licensing standards, which are reflected in the NAIC's Producer Licensing Model Act. TDI plans to present a legislative proposal to the 77th Texas Legislature that incorporates these standards.[37]

Affiliation Review Period

TDI has identified Insurance Code Article 21.49-1 §4(d)(1) as being pre-empted by GLBA to the extent that it gives the Insurance Commissioner a longer period to review proposed affiliations between depository institutions and insurers than permitted under GLBA. Therefore, Insurance Code Article 21.49-1 §4(d)(1) should be amended to shorten the review time to 60 days in conformity with GLBA.

ATM Fee Disclosure Reform

GLBA enacted the "ATM Fee Reform Act of 1999," which amends the Electronic Fund Act ("EFA")[38] to require ATMs that charge a fee to a customer of another financial institution to notify the customer of the fee. Disclosure must appear on the machine itself and on the screen at a point when the customer can cancel the transaction and avoid paying the fee. Financial Institutions are also required to explain to its customers that ATMs of other financial institutions may charge a fee when they use their ATM card. Aside from certain grandfather exceptions, ATMs that do not provide these disclosures are not allowed to charge a fee.

Texas law does not require fee disclosure to ATM customers to the extent established by GLBA. While state law that goes further than the EFA is allowable and will not be pre-empted, Texas law does not meet the requirements and will therefore be pre-empted unless amendments are made to meet the EFA requirements. Texas Finance Code §59.202 should therefore be amended to conform to the ATM Fee Reform Act of 1999.

Information Sharing Among Regulatory Agencies

The Texas Finance Code, Texas Insurance Code and Texas Securities Act should be amended to effectively protect the confidentiality of information shared among regulatory agencies. Each provision should:

- Specifically disclaim and prevent waiver of any privilege or loss of confidentiality of information;
- Preserve each Agency's discretion regarding the appropriate use of its confidential regulatory information; and,
- Authorize the use of interagency agreements for the purpose of specifying procedures regarding the use and handling of shared information.

Confidentiality of Insurance Company Data

The Agencies are concerned about the confidentiality of insurance company data. Concerns have been raised that confidential information when shared with another regulator for functional regulation may be "deemed" public. In that case, confidential information may be available to the public pursuant to the Public Information Act. Therefore, measures should be taken to protect the confidentiality of insurance company data to assure that confidential information does not become public under the Public Information Act when shared with another regulatory entity.

Enhance Regulatory Adaptability to Future Developments

The DOB, TSLD, and SSB have adequate flexibility and adaptability as allowed by law to adapt regulatory practices to respond to future developments in the marketplace. Each of these agencies can adapt rules to allow their regulated entities to compete in an ever-changing market to the extent consistent with safety and soundness standards and applicable federal law. However, TDI has less flexibility because of limitations in the Insurance Code.

The Legislature should consider the possibility of amending Insurance Code §36 to allow TDI to adapt its regulatory practices to promptly respond to market changes and allow competition by financial institutions. Because much of an agency's ability to achieve such a prompt response derives from its ability to adopt rules, flexible rulemaking authority is needed for TDI (similar to the rulemaking authority allowed for DOB, TSLD, and SSB). Such across the board rulemaking authority for all affected state agencies will allow clear definition and communication for the purposes of public policy regarding necessary restrictions and limits on business functions.

Enhancing State Banking Activities

State law should be amended as follows to enhance state banking activities and further conform Texas statutes with GLBA. State law pertaining to state banks, state savings banks and holding companies, state trust companies, and bank holding companies should be amended to allow these entities to fully engage in new activities as allowed and anticipated by GLBA. All newly allowed activities will be subject to functional regulation by the appropriate governmental agency. The recommended amendments as they pertain to specific banking entities are as follows:

- **Amendments to State Law Pertaining to State Banks**

  State law pertaining to state banks should be amended to allow these companies to engage in new activities subject to full functional regulation. Finance Code Title 3, Subtitle A should be amended to clarify the authority of state banks to conduct certain activities to the extent consistent with safety and soundness, functional regulation and consumer protection principles. Specifically, Finance Code §32.001 should be amended to (a) characterize a state bank as a corporation with banking powers to increase future flexibility, and (b) authorize a state bank to (i) act as a financial agent, and (ii) engage in certain nonbanking activities. The possibility of adding a new Finance Code §32.011 should be considered to grant the Banking Commissioner the authority needed to make determinations based on similar considerations as contained in federal law as allowed by the previously mentioned amendment to Finance Code §32.001. Finally, Finance Code Chapter 34, Subchapter B should be amended to modernize treatment of securities eligible for bank investment and permissible activities for subsidiaries as established by federal law.

- **Amendments to State Law Pertaining to State Savings Banks and Holding Companies**

  State law should also be amended to allow state savings banks and holding companies equal flexibility to engage in these newly allowed activities. To do so, Finance Code, Title 3, Subtitle C should be amended to preserve the authority of a grandfathered "unitary thrift" operating in Texas. The possibility of amending Finance Code §93.001(c) should be considered to create authority for the Savings and Loan Commissioner to make such determinations. Also, Finance Code Chapter 94 should be made to conform with amendments to Chapter 93 in regards to permissible investments for a state savings bank. Lastly, Finance Code Chapter 97 should be amended to explicitly preserve the powers of unitary thrifts, confirm the powers of all other state savings bank holding companies, confirm the ability of a bank holding which controls a state savings bank to become a financial holding company, add new definitions to incorporate the terminology created by GLBA, and authorize information sharing among state and federal regulators as a means of promoting efficient regulatory activity.

- **Amendments to State Law Pertaining to State Trust Companies**

State law should similarly be amended to enhance and preserve the state trust company charter and allow these entities to remain competitive by permitting state trust companies to engage in certain financial activities in Finance Code Title 3, Subtitle F. Specifically, Finance Code §182.001 (and Texas Civil Code Statutes Article 342a-3.001 due to pending codification) should be amended to allow state trust companies to both act as a financial agent and engage in activities that are financial in nature or that are incidental or complementary to a financial activity. These activities must be consistent with a state trust company's existing fiduciary duties. Finance Code §182.001 should also be amended to add a new subsection (g) characterizing a trust company as a corporation for purposes of other state law. Finance Code Chapter 182, Subchapter A, should possibly be amended to add a new §182.020 to allow the Banking Commissioner to authorize new activities as to whether or not they are financial in nature or incidental or complimentary to a financial activity, based on similar considerations in federal law.

