SUBJECT: Continuing the Office of the Consumer Credit Commissioner

COMMITTEE: Financial Institutions — committee substitute recommended

VOTE: 5 ayes — Averitt, Denny, Hopson, Menendez, Pitts

0 nays

4 absent — Solomons, Grusendorf, Marchant, Wise

SENATE VOTE: On final passage, April 10 — voice vote

WITNESSES: For — Rob Schneider, Consumers Union; Registered but did not testify: Mandy Balch, Texas Independent Automobile Dealers Association; Sam Kelley, Texas Consumer Finance Association.

Against — Robert Hagan; Neil H. Mody, M.G. Capital Investment Corp.; Johnny Nunez

On — Leslie Pettijohn, Office of the Consumer Credit Commissioner; Registered but did not testify: Andrea Varnell, Sunset Advisory Commission

BACKGROUND: Established in 1963 as the Office of Regulatory Loan Commissioner, the Office of the Consumer Credit Commissioner (OCCC) was renamed in 1967 when the Legislature enacted the Texas Credit Code and designated the agency to regulate consumer lending. Since then, the office has been charged with regulating pawn brokers (1971) and home equity lenders (1997).

In fiscal 2000-01, the OCCC was appropriated a budget of $4.7 million and employed 47 full-time employees in five cities across the state to perform the following major functions:

- registering or licensing consumer lenders at more than 20,000 locations, including home equity lenders and those who make small unsecured personal loans, secured personal loans, and payday loans;
- examining licensed lenders at almost 5,300 locations on approximately a 12-to-18-month cycle;
registering almost 16,000 retailers who extend credit, including automobile dealers, manufactured housing retailers, and consumer goods and services creditors; licensing and regulating more than 1,500 pawnshop locations and about 5,000 pawnshop employees; investigating consumer complaints and assisting (including mediating) in disputes between consumers and creditors; and conducting education programs to inform consumers about credit use.

The Finance Commission is the OCCC’s policy-making and governing body. The OCCC is subject to the Texas Sunset Act and will expire September 1, 2001, unless continued by the Legislature.

DIGEST:

CSSB 317 would continue the OCCC until September 1, 2013, and would revise the agency’s authority extensively, including by providing for regulation of sale-leaseback and deferred presentment transactions and for licensing and examination of lenders who finance motor vehicle sales.

Sale-leaseback and deferred presentment transactions. CSSB 317 would add definitions of these transactions to the Texas Credit Code (Finance Code, Title 4) and would amend the definition of “loan” to include both of these types of transactions. It would define a deferred presentment transaction as one in which a cash advance is made in exchange for a personal check or authorization to debit a bank account that equals the amount of the cash advance plus a fee, and in which the lender promises not to cash the check or debit the account if the advance is repaid within a certain time. It would define a sale-leaseback transaction as one in which a person sells personal property and the buyer agrees to lease it back to the seller. The bill would treat as interest any amounts in excess of the sales price paid.

The bill would prohibit a lender from using a device, pretense, or subterfuge to avoid regulation of the lender’s transactions, including by recharacterizing fees on a loan as a purchase of a good or service. The Finance Commission would have to adopt rules to govern deferred presentment transactions.

Automobile dealer licensing. CSSB 317 would eliminate the registration requirement and substitute a licensing requirement for lenders who finance
sales of motor vehicles or who buy such loans from retailers, except for lenders already authorized under the Finance Code. It would set requirements and fees for a license application, set standards for approving or denying applications, and require the OCCC to investigate an application to determine whether to issue the license. The bill also would provide for appealing a denial of a license and for returning the license fee (but not the investigation fee) to an applicant if the license was denied. The commissioner would have to approve all transfers of licenses.

The bill would provide for annual license fees and expiration of the license for unpaid fees after a delinquency notice. It also would give the commissioner the right after notice and a hearing to suspend or revoke a license for failure to pay a required fee, for knowing or negligent violations of regulations, rules, or orders issued under the chapter, or if a fact was discovered that would have justified denying the license application originally. Similarly, the commissioner could reinstate a license that should not have been revoked or suspended. Suspension, revocation, or surrender of a license would not affect the licensee’s liability and would not affect contracts executed while the license was in effect.

