

- SUBJECT:** Revising the Finance Code
- COMMITTEE:** Financial Institutions — committee substitute recommended
- VOTE:** 7 ayes — Solomons, McCall, Guillen, Chavez, Flynn, Orr, Riddle
0 nays
- WITNESSES:** For — William Daniel, Ford Motor Credit Company and General Motors Acceptance Corporation; Karen Neeley, Independent Bankers Association of Texas; Scott Sheehan, Texas Business Law Foundation (*Registered but did not testify*); John Lederer, Credit Union of Texas; Val Perkins, Texas Business Law Foundation; Eric Sandberg, Texas Savings and Community Bankers Association; Brad Shields, Security Finance, Inc.; Todd Smith, Ameriquest Mortgage Corporation, Argent Mortgage Corporation; Melodie Stegall, Credit Union Legislative Coalition; Larry Temple, Texas Mortgage Bankers Association; Mark Vane, Gardere Wynne Sewell LLP

Against — None

On — John Fleming, Texas Savings and Loan Department; Sealy Hutchings, Leslie Pettijohn, Office of Consumer Credit Commissioner; Danny Payne, Texas Savings and Loan Department, Commissioner
- BACKGROUND:** The Finance Commission is the policy-making body for the Department of Banking, the Office of Consumer Credit Commissioner (OCCC), and the Savings and Loan Department. The OCCC regulates the credit industry, enforces Texas lending laws, and licenses and registers creditors operating in Texas. The Savings and Loan Department regulates Texas chartered savings institutions for residential housing and real estate finance, mortgage brokers, and mortgage bankers.
- DIGEST:** CSHB 955 would make several modifications to the Finance Code, including:
- changing the powers of the Consumer Credit Commissioner;
 - exempting certain commercial loans from rate ceilings;
 - adding provisions related to consumer credit protection;

- making changes to savings banks, limited savings banks, and the Savings and Loan Department; and
- amending the Mortgage Broker License Act

Consumer Credit Commissioner. The powers of the Consumer Credit Commissioner would be changed through new language on cease and desist orders. A person against whom an order was issued could appeal either to the Finance Commission or directly to district courts. Procedural changes would be made to hearings for cease and desist orders, including allowing the assessment of up to \$1,000 in administrative penalties for each day of violation. Changes also would be made to the process by which an individual could seek a review of the cease and desist order by the finance commission.

CSHB 955 would increase the maximum cap on penalties assessed against most lenders from \$50,000 to \$100,000 or an amount that was equal to the greater of 5 percent of the net worth of the creditor or \$5,000. The bill also would remove the formula for determining administrative penalties for the Pawn Shop Act so that penalties could be assessed up to a maximum of \$1,000.

An individual could grant assurance of voluntary compliance in connection with a violation, and any amounts paid as restitution would be taken into consideration in assessing penalties under a suit. If an entity already had been assessed administrative penalties or fines under state and federal law, this would also be taken into consideration in civil suits in determining further recovery on the same act. Suits by private individuals would not prevent state or federal agencies from seeking administrative remedies.

Interest rate and usury changes. The bill would standardize the determination of what constituted interest and eliminate certain interim rate ceilings. It would allow for creditors and obligors to include additional classes of penalties in a loan contract payable in cases of premature termination of the loan, and these penalties would not be calculated as interest. The definition of “affiliate” would be expanded to include a person in which the obligor directly or indirectly, or through one or more intermediaries or other entities, owned an interest. If an obligor assumed a debt on another person’s obligation, it would not constitute interest.

The bill would provide that a commercial loan of \$7 million or more that was not primarily secured by real property, or one of \$500,000 or more which was primarily secured by real property, would be exempted from interest rate ceilings such that the rate of interest would be the rate the parties agreed to in contract. It would provide that commercial loans between \$1 million and \$7 million secured primarily by real property and ones between \$100,000 and \$500,000 that were not secured by real property would be considered qualified consumer loans. Provisions related to exempting certain commercial loans from rate ceilings would be contingent on the adoption of a constitutional amendment that would authorize such action. These provisions would take effect on the date the constitutional amendment was adopted.

CSHB 955 would provide flexibility for certain loans for personal, family, or household use to be regulated either under regulations governing consumer loans or using optional rate ceilings. It would remove a rate requirement on retail credit cards. Regulations for revolving credit accounts would be applied to consumer loans only, and creditors could opt in commercial loans under these regulations. It would exclude commercial loans from regulations on manufactured housing transactions on credit. Loans for towable recreational vehicles could be regulated under requirements for either motor vehicle installment sales or consumer goods and services.

The bill would define different standard penalties for consumer and commercial usury and would allow double usury penalties only for consumer loans. A defendant being sued by a creditor could file a counterclaim alleging usurious interest in an original action by the creditor. The defendant would provide notice on the counterclaim, and the action would be abated for 60 days for the creditor to correct the alleged violation.