- **Amendments to State Law Pertaining to Bank Holding Companies**

State law as it pertains to a bank holding company ("BHC") should be amended in Finance Code, Title 3, Subtitle G, to facilitate the ability of a BHC to become a financial holding company ("FHC") and thus engage in expanded non-banking activities as allowed under GLBA. Specifically, Finance Code §201.002 should be amended to incorporate definitions related to FHCs and financial activities. Also, Finance Code Chapter 202, regarding BHC regulation, should be amended to explicitly affirm the ability of a BHC to elect to become a FHC, to authorize information sharing among state and federal regulators to promote efficient regulation, and to possibly create authority to allow the Banking Commissioner to determine activities that are financial in nature, or incidental or complimentary to a financial activity, based on similar considerations found in federal law.

RECOMMENDATIONS

The House Committee on Financial Institutions, in coordination with the House Committee on Insurance, recommends the following in response to the Interim Charge relating to the Gramm-Leach-Bliley Financial Services Modernization Act of 1999:

1. S.B. 956, 76th Texas Legislature, vetoed on unrelated grounds, should be revised and reintroduced to fully implement uniform and/or reciprocal agent licensing between Texas and other states.

2. Insurance Code Art. 21.49-1 §4(d)(1) should be amended to shorten to 60 days the period for TDI to review proposed affiliations between depository institutions and insurers.

3. Texas Finance Code §59.202 should be amended to conform to the ATM Fee Reform Act of 1999.

4. The Texas Finance Code, Texas Insurance Code and Texas Securities Act should be amended to effectively protect the confidentiality of information shared among regulatory agencies.

5. Protect the confidentiality of insurance company data to assure confidential information does not become public under the Open Records Act when shared with another regulatory entity.

6. Finance Code Title 3, Subtitle A should be amended to clarify the authority of state banks to conduct certain activities to the extent consistent with safety and soundness, functional regulation and consumer protection principles.

7. Insurance Code §36 should be amended to allow the Texas Department of Insurance to adapt its regulatory practices to promptly respond to market changes and allow competition by financial institutions.

8. Finance Code Title 3, Subtitle A should be amended to clarify the authority of state banks to conduct certain activities to the extent consistent with safety and soundness, functional regulation and consumer protection principles.

9. Finance Code, Title 3, Subtitle C should be amended to preserve the authority of a grandfathered “unitary thrift” operating in Texas.

10. Finance Code Title 3, Subtitle F, should be amended to enhance and preserve the state trust company charter and allow these entities to remain competitive by permitting state

trust companies to engage in certain financial activities.

11. Finance Code, Title 3, Subtitle G, should be amended to facilitate the ability of a bank holding company to become a financial holding company and thus engage in expanded non-banking activities as allowed under GLBA.

HOME EQUITY LENDING

BACKGROUND

In the 75th Legislative Session, the Texas Legislature passed historic legislation allowing for home equity loans in Texas. For the first time in the history of the State of Texas, the Texas Constitution was amended to allow homeowners to use the equity in their homes as collateral in a loan. Historically, the homestead protections in the Texas Constitution have protected Texas homeowners from losing their homes for all but a few specific reasons. Prior to the 75th Session, the Texas Constitution, Article 16, Section 50 protected a homestead from forced sale except to repay debts for: (1) the purchase money owed on the homestead; (2) any taxes owed on the homestead; (3) any money owed in part due by either party in a divorce; (4) any money owed on a refinance of the lien, including federal tax money owed, and (5) any money owed due to a home improvement loan taken out against the home. With the passage and subsequent voter approval of House Joint Resolution 31 by L. P. "Pete" Patterson in the 75th Legislature, the Constitution was amended to effectively allow homeowners to obtain home equity loans by borrowing money against the equity in their homes.

The 75th Legislature gave serious consideration to the best approach to allow this new product in the State. The Legislature wanted to ensure that home equity lending be conducted in a safe and sound manner. Through the arduous work of several key lawmakers and numerous interested parties, an approach was crafted to allow this type of lending to go forward while ensuring the protection of the consumer and their homes. Considerable consumer protections were built into the law to ensure the safety and soundness of the home equity lending market, to assure the protection of consumers engaging in home equity loans, and to protect the sanctity of the homestead. These provisions were included in the Constitution to ensure that these protection measures would remain a vital part of the home equity market in Texas. Interestingly, companion enabling legislation was not passed, creating a situation where any future amendments to the home equity law must be done by passage of additional Constitutional amendments, requiring both the approval of two-thirds of both the House and Senate membership as well as voter approval by referendum. Voter approval is only required to be by simple majority.

The consumer protections included in the Constitution are considerable both in number and, at times, in length. Several important protections include:

- <u>Eighty percent loan-to-value ratio ("80% LTV")</u>: Limits the amount that may be loaned to eighty percent of the value of the home minus the amount still owed on the original mortgage.
- <u>Non-recourse loan:</u> Restricts the lenders from accessing the borrower's personal finances to repay the loan. In the event of default, the lenders must foreclose on the property.
- <u>Judicial foreclosure</u>: Requires the lenders to go through judicial foreclosure proceedings before foreclosing on the property.
- <u>Three percent fee cap:</u> Limits all fees charged in a home equity loan to three percent of the loan total. Common fees charged include appraisal fees, attorney fees, and certain

types of insurance. Initially there was a question as to whether homeowners insurance was included in the 3% fee cap, but Texas regulatory agencies opined that it is not included.[39]

- No lines of credit: Restricts home equity loans made in Texas are from being open ended "lines of credit" loans, which allow the borrower to access their equity in installments. The result of this restriction forces Texas consumers to take the entire amount of the loan at once.
- No prepayment penalty: Restricts a lender from charging a penalty fee in the event the loan is paid back ahead of time.
- No additional collateral: Restricts a lender from accepting any real or personal collateral other than the security interest in the homestead. The parties may agree, however, for the lender to acquire an interest in items incidental to the collateral.
- Agricultural exemption: Restricts, with the exception of dairy farms, homesteads used for agricultural purposes from being used for collateral for obtaining a home equity loan.
- Acceleration prohibited: Restricts a lender from accelerating an equity loan because of a decrease in the market value of a home or because a borrower defaults on another indebtedness except a debt secured by a prior valid encumbrance against the homestead.
- Only debt secured on house (except provided in Art. 50 Sec. 16 (a)1-5): There cannot be an additional lien on the homestead except as provided in the Constitution (as listed above) for allowable encumbrances against a homestead.