**Examinations of automobile dealers.** The commissioner could examine each licensee’s place of business with advance notice and during normal business hours and could investigate and have free access to the licensee’s premises to inspect the licensee’s transactions, books, records, accounts, correspondence, and other documents, to the extent that they pertained to the licensee’s regulated business. Licensees would have to allow the commissioner access to their premises and files and allow copying of documents. The commissioner or a representative could administer an oath during an examination and could take testimony pertinent to a matter about which the commissioner was authorized to investigate, consider, or secure information. The commissioner could impose a fee on an examined licensee to defray the costs of the examination.

Information obtained in an examination or investigation would be confidential, although the OCCC could share information with the Texas Department of Transportation (TxDOT) to ensure consistent enforcement of the law and to minimize regulatory burdens. Shared information would retain its confidential character.
CSSB 317 would require licensees to maintain records of each retail installment transaction for three years following the last payment or for two years after the last transaction on an account was entered, whichever was later. Documents that the commissioner would need to determine whether the licensee was in compliance with chapter 348 would have to be kept, and generally accepted accounting practices would have to be used. If the lender wished to sell the obligation, the sales agreement would have to provide the commissioner with access to the obligation.

The commissioner also could investigate non-licensees to discover violations of the regulations or to obtain required information, if the commissioner had reasonable cause to believe that the non-licensee was committing a violation.

The Finance Commission could adopt rules to enforce these requirements, and the commissioner would be responsible for proposing rules.

**Pawn loans.** CSSB 317 would increase from $480 to $960 the maximum loan amount that would be subject to the 15-percent monthly interest rate. It also would reduce the number of days that pawnbrokers would have to hold unredeemed goods before they were forfeited to the pawnbroker.

**General provisions.** CSSB 317 would allow the OCCC to obtain criminal background information on an applicant for or holder of a license issued by the OCCC to a consumer lender or a car dealer.

The bill would eliminate the statutory fees for licensing and registration of entities and persons regulated by OCCC. Instead, it would allow the Finance Commission to set fees by rule at the amount necessary to recover OCCC’s costs of administering the relevant chapters of the Finance Code. Licensing fees for a new licensee would be prorated for the number of months the licensee was to be licensed during the initial fiscal year.

The bill would make an appeal of the OCCC’s denial of a license subject to the substantial evidence rule under Government Code, chapter 2001.
The bill would state explicitly that Insurance Code, chapter 24, relating to financing of insurance premiums, does not apply to retail installment contracts.

Loan contracts of lenders regulated by the OCCC would have to be written in plain language and printed in an easily read font size and type. The Finance Commission would have to adopt model forms that regulated lenders would have to use unless they submitted an alternative contract for the approval by the commissioner, in which case the alternative could be used until the commissioner disapproved it.

The bill would direct the OCCC and the Finance Commission to conduct a study of mortgage lending practices to identify possible predatory and or discriminatory lending practices. The agencies would have to submit a report of their findings to the presiding officer of each house of the Legislature and to the House Financial Institutions and Senate Business and Commerce committees by December 1, 2002.

The bill would add standard sunset provisions related to conflicts of interest, equal employment opportunity policies and data reporting, handling of complaints, training of employees, staggered renewal of licenses, and licensee advertising.

CSSB 317 generally would take effect September 1, 2001. The provision specifying that Insurance Code, chapter 24 does not apply to installment loan contracts would take immediate effect if the bill was finally passed by a two-thirds record vote of the membership of each house. Licensing requirements for lenders who finance the sale of motor vehicles and the repeal of the requirements for those sellers’ registration would take effect September 1, 2002.

**SUPPORTERS SAY:**

CSSB 317 would continue the OCCC so that it could continue to fulfill its necessary functions of regulating consumer credit transactions, protecting consumers through investigation of potentially deceptive, fraudulent, or illegal lending practices, educating consumers about credit use, and educating creditors about the laws and rules applicable to the industry. The office has performed those functions well, so there is no need to consider moving the functions to another agency.
The bill also would make needed improvements and additions to the OCCC’s authority. By expanding regulation of those who make loans to consumers for motor vehicles, it would correct deficiencies in the OCCC’s authority in this area. Almost three-quarters of the consumer complaints and questions that the agency receives relate to motor vehicle lending, so the industry obviously could use better oversight. Currently, the OCCC is limited to registering these lenders and cannot examine them to ensure that their lending practices are proper and fair. CSSB 317 would provide this needed authority while seeking to minimize the regulatory burden by allowing information sharing between the OCCC and TxDOT, which licenses automobile dealers generally.