Consumer credit protections. The bill would add several provisions relating to consumer credit protection including:

- preventing creditors from using false, misleading, or deceptive advertising regarding credit transactions or advertising credit terms they did not intend to offer;
- allowing the assessment of civil penalties for discriminatory lending practices;

- requiring unlicensed lenders to comply with Federal Fair Trade practices; and
- preventing multiple actions against an offender against whom a claim has been made of a violation of the Consumer Credit Protection Act.

Department of Savings and Mortgage Lending. The Savings and Loan Department would be renamed the Department of Savings and Mortgage Lending. With respect to all functions under Finance Code, ch. 156 and ch. 157, the agency would be self-leveling and self-funding. The maximum administrative penalty for violations would be raised from \$1,000 to \$10,000 per day. The commissioner of the department would conduct a study on developing alternative thrift charters.

Savings banks and limited savings banks. CSHB 955 would define a limited savings bank to be organized as a limited liability company and introduce transitional rules for the statutes under which these entities would be governed. It would add a subchapter governing the new limited savings banks that generally mirrors the regulations for limited liability companies under the Texas Limited Liability Company Act. Modifications would include restrictions on the ability of a person to obtain capital contributions and stipulations on dissolution and distribution. It also would create a new subchapter to permit the formation of mutual holding companies and establish the procedure and requirements to receive this designation.

CSHB 955 would allow a savings bank to be established to facilitate reorganizations and mergers. A savings bank could merge or reorganize with other entities such as limited liability companies. It could convert to another financial institution if it filed an application to convert within 30 days after a meeting of shareholders or members which approved the measure. The bill would allow a savings banks to act as depository for other entities, such as cooperatives, which serve a public purpose.

Thresholds for the thrift lender test would be reduced so that a savings bank would be required to maintain only 50 percent of its portfolio assets in residential mortgage loans and related assets. It would expand the loan forms that could be counted towards meeting the 15 percent rule for required investments to be made in local service areas.

The bill would eliminate the requirement that a savings bank file its indemnity bond with the new Department of Savings and Mortgage Lending. The department could make rules establishing the amount and form of the bond and the sufficiency of the surety. Either the board or the president and secretary could sign certain documents. A savings bank, its holding company, and its affiliates could adopt a stock repurchase plan subject to approval by the commissioner. A dividend would not be payable if retained income was negative.

The bill would provide parity for issuance of securities with those permitted by national banks, federal savings and loans, federal savings banks, or state banks. Texas savings banks also could own property or offer products or services that were permissible within the United States for a depository institution organized under federal law or the law of Texas or another state, subject to limitations prescribed by rule of the finance commission.

Amending the Mortgage Broker License Act. The bill would specify that the rules related to affiliated business arrangements between mortgage brokers and others would be subject to state and federal law related to affiliated business arrangements. It would require the governor to consult with the commissioner when adopting rules and for the commissioner to consult with the advisory committee on certain proposals. The committee would take non-binding record votes on any proposed rule.

CSHB 955 would provide additional reasons for the commissioner to deny renewal of a mortgage broker or loan officer's license and prevent the fee from being credited or applied to any other fee owed by the applicant. It would shorten the time from one year to 90 days after which a license could not be renewed and would require license renewal notices to be sent 60 days, rather than 30 days, prior to license expiration. The bill would expand the time period in which a hearing would have to be held from 30 days to 90 days and would require a refundable cost deposit of up to \$500 for persons wishing to appeal denial of licensure. A person whose license was denied could not apply again for two years unless this time was shortened by rule of the commissioner. A person whose license had been revoked could not engage in mortgage loans personally or as an employee or other affiliate of a person engaging in making and originating mortgage loans.

The commissioner could share information gathered during an investigation or inspection with any state or federal agency. Administrative subpoenas could be issued to aid in the investigation of mortgage banker and loan officer improprieties. A mortgage broker would be liable for acts performed by a sponsored loan officer in connection with the origination of a mortgage loan.

Submitting false information in connection with license renewal would constitute a disciplinary offense. Disciplinary action also could be taken against licensees who were convicted of fraud or moral turpitude. The bill would provide a mechanism to order administrative suspensions for failure to comply with an order and would provide for a review of that suspension, in an expedited manner. It would clarify the commissioner's ability to order restitution to consumers. An administrative penalty of up to \$1,000 per day would be assessed against someone engaging in unlicensed activity. The bill would clarify that recovery funds would be granted to consumers and not lenders.

CSHB 955 would exempt subsidiaries, affiliates, and credit union service organizations of state or federal credit unions from the Mortgage Banker Regulation Act. It would clarify that fees paid were not refundable and could not be credited to any other fee owed by a mortgage broker. The number of education hours required to become loan officer would increase from 15 to 30. The bill would amend the definition of net assets to exclude assets that were exempt under state or federal law.