Helpful Mortgage Definitions

A "**mortgage lender**" is any person who makes a mortgage loan, a loan for personal, family, or household use secured by residential real property.

A "**mortgage broker**" is any person who assists in obtaining, attempts to obtain, or obtains a mortgage loan for a borrower from a mortgage lender in return for consideration or in anticipation of consideration.

A "**first lien mortgage loan**" is a first mortgage secured by residential real property. This mortgage lender generally has first priority rights of foreclosure in the event of default by the borrower.

A "**first lien home equity loan**," commonly called a "cash-out refinance" or "cash-out re-fi" is a first mortgage secured by the borrower's homestead where the borrower obtains cash for equity and refinances the existing mortgage, if any.

A "**second lien residential mortgage loan**" is a junior mortgage secured in whole or part by residential real property that is subject to a first lien or prior mortgage. This mortgage lender's rights of foreclosure stand behind the rights of the first lien or prior lien holder. These loans may either be home equity loans where the borrower receives cash or may be an obligation arising from another source such as home improvement.

A "**second lien home equity loan**" is a junior mortgage loan secured by the borrower's homestead where the borrower obtains cash for equity.

CURRENT HOME EQUITY LENDING MARKET IN TEXAS

Agency Reports

In an effort to assess the current home equity lending market in Texas, several state agencies have conducted studies of both lenders and consumers involved in the actual process. The Finance Commission of Texas released a final report entitled "Home Equity Lending in Texas" on December 17, 1999 which was conducted by Analytica, Inc in Houston Texas. The report included results from both a consumer and lender survey conducted in 1999. Additionally, the Office of Consumer Credit Commissioner compiled data from its licensees for home equity lending activity in Texas for 1998. A similar Department of Banking survey was conducted in December 1999 of state-chartered banks.

The Finance Commission Report

The Texas Finance commission contracted with Analytica, Inc. to conduct a survey of both consumers and lenders involved in home equity lending. The consumer survey was conducted by interviewing 1,201 Texas homeowners to "develop a better understanding of the perceptions and experience of Texas consumers regarding the newly-passed home equity lending legislation."[40] Of these homeowners surveyed, 301 respondents had some experience with the home equity lending process.

Of all 1,201 respondents to the consumer survey, 77.4% were aware of the changes to Texas law to allow home equity lending in the State, with 72.1% of the respondents having noticed advertising for home equity loans. Of all people surveyed, 52.2% were found to have a mortgage with the median value of these homes being $85,000. Interesting findings include:

- 41.5% of respondents felt the biggest disadvantage to taking a home equity loan was the possibility of losing your home;
- The respondents were split on how they felt on the changes on the law, with 37.4% feeling it was a good thing to allow this new borrowing source and an equal 37.4% feeling it was a bad thing because of the threat of losing their home;
- 13.8% had investigated the possibility of taking out a home equity loan; 10.4% had actually applied for a loan, and 8.9% had actually obtained a loan;
- The vast majority of loans were made in urban (13.2%) and suburban (8.4%) regions compared to rural (2%);
- The majority of the respondents used the loan proceeds to pay off other debt (66.7%) and for home improvement purposes(62.6%); and,
- Uses such as educational (12.3%) and medical expenses (9.2%), which were referred to quite regularly during negotiations of the home equity legislation as common uses of home equity loan proceeds, were significantly less that the two main uses.

One important survey area of particular importance to policy makers is the section that identifies areas of the home equity law that consumers would like to see changed. The 301 respondents who had investigated taking out a home equity loan were asked the question, "Is there anything about the home equity laws in Texas that you would like to see changed?" While 50.2% felt that the laws are fine and did not want to see anything changed, 18.3% could not think of anything or did not feel that they knew enough about it to comment.

Several changes were suggested by Texas consumers. Heading the list of suggestions:

- 5% of consumers would like to be able to borrow the full amount of their homes (a 100% LTV rather than 80%);
- 5% would like to see lower interest rates;
- 3.7% felt that the law should be done away with, that the law was not worth the risk and not worth the possibility of losing their home;
- 2.3% of respondents felt the 12 day waiting period should be shortened;
- 1.7% felt that consumers should not lose their homes and that the wording in the notice should be made clearer; and,
- 0.7% responded that the legislature should remove the one acre restriction, the one year wait to refinance and the agricultural restriction.

Alongside the consumer survey, Analytica Inc. performed a lender survey of 347 financial institutions doing business in Texas. Of the 75 institutions which were able to provide application numbers, a total of 277,706 home equity loan applications were received since January 1998, with 105,823 of these being approved (38.1%). Minimum interest rates ranged from 6.89% to 12.0% and averaged 8.47%. The range for maximum interest rates was 8.0% to 18.0% with a 10.83% average. The two primary factors reported by lenders affecting interest rates of applications were credit history, credit score of the borrower, and terms of the loan.

Again of particular importance to lawmakers is the section detailing changes the lenders would make in the home equity loan laws. The suggestions included:

- 29.7% of lenders surveyed wished to remove the one-acre limit for urban homestead loans (Fittingly, this limitation was changed to ten acres in the 76th Legislature and passed subsequent voter approval. Whether further expansion of this acreage limitation will be pursued is yet to be determined, but the ten acre limit seems to have addressed the majority of consumer and lender concerns over the acreage limit.);
- 26.4% surveyed would like to change the 3% fee cap;
- 19.8% of lenders surveyed would like to remove both the 12-day waiting period and the 80% loan to value ratio;
- 17.6% of those surveyed desired the removal of the severe penalty (loss of principal and interest) due to a mistake by the lender;
- 14.3% preferred to allow a line of credit;
- 13.2% said to use traditional foreclosure rules;
- 13.2% listed the removal of the agricultural exemption (all were rural lenders);

- 11% listed the removal of the non-recourse and no personal liability clause;
- 8.8% of institutions responded that they would change the regulations for more clarity;
- 7.7% would remove the twelve month wait for a new application;
- 5.5% requested to drop the "once home equity, always home equity" requirement restricting against rolling a second mortgage into a first mortgage to avoid the home equity loan provisions;
- 5.5% would remove the urban/rural distinction;
- 3.3% would remove the limitations on where closings may take place;
- 3.3% requested clarification on charges that fall within the 3% fee cap; and,
- 4.4% would not change any aspect of the home equity lending laws in Texas.