Likewise, CSSB 317 would impose requirements on lenders for the direct protection of consumers. For instance, the requirement that contracts be written in plain language would help head off any potentially fraudulent practices and would guarantee that consumers understand the terms of the transactions they enter into. Requiring the Finance Commission to create standard forms not only would protect consumers but would help lenders avoid doubts about the clarity of their contract language.

By defining sale-leaseback and deferred presentment transactions as loans, the bill would bring these transactions under the OCCC’s regulation. Both kinds of transactions are functionally loans but have not been regulated by the OCCC because the lenders have redefined the interest they charge as a “fee” to evade regulation. As a result, such transactions often have “fees” that are the equivalent of a 650 to 1000 percent interest rate, especially when the loan is extended or rolled over several times, as a large number of borrowers do. The bill’s explicit definitions and prohibition against using any device, subterfuge, or pretense to evade regulation would prevent such abuses and would protect consumers from usurious interest rates.

Similarly, CSSB 317 would ratify the rules that the OCCC has promulgated for payday lenders, including maximum charges, minimum terms, required disclosures, and prohibitions on duplicate or multiple loans, by directing the Finance Commission to adopt rules regulating such loans, thus heading off any challenge of the rules by the industry.
This bill’s benefits would cost the state relatively little. The OCCC could set fees at an amount necessary to administer regulatory programs under the Finance Code. Thus, the OCCC’s licensees would pay for the increased staff and capital expenditures that the bill would make necessary.

Although some sale-leaseback companies argue that they would be driven out of business if their transactions were treated as loans and subject to the current maximum 18 percent interest rate on personal loans, this makes no sense considering that many lenders successfully make loans at that rate now. Also, this may not remain a concern. SB 272 by Carona, which has passed both houses of the Legislature, would increase the maximum interest rate for many loans to 30 percent.

OPPONENTS SAY:

CSSB 317’s definition of sale-leaseback transactions as loans would be inappropriate. Sale-leasebacks are not loans, because the property actually is purchased and then leased. The sold/leased property is not collateral for a loan. The risk of damage to the property falls entirely on the owner/lessor. If the seller decides to take the sales price after making a few lease payments and turn in the property, the seller has that right, and there is no loan that has been defaulted on. Because of risks such as these, treating the sale-leaseback transaction as a loan subject to the existing interest-rate ceilings could make these transactions unprofitable.

More importantly, defining sale-leaseback transactions as loans would limit the financial options of consumers with less than sterling credit. If no or fewer businesses were willing to make these agreements, many consumers might not be able to get cash when they needed it. Depository institutions and other lenders will not make loans secured by, for instance, an older or high-mileage vehicle or a television. The only way these consumers can get cash for their personal property is to pawn it or to sell it and lease it back. If the person needs to be able to use the property, pawning it is not an option. If the sale-leaseback option goes away, these consumers will be harmed.

The bill also would reduce revenues to the state, because sale-leaseback transactions are subject to state sales tax. As loans, they become nontaxable. According to the bill’s fiscal note, the state stands to lose tax revenues averaging about $1.9 million per year over the next five years, while local
governments are estimated to lose an average of about $470,000 per year, collectively.

Changing the pawn loan bracket that is subject to 15-percent monthly interest would result in a substantial increase in interest rates for a large number of pawn loans that already are very expensive. At the same time, the bill would reduce the amount of time that a consumer who had pawned an item would have to redeem it by repaying the loaned amount. By giving the consumer less time, the bill not only would make pawn loans more risky for consumers but effectively would increase the cost of borrowing by reducing the term of the loan before the consumers forfeited their pawned property for the relatively small cash advance amount.

NOTES:

The committee substitute added the provision that would make an appeal of an OCCC decision subject to the substantial evidence rule, rather than a trial de novo, as in the Senate engrossed version. The substitute also added the provision that characterizing a fee in a deferred presentment transaction as a payment for a good or service would be a device, subterfuge, or pretense designed to evade regulation by OCCC. It also added the provision that would authorize the OCCC to obtain criminal background information.

The fiscal note for CSSB 317 estimates a loss of $3.7 million in state general revenue in fiscal 2002-03 and a loss of $2.1 million to $2.3 million in each of the next three years because sales-leaseback transactions no longer would be subject to the sales tax. The OCCC would require six additional full-time employees beginning in fiscal 2003 and additional computer equipment, at a cost of slightly more than $1 million per year. However, it is assumed that those expenses would be recouped by fees assessed against licensees.