Miscellaneous provisions. The post-judgment interest rate would be the prime rate as published by the Federal Reserve System. The Finance Commission and Credit Union Commission would be required to produce a study on preemption issues. A provision on requiring savings banks to publish a statement of financial position in local newspapers would be repealed. Other repealed provisions would include those on market competitive rate affidavit filing procedures and those relating to certain businesses that make commercial loans.

The bill would take effect September 1, 2005.

**SUPPORTERS
SAY:**

CSHB 955 would provide a comprehensive modernization of the Texas Finance Code to reflect major industry changes that have occurred since the 1960s. It would streamline processes and remove provisions that no longer apply to standard Texas banking practice.

The regulatory powers and enforcement tools of the OCCC would be increased to prevent predatory lending practices and general statutory violations by creditors within the state. The bill would provide consumer protections against misleading, false, or deceptive advertising for various consumer, home equity, mortgage, auto, and other consumer loans and transactions. It also would add regulatory tools to address lenders or creditors who practiced without a proper license.

CSHB 955 would provide for the modernization of Texas usury laws and, in particular, would strengthen usury laws pertaining to consumer lenders. Commercial lenders make large, complex transactions on a daily basis, and the transactions conducted by Texas lenders are subject to tight restrictions. Texas' commercial lending laws place both Texas borrowers and lenders at a competitive disadvantage compared to the laws of 46 other states. In these states, sophisticated commercial lenders and borrowers are allowed greater freedom to structure the unique loan arrangements that commercial parties often require. The provisions of CSHB 955 would provide for a more robust market, making Texas, once again, one of the premier commercial lending states in the country. This added business would provide much needed economic development for the state.

Changing the name of the Texas Savings and Loan Department to the Department of Savings and Mortgage Lending would better reflect the agency's current responsibilities. Only one savings and loan institution still operates in Texas, and the department now has jurisdiction over not only savings institutions but also mortgage brokers and bankers. CSHB 955 would modernize the Finance Code to better reflect the agency's new responsibilities and address new trends as savings banks have begun to realize the benefits of utilizing structures that closely match those of modern corporations. Such tools can facilitate modern business practices, such as easing the merger process. By offering more beneficial and efficient products and services, new kinds of hybrid structures, such as the limited savings bank established in this bill, would help Texas savings banks compete with out-of-state banks. Competition also would be enhanced through increased parity between Texas laws and laws of other states and the federal government.

CSHB 955 would bolster the regulatory and enforcement authority of the Department of Savings and Mortgage Lending. The provisions of this bill

further would equip the department to protect consumers in making what for most consumers is their single largest investment.

The bill would include technical corrections to the determination of post-judgment interest rates, resolving issues that mistakenly were introduced through the tort reform legislation during the 78th Legislature.

OPPONENTS
SAY:

Texas' current commercial lending laws provide protections against usurious lending practices. While some commercial borrowers have the sophistication to enter into complex loan agreements, not all commercial loans are obtained by sophisticated borrowers. While CSHB 955 contains safeguards for less sophisticated borrowers, such as thresholds under which commercial loans could not be exempted from the interest rate ceiling, the bill could open the door for more safeguards to be removed in the future. Less sophisticated borrowers could be victimized by unscrupulous lenders who incorporated unfavorable terms into contracts without the knowledge of borrowers. Small borrowers may not recognize the implications of all the terms included in a loan contract and often do not possess adequate resources to subject contracts to legal review prior to signing. Texas should not follow the dangerous lead of other states that have exempted all commercial lending from interest-rate ceilings and removed other safeguards for smaller borrowers.

NOTES:

The bill as introduced would:

- have included more extensive consumer-related protections;
- have contained a more elaborate definition of a mortgage loan and provisions regulating credit card accounts;
- have removed the definition of a revolving tri-party account and a cap on aggregate penalties assessed in a year;
- not have included provisions on the abatement process provided for lenders on counterclaims;
- have required the exemption of certain commercial loans from the interest rate ceiling;
- have established real property conditions on qualified commercial loans;
- have created additional penalties for premature termination of a loan;
- have restricted the application of revolving credit account regulations to consumer loans;

- have increased the administrative penalty to savings banks;
- have required finance commission review of injunctive orders;
- have allowed application of restitution to future penalties; and
- have limited multiple recovery penalties.

Provisions in CSHB 955 related to exempting certain commercial loans from rate ceilings would be contingent on the adoption of a constitutional amendment authorizing such action. SJR 21 by Averitt, which would allow the Legislature to create exemptions from the maximum rates of interest on commercial loans, is on today's Constitutional Amendments Calendar.