Office of Consumer Credit Commissioner Report

The Consumer Credit Commissioner's report, compiled from licensee reporting data from certain non-depository lenders for 1998, indicates a healthy home equity lending market in Texas. According to licensee data, an excess of $2 billion of home equity loans were made by regulated lenders during 1998, with only 2.75% of all consumer complaints for this time period being related to home equity lending. The average dollar amount for a second mortgage home equity loan in Texas in 1999 was $37,000. According to testimony given before the Committee, consumer complaints to the agency included questions on authorized fees, documentation errors, the one-acre limit, the one-year limitation on refinancing and debt consolidation loans. Areas that consumers expressed dissatisfaction over in particular are the one-acre limit (changed to ten acres in 1999), the one-year limit on refinancing (people are ready to refinance and get more equity out of their homes due to value of the home having risen) and debt consolidation loan problems regarding errors on creditors and amounts being paid off.

Regarding examination findings, the Office of Consumer Credit Commissioner completed 663 mortgage examinations from April, 1998 to April, 2000. Of the findings, the most frequent violation issues involved the acknowledgment of fair market value, the three percent fee limitation, the eighty percent loan to value limitation, unauthorized charges on secondary mortgage loans, improper interest accrual, the one-acre limitation and the twelve day notice. Testimony was given that while these errors were caught and remedied, at times the rules are unclear as to the intentions of the particular provision.

The Department of Banking Study

The Department of Banking (the "Department") conducted a survey of all 375 state-chartered banks in December of 1999 regarding home equity lending. Of those surveyed, 236, or 63%, responded. Of these, 141, or 60%, of state-chartered banks reported making home equity loans. The figures reported by the state-chartered banks that responded indicated approximately $200 million in home equity loans with an average loan size of $30-35 thousand. The majority of loans made by state-chartered banks were for debt consolidation purposes.

Of the state-chartered lenders surveyed, the top rated aspect of the home equity laws that they would most like to see changed was a tie between the removal of the restriction that makes agricultural property ineligible and the removal of the provision which allows no personal liability to the borrower beyond the homestead. 13.5% of the state-chartered banks that responded indicated these two changes as their most wanted change. Of the remaining changes, 9.2% of respondents ranked the removal of the provision requiring judicial foreclosure to obtain the property as their most desired change. Finally, 7.1% of respondent banks would like to remove the provision that results in forfeiture of all principal and interest if the lender fails to comply with the obligations.

AREAS OF CONCERN IN HOME EQUITY LAW

Representatives ranging from state agency regulators to active lenders to consumer groups have all voiced their concerns over the current home equity law. Reminiscent of the negotiations involved in the passage of the measure in the 75th Legislature, views are quite varied on whether or not anything even needs to be changed and if so, where to start. Most everyone agrees that confusion exists in the market regarding certain topics. Whether this confusion merits actual legislative action is another matter altogether. The areas of concern range from agency oversight and rulemaking authority to inconsistencies in the language written in the Constitution. Industry representatives have identified confusion regarding the three percent fee cap, the ability to cure a loan, and the continued debate on lines of credit. Consumer representatives raised the issue of possible predatory lending practices in historically under-served neighborhoods. Clearly, the kinks are still working themselves out of the home equity market and may require legislative intervention in the future.

Agency Oversight/Rulemaking Authority

Currently, there is no state agency in the State of Texas that has oversight and rulemaking authority in regards to the home equity lending laws. Enabling legislation filed alongside HJR 31 in the 75th Legislature would have given rulemaking authority to the Finance Commission of Texas.[41] Among other rulemaking authority pertaining to home equity lending, the bill would have granted rulemaking authority to the Consumer Credit Commissioner for "the interpretation, implementation, and enforcement of this article," thus providing an alternative to litigation in the event of a dispute. Without agency oversight, lenders are left to make their own interpretations of the provisions of the law, which has contributed to restricting certain lenders from entering the market. Smaller lenders with smaller overall loan portfolios have been hesitant to enter the market due to the complicated loan provisions and the severe penalties resulting from any mistakes made in the loan. Furthermore, in the event of a dispute with a consumer, the banker would be faced with possible litigation. This threat has dissuaded many of the smaller lenders in the State from entering the home equity lending market. They simply feel it is not worth the risk. Agency oversight would provide some relief to the threat of litigation if only by addressing some of the questions regarding interpreting the law, rather than relying on a court decision in a particular case.

Constitutional Inconsistencies

Another area of serious concern shared by many involved in the home equity market centers around inconsistencies in the language used in the Constitutional provision. The law requires lenders to provide a notice to the borrowers at the time the loan is processed so the borrower would understand all the various provisions of the loan. These provisions are established in the Constitution in Article 16, Section 50. In an attempt to make the notice more readable, the wording used is intended to be closer to plain language than the actual Constitutional provision. One problem that has arisen as a result of this attempt to make the notice more understandable, however, is the inconsistencies in terminology used between the notice and the rest of Article 50. For example, the term "home" is used in the notice, where the rest of the article used the legal term "homestead." In an attempt to clarify this inconsistency, certain lenders have added an explanation to their loan notice to explain the inconsistency to the borrower. Alas, these lenders are now being sued over this, under the claim that they did not give the borrower the correct notice because it is not the exact notice as written in the Constitution.

Three Percent Fee Cap

Certain questions have dealt specifically with particular provisions of the home equity law. One of these questions has involved the limitation on fees to not exceed three percent of the total loan. In Article XVI §50 (a)(6)(E), the Texas Constitution allows for an extension of credit that "does not require the owner or the owner's spouse to pay, in addition to any interest, fees to any person that are necessary to originate, evaluate, maintain, record, insure, or service the extension of credit that exceed, in the aggregate, three percent of the original principal amount of the extension of credit." Apparently, questions have arisen regarding what is included in this fee cap. Uncertainty involving whether discount points, prepaid finance charges, hazard insurance and other items are included in this cap has led to perceived violations of the law and resulting lawsuits. Lenders feel that there needs to be additional clarity over what exactly is included in the 3% fee cap. Lenders claim again that uncertainties such as this one have contributed to certain institutions being afraid to enter the market because they are being sued over uncertainties in the law rather than because of fraudulent behavior.

Ability to Cure

Another area of contention within the home equity lending market is the ability to cure a loan. Currently there are no provisions in the law regarding the lender's ability to cure a loan when a mistake has been made. Typically, when a mistake has been made and a borrower has been charged too much interest, for example, a lender has the opportunity to correct the mistake by refunding the overcharged money to the borrower. If a mistake is cured in a home equity loan, the lender avoids loss of principal and interest, but uncertainty remains regarding the lien. Questions have been raised whether or not a lien is still valid after a loan has been cured. Lenders argue that yes, the lien is rehabilitated once the loan has been cured, and is thus a valid lien against the property. Certain borrowers, however, feel otherwise and have pursued legal means to find out. If indeed the lien cannot be rehabilitated, lenders point out that there is therefore no incentive to repay the loan by the borrower. Since all home equity loans are non-recourse, without a valid lien on the house the loan would end up being both unsecured and non-recourse, leaving no legal incentive for repayment.

Lines of Credit

Texas law does not currently allow lenders the option of obtaining a "line of credit" home equity loan. An equity line of credit is similar to a credit card in that consumers can access the equity in their home as needed rather than in one lump sum. Debate during the 75th Session raised concerns related to ease of access issues and the dangers of monthly payments so low that borrowers would fail to amortize the debt.[42] Legislators were also aware of the long standing protections against losing your home in Texas, as established by the homestead provisions in the Constitution. Due in large part to a desire to approach home equity lending in a prudent manner, equity lines of credit were prohibited. Proponents of equity lines of credit point to this, alongside the prohibition against refinancing a home equity loan within a year of origination or previous refinance, as reasons that may be forcing borrowers to borrow and pay interest on more money than they may actually need. Furthermore, proponents suggest that equity lines of credit would provide a better source of credit to small business operators in need of capital. According to testimony given to the Committee, 56 percent of small business operators are currently financing their businesses by credit cards. Equity lines of credit, they argue, would provide access to capital at a much lower interest rate for these small businesses.[43]

LITIGATION

Considerable mention was given to the Committee on current litigation surrounding the home equity lending market. The threat of individual litigation as well as class action lawsuits has been of considerable concern to lenders across the state since the law was passed. According to industry representatives, a great deal of current litigation is based not on intentional fraudulent activity, but rather on confusion surrounding various aspects of the law. Particular attention has surfaced regarding questions about what fees are to be included under the three percent fee cap. A few significant cases involving home equity lending are highlighted below:

- Stringer v. Cendant Mortgage Corp.[44]-- On December 14, 1998, the U.S. District Court for the Eastern District of Texas in Tyler ruled in favor of Cendant Mortgage by dismissing the case. The Stringers had alleged that they were required to use a portion of the loan proceed they received from Cendant to pay off debts other than the Defendant, which violated Section 50(a)(6)(Q)(i) of the home equity provisions. Cendant argued that the lender may require the debtor to repay a debt that is secured by the homestead, and if the debtor has loans not secured by the homestead, the lender may require those debts to be paid off so long as they are not owed to the lender. The Texas Supreme Court eventually opined that a lender may indeed require a borrower to pay off other debt in a home equity loan. In the opinion, the court cited the Regulatory Commentary, giving additional credibility to the commentary as a source of advice for lender's reliance in complying with the Constitutional home equity lending provisions.

- Doody v. Ameriquest Mortgage Co.[45]-- On June 30, 1998, the Doody plaintiffs brought suit in Dallas County, alleging violation of the 3% fee cap and the notice provision. The plaintiffs alleged that all sixteen charges included in the loan were fees under Section 50(a)(6)(E), that the "points" charged were not necessary to "buy down" the interest rate, and Ameriquest had merely relabled fees to avoid the 3% fee cap, and that Ameriquest had further violated the fee cap by requiring the payment of hazard insurance monthly over the period of the loan. Plaintiff's summary judgement argument was that no home equity violation is curable and the lien is invalid from day one because of homestead protections. On November 22,1999 the Judge entered a Memorandum Opinion and Order that the plaintiff's declaratory judgment claim did not present a case of actual controversy, and, therefore, the case was not ripe for judicial determination. The court did rule that the lender could require plaintiffs to apply proceeds to repay pre-existing debts that each was secured by the homestead or owed to another lender.

- Tarver v. Sebring Capital Credit Corp.[46]-- On September 10, 1998, the Tarvers brought suit against Sebring, claiming only a violation of the 3% fee cap. The Tarvers allege that Sebring charged fees in excess of 3%. Among the charges the Tarvers described the fees, or "closing costs," was a 3 per cent "loan discount fee" and a loan origination fee. Sebring reduced these charges with a credit payment. Plaintiffs seek a judicial declaration that the charging of points is not interest, but rather is subject to the 3% fee cap, and a declaration that a lender may not charge more that 3% in "closing expenses." The court has made no decision in the case.

RECOMMENDATIONS

The House Committee on Financial Institutions recommends the following in response to the Interim Charge relating to Home Equity Lending:

1. The Committee has assessed that due to changing market dynamics and the fact that the nature of home equity transactions change over time, a more responsive regulatory structure is needed. Therefore, the Committee recommends that rulemaking authority be given to the appropriate regulatory entity.

AGENCY OVERSIGHT

The Committee on Financial Institutions was charged to conduct active oversight of the agencies under its jurisdiction. These agencies include the Finance Commission of Texas, the Credit Union Commission of Texas, the Banking Department of Texas, the Office of Consumer Credit Commissioner of Texas, the Savings and Loan Department of Texas, the Texas Public Finance Authority and the Texas Bond Review Board.

At the April 6, 2000 hearing, the Committee heard testimony from several of the agencies under its jurisdiction. In addition to this testimony, Committee staff regularly attended agency meetings and maintained regular communication with agency members and staff to remain aware of any important developments during the interim. Additionally, four of the agencies (Finance Commission, Department of Banking, Office of Consumer Credit Commissioner and Savings and Loan Department) are currently undergoing review by the Sunset Advisory Commission, which has involved meetings between Committee staff and Sunset staff to discuss the agencies and the ongoing review process.

Texas Department of Banking

Banking Commissioner Randall S. James addressed the Committee on April 6, 2000, to outline important issues facing the Department of Banking ("DOB") over the course of the interim. Commissioner James identified several areas of focus for the DOB, including preparations for Sunset review, responding to Financial Services Modernization, preparing for electronic banking, concluding Y2K preparations from 1999, and various internal operations matters as addressed below:

- <u>Sunset Advisory Committee Review:</u> To prepare for the Sunset review process, the DOB has submitted a self-evaluation report, posted these reports on the agency web site, prepared internally for on-site Sunset review and briefed Sunset staff on DOB and Finance Commission ("the Commission") operations and issues. For the DOB, these issues focused primarily on the funeral industry, specifically whether the industry might be better regulated through a restructuring of supervision, increased specificity in the statutes, and redesigned agency authority to encourage statutory compliance. Finance Commission issues for Sunset included whether the Commission's Administrative Law Judge should be maintained or folded into the State Office of Administrative Hearings, whether the make up of the Commission and whether membership should be realigned to represent industries currently regulated by the Commission's agencies, whether the Commission and its agencies should become self-directed or semi-independent agencies, whether there should be a review of the oversight structure of the Commission, and last, whether the Commission should be given rulemaking authority over the home equity lending provisions in the Texas Constitution.

- <u>Financial Services Modernization:</u> As detailed earlier in this report, the DOB, along with the Texas Department of Insurance, the Texas Savings and Loan Department, and the Texas State Securities Board prepared a report detailing the legislative response necessary to comply with the Gramm-Leach-Bliley Act of 1999. The DOB also initiated functional regulation meetings between the involved agencies and the Attorney General's Office. The DOB continues to work with bankers, mixed-industry groups and the Conference of State Bank Supervisors to assist with compliance issues as GLBA is implemented.

- Electronic Banking: Through continued involvement with the Conference of State Bank Supervisors, the DOB is reviewing current state laws regarding digital signatures. The DOB is also surveying state banks in Texas to determine the level of "e-banking" currently being offered. The DOB is training examiners so that they are able to conduct accurate reviews of e-banking activity at regularly scheduled bank examinations. Additionally, the DOB identified the upcoming National Conference of Commissioners' proposal for uniform state laws that may need to be addressed by the 77th Legislature.

- Y2K: Apparently, all preparations for the Y2K rollover were successful as the DOB reported an uneventful weekend last January. No banking system fallouts were reported from computer failures as bank systems state and nationwide have all been upgraded in preparation for Y2K.

- Internal Matters: The DOB has completed its implementation of a digital optical imaging system which it will share with the Savings and Loan Department and the Office of Consumer Credit Commissioner. The DOB noted serious concerns over staff retention problems, particularly in the area of bank examiners. The DOB also noted difficulties meeting examination mandates in prepaid funeral, perpetual care cemetery, sale of checks and currency exchange areas.

- Finance Commission Reports: Two studies recently completed by the Finance Commission concentrate on consumer depository and cash services and home equity lending. An upcoming report expected to be completed by Fall of 2000 is focusing on non-residential consumer lending. All studies are available on the Commission's website at www.fc.state.tx.us.

Texas Bond Review Board

Executive Director Jim Buie of the Texas Bond Review Board spoke to the Committee on April 6, 2000, regarding current operations and issues of the Review Board. The Bond Review Board approves the issuance of bond debt for Texas, which amounts to almost a half a billion dollars. Of this amount, approximately $21 million is in conduit transactions (through such agencies as the Texas Department of Housing and Community Affairs), $7.4 million in lease-purchase transactions, $137 million in general obligation bonds, and $250 million in revenue bonds.

Internally, the agency faced considerable reorganization over the first few months of 2000, having been short staffed for quite some time. The agency has found attracting qualified candidates for employment a challenge due to limits in pay that can be offered in combination with the high cost of living in Austin today. In response to this, Mr. Buie explained the agency has begun an effort to cross-train its employees to compensate for the shortage or loss of current employees.

Office of the Consumer Credit Commissioner

Consumer Credit Commissioner Leslie Pettijohn also testified before the Committee on April 6, 2000 to update the members on the current work of the Office of Consumer Credit Commissioner. Commissioner Pettijohn identified the following issues of focus for the agency:

- <u>Pawnshops:</u> Implementation of legislation passed last session to replace the showing of public need with a distance requirement for the location of a new pawn shop has gone exceedingly well. Only one public need case remained at the time of the April 6th hearing. Additionally, the agency has been working on rules for pawn shops in relation to operations, specifically in the area of data sharing with law enforcement officials. The OCCC has set up guidelines and standards for a voluntary electronic data transfer program in hopes of assisting in this process between pawn shop operators and law enforcement agencies.

- <u>Administrative Rulemaking:</u> The OCCC has developed model forms for motor vehicle financing contracts, has worked on modifications to rules in regulated lending as well as interest lending, and is developing new credit education activities through new e-learning modules.

- <u>Interest Rate Simplification:</u> While no official proposal has been developed, Commissioner Pettijohn discussed the current rate scheme in Texas and the complicated pre-computed rate structures currently established in statute, some of which were established over 30 years ago. In the interest of modernization, a plan to simplify and modernize our state rate structure may be an appropriate future project.

- <u>Sunset Advisory Commission Review:</u> Several policy issues for consideration during the Sunset Review process were discussed. Similar to the rate structure in Texas, the method of collecting revenue the agency uses is outdated and may need to be reassessed in the interest of balancing the costs of regulation fairly across the regulated industries. Also, the fact that no state agency was designated to have rulemaking authority or interpretive powers of the home equity provisions in the Constitution was addressed. The emerging payday lending industry and the rate simplification issue discussed elsewhere in this report are also being considered by Sunset. Lastly, the continual trend of federal pre-emption for state law continues to threaten the integrity of state usury laws, especially in today's emerging global economy.

Texas Credit Union Department

Credit Union Commissioner Harold Feeney addressed the Committee on April 6, 2000, to provide an update on the credit union industry in the State and highlight issues the Department is currently facing. Texas chartered credit unions totaled 260 as of December 31, 1999, with a total membership of 2.2 million people. Assets totaled $10.1 billion with an average net capital/total asset ratio of 10.5%. Of particular interest to the committee because of an interim charge pertaining to the subject, the Commissioner identified that fifty-two Texas chartered credit unions are making home equity loans, with over $267 million of these loans outstanding. Commissioner Feeney noted that 87% of the total loan volume by Texas credit unions is generated by the 18 largest entities. All of these 18 Credit Unions have assets over $100 million.

One difficult area the Department has faced recently that other state agencies have also experienced is the difficulty faced in continued high turnover rate. While the Credit Union Department's turnover rate has reduced from 56% in 1998 to 33% in 1999, the agency is seeking some long term solutions to insure prudent and quality regulatory efforts. Mr. Feeney testified that over 50% of the staff has less than two years experience in examinations. The main issue that has been identified, which contributes to this high turnover rate, concerns employee pay and travel associated with examinations.

Texas Public Finance Authority

Executive Director Kim Edwards testified before the Committee on April 6, 2000, on current matters the Texas Public Finance Authority ("TPFA") is working on. The TPFA is one of the state agencies that issues bonds for the state and is under the purview of the Bond Review Board. Ms. Edwards explained that three bond sales have recently been completed totaling over $42 million. Additionally, there are financing projects in process totaling over $61 million. Updates on the Commercial Paper Program and recent defeasances were also given. In regards to the 77th Legislative Session, Ms. Edwards mentioned that a few technical corrections from last Session's re-codification may need to be made and that specific recommendations will be presented to the Committee by the end of the interim. The TPFA also included their newly developed "Compact with Texans" and a "Customer Service Survey" in the materials presented to the Committee.

Internally, the TPFA underwent operational reorganization in 1999 and is currently operating with 14 full-time employees ("FTEs"). The agency has a cap of 15 FTEs, and is currently operating under its budget due to the salary savings of the open position.

Texas Savings and Loan Department

Commissioner Jim Pledger addressed the Committee on April 6, 2000 on current operations issues the Department has been working on since the end of last session. Key issues included in the presentations were:

- Status of State Thrift Industry: The state thrift industry remains strong and well capitalized, with 28 state savings banks and savings institutions with assets of $13.4

billion as of December 31, 1999.

- Reorganization of Consumer Protection Group: In an effort to better serve and respond to Texas consumers, the Department has recently reorganized its consumer complaint and consumer protection group to cover both depository institutions and mortgage brokers. A statewide toll-free consumer hotline will be available for all consumer concerns.

- Mortgage Broker Licensing: The Department had issued 7,643 licenses associated with the Mortgage Broker Licensing Act of 1999 ("MBLA"), of which 2,563 are mortgage broker licenses and 5,036 are licenses for loan officers. The licensing process went smoothly. In particular, the provisional license authority proved extremely valuable, allowing the Department to issue provisional licenses while the initial license applications were processed. One area for improvement may be in the area of criminal convictions and resulting denial of applications. Commissioner Pledger recommended some clarification may be needed relating to specific crimes that would automatically deny an application for license. The statute currently states that licenses will be denied on the basis of an applicant having committed a crime related to mortgage brokering, but does not identify specific crimes by law.

- Budget and Appropriations: The agency is on target with its appropriations, with revenues from the thrift industry covering 100 percent of expenditures, and revenues from the mortgage broker industry exceeding expenditures by approximately $1 million.

- Key Legislative Issues for Next Session: Commissioner Pledger identified several key issues the Department recommends the Legislature may want to address in the upcoming session. In addition to clarifying specific crimes that would deny mortgage broker license applications, the requirement for criminal background checks for applicants may need to be revised. As currently written, the MBLA authorizes but does not require that FBI background checks be performed on all applicants. The Department feels that the requirement should be made mandatory for all applicants to effectively use these background checks.

  Also relating to mortgage broker licensing, the Department recommends the Legislature consider a registration requirement for companies through which brokers do business and an annual reporting requirement for such companies. This would allow the Department to ascertain data on the volume of business conducted by mortgage brokers in Texas. All such information would be available as aggregate data and would be specifically identified as confidential.

  In regards to the consumer complaint process the Department operates under, the Department feels its ability to take enforcement action may need revision. Currently, the consumer complaints drive enforcement action. In order to more effectively regulate, the Department needs to be allowed to take enforcement action before a problem arises.

ENDNOTES

1. NATIONAL CONSUMERS LEAGUE, E-CONSUMER CONFIDENCE STUDY # (August 2000).

2. MERRIAM-WEBSTER'S COLLEGIATE DICTIONARY, p.927 (10th ed. 1993).

3. *Financial Services Modernization and Consumer Financial Privacy in Texas*: *Joint Hearing Before the House Comm. on Fin. Inst. and the House Comm. on Ins.*, 76th Tex. Legis., Interim (May 4, 2000) (testimony of Karen Neeley, General Counsel, Independent Bankers Association of Texas).

4. *Fair Credit Reporting*, Federal Trade Commission, March 1999.

5. *Fair Credit Reporting Act*, Financial Services Institutions Task Force, August 2000.

6. 12 C.F.R. § 40.3(e)(1).

7. *Analysis of Final Regulations Implementing the Financial Privacy Provisions of the Gramm -Leach-Bliley Act*, Memorandum from Covington & Burling (Washington, D.C.) (June 2, 2000).

8. *Id*.

9. *Id*.

10. O.C.C. §40.14(a)

11. *See, e.g.*, H.Bs. 391, 3622 (by Tillery), H.B. 562 (by Giddings), and S.Bs. 88, 1339 (by Carona), 76th Tex. Legis. (1999).

12. *Home Equity Lending, Payday Lending, and Sale Leaseback Transactions in Texas*: *Hearing Before the House Comm. on Fin. Inst*., 76th Tex. Legis., Interim (April 6, 2000) (testimony of Leslie L. Pettijohn, Consumer Credit Commissioner of Texas).

13. JEAN ANN FOX, CONSUMER FED'N OF AMERICA, THE GROWTH OF LEGAL LOAN SHARKING: A REPORT ON THE PAYDAY LOAN INDUSTRY (Nov. 1998).

14. 12 C.F.R. Part 226.2(a) and 226.2(a)(14).

15. John Cornyn, State of Texas Attorney General, Press Release (December 17, 1999).

16. John Cornyn, State of Texas Attorney General, Press Release (May 12, 1999).

17. John Cornyn, State of Texas Attorney General, Press Release (September 12, 1999).

18. TEX. CONST., art. 1, § 18.

19. TEX. FIN. CODE ANN.§ 392.301(a)(5) (West 1998).

20. *Id.* § 392.301(a)(6).

21. Texas Penal Code §39.02 addresses the issuance of a bad check in the example given of a consumer writing a check in a grocery store and establishes the offense in most cases as a Class C Misdemeanor.

22. Some entities contend that agents of a national lender would not be required to be licensed by the Texas Office of the Consumer Credit Commissioner and therefore be subject to the provisions of Rule 7 TAC §1.605 due to Federal Interstate Branching Law. It is the opinion of this Committee, however, that they would in fact be subject to all Texas laws relating to small consumer loans, including licensing and regulation with the OCCC.

23. TEXAS FIN. COMM'N, RESEARCH INTO CONSUMER LENDING IN TEXAS, p.7 (Sep. 2000) (hereinafter CONSUMER LENDING IN TEXAS).

24. Nazrul Hogue & Steve Murdock, *More Households More Houses*, TEX. A&M U. REAL ESTATE CENTER J., July 1999.

25. ADMINISTRATOR OF THE UNIFORM CONSUMER CREDIT CODE, STATE OF COLORADO, 1999 DEFERRED DEPOSIT LENDERS SUPERVISED LENDERS' ANNUAL REPORT (November 22, 1999).

26. *Home Equity Lending, Payday Lending, and Sale Leaseback Transactions in Texas*: *Hearing Before the House Comm. on Fin. Inst.*, 76th Tex. Legis., Interim (April 6, 2000) (testimony of Leslie L. Pettijohn, Consumer Credit Commissioner of Texas).

27. CONSUMER LENDING IN TEX., *supra* note 22.

28. Hogue & Murdock, *supra* note 23.

29. *Home Equity Lending, Payday Lending, and Sale Leaseback Transactions in Texas*: *Hearing Before the House Comm. on Fin. Inst.*, 76th Tex. Legis., Interim (April 6, 2000) (testimony of Leslie L. Pettijohn, Consumer Credit Commissioner of Texas).

30. The Texas Office of Consumer Credit Commissioner does not collect official data for pawnshop loans in Texas as of 2000. However, pursuant to a new administrative rule, the Agency will begin collecting loan data from pawnshops to report the findings beginning in 2001.

31. Texas Office of Consumer Credit Commissioner, Subchapter F Lender Report Data, 1999.

32. ADMINISTRATOR OF THE UNIFORM CONSUMER CREDIT CODE, STATE OF COLORADO, 1999 DEFERRED DEPOSIT LENDERS SUPERVISED LENDERS' ANNUAL REPORT (November 22, 1999).

33. 12 C.F.R. Part 213 (Regulation M).

34. 12 C.F.R. Part 213(2)(e)(1).

35. Richard P Ieyoub, State of Louisiana Attorney General, Opinion No. 00-177, (August 2, 2000).

36. 15 U.S.C. §§ 6751 *et seq.*

37. The Agency Report details numerous specific provisions of the Insurance Code that need to be amended or repealed. *See* Agency Report, Section II. D. 4., p. 29.

38. 15 U.S.C. §§ 1603 *et seq.*

39. OFFICE OF CONSUMER CREDIT COMMISSIONER OF TEXAS, TEXAS DEPARTMENT OF BANKING, TEXAS SAVINGS AND LOAN DEPARTMENT, TEXAS CREDIT UNION DEPARTMENT, REGULATORY COMMENTARY ON EQUITY LENDING PROCEDURES (October 7, 1998).

40. TEXAS FIN. COMM'N, FINAL REPORT: HOME EQUITY LENDING IN TEXAS STUDY # (Dec. 17, 1999).

41. H.B. 1188, art. 5A.09(d), 75th Tex. Legis. (by Danburg, et al.) (1997).

42. *Home Equity Lending, Payday Lending, and Sale Leaseback Transactions in Texas*: *Hearing Before the House Comm. on Fin. Inst.*, 76th Tex. Legis., Interim (April 6, 2000) (testimony of Robert Norcross, Texas Home Equity Lenders Group).

43. *Home Equity Lending, Payday Lending, and Sale Leaseback Transactions in Texas*: *Hearing Before the House Comm. on Fin. Inst.*, 76th Tex. Legis., Interim (April 6, 2000) (testimony of David Pinkus, Small Business United of Texas).

44. <u>Joe R. Stringer and Desiree H. Stringer v. Cendant Mortgage Corporation d/b/a PHH Mortgage Services Corporation</u>, No. 6:98cv664 (E.D. Tex--Tyler Division 1998).

45. <u>James S. Doody & Paul Carrington v. Ameriquest Mortgage Co.</u>, No. DV98-5033, 95th Judicial District, Dallas County District Court. On removal by the defendant, the case became No. 3-98CV1844, N.D. Tex--Dallas Division.

46. James Heath Tarver and Shannon Tarver v. Sebring Capital Credit Corporation and Gregory S. Graham, N. 98-09-15,645-CV, 82nd Judicial District, Robertson County District Court.

The Financial Institutions and Taxation Committee is a select standing committee of the Missouri House of Representatives. Per Rule 22 of the House Rules, standing, conference, interim and statutory committees in the Missouri House of Representatives are appointed by the Speaker of the House, with minority members of regular standing committees being appointed by the Minority Floor Leader. Special standing committees are appointed by the Speaker with input from the Minority Floor Leader on minority Texas House of Representatives, Interim Report 1992. Texas State Legislature, Austin. House Committee on Higher Education. 14 Sep 92. 35p.Â on tuition and fee increases at institutions in the state system of higher education were held and the subcommittee in that area. recommended maintaining the status quo in regard to the current level of tuition and fees using the established schedule which will reach a. maximum tuition rate of $32 per semester credit hour in the fall of. Speaker, Texas House of Representatives Members of the Texas House of Representatives Texas State Capitol, Rm. 2W.13 Austin, Texas 78701. Dear Mr. Speaker and Fellow Members: The Select Committee on Economic Competitiveness of the Eighty-fifth Legislature hereby submits its interim report including recommendations for consideration by the Eighty-sixth Legislature. Respectfully submitted, _ Byron Cook, Chairman. See the House Financial Services profile for committee activity and links to committee documents. â€œHowInvidious Discrimination Works and Hurts: An Examination of Lending (EventID=111236).Â Length: 1 Minute. Chairwoman Waters' Statement on Passage of Interim COVID-19 Relief Package. 03/11/2020 at 10:00 a.m. Length: 2 Hours, 59 Minutes.Â Rep. Waters, Chairwoman, House Committee on Financial Services, on Bank Diversity & Inclusion. 02/12/2020 at 2:00 p.m. Length: 1 Hour, 30 Minutes.