

- SUBJECT:** Modifying provisions of the Finance Code regulating banks
- COMMITTEE:** Financial Institutions — favorable, without amendment
- VOTE:** 6 ayes — Solomons, Flynn, Chavez, Anderson, McCall, Orr
0 nays
1 absent — Anchia
- WITNESSES:** For — (*Registered, but did not testify:* John Heasley, Texas Bankers Association; Karen Neeley, Independent Bankers Association of Texas)
Against — None
On — Randall S. James, Texas Department of Banking; (*Registered, but did not testify:* Everette Jobe, Texas Department of Banking)
- BACKGROUND:** The banking system is a dual system of state and federal regulation. Finance Code, ch. 12 governs the structure and function of the Texas Department of Banking. Sec. 31 et seq., the Texas Banking Act, provides for regulation of state-chartered banks.

The state of Texas uses a bank’s level of capital and certified surplus as the basis for calculating investment and lending limits. This figure represents the institution’s capital plus an amount the bank board is willing to certify from earnings that would be money available for lending. The certified portion of surplus would not be available for distribution to shareholders as dividends. The federal government and most states use a standard of unimpaired capital and surplus to determine investment and lending limits.
- DIGEST:** HB 2007 would amend the Finance Code to:
- require the Department of Banking to create a financial literacy program;
 - place the banking examination schedule in rule rather than in statute;

- classify nonworking mineral or royalty interests as personal property;
- base the calculation of legal loan and investment limits on unimpaired capital and surplus;
- alter the entities for which a state bank could pledge its assets to secure a deposit; and
- provide for temporary branches in the event of emergencies.

HB 2007 would require the Texas Department of Banking to seek to improve financial literacy and education and to encourage people who previously had not participated in the conventional finance system to use mainstream financial products and services. The department could solicit and accept funds from any source to assist in the implementation of the literacy program. The department would provide resources and follow prescribed methods for helping banks develop financial literacy, education programs, and community outreach.

HB 2007 would remove requirements for the state bank examination schedule from the Finance Code. Instead, the banking commissioner would examine each state bank annually or on another schedule defined by rule or policy.

HB 2007 would base the calculation of legal loan and investment limits on unimpaired capital and surplus rather than unimpaired capital and *certified* surplus.

The banking commissioner could order a state bank that held nonworking mineral or royalty interests to divest such interests if the commissioner determined that continued ownership of the interests was detrimental to the state bank. Nonworking mineral or royalty interests held by a state bank would not be considered real property if:

- the state bank acquired the interest to avoid or minimize a loss on a loan or investment previously made in good faith;
- the interest was not subject to expenses associated with extracting and marketing the minerals subject to the rights or interest;
- the interest was reasonably valued for not more than a nominal amount, and the aggregate amount of earnings from such interests was disclosed in the annual financial statements of the state bank;
- the state bank did not make new investments relating to the rights or interests without the approval of the banking commissioner; and

- the banking commissioner determined that the possession of the interests was not inconsistent with the safety and soundness of the state bank.

A state bank could pledge its assets to secure a deposit of:

- any state or an agency, political subdivision, or instrumentality of any state;
- the United States or an agency or instrumentality of the United States;
- any federally recognized Indian tribe; or
- another entity as authorized by Texas or the United States.

The banking commissioner could authorize a bank or banks to open temporary branch offices to restore banking services to bank customers and the public, if:

- the banking commissioner determined that an emergency would continue to affect one or more particular bank offices for an extended period; or
- if requested by the state bank regulatory agency of a state contiguous to Texas that was experiencing an emergency.

A temporary bank office could remain open for the period specified by the bank commissioner. The bank could convert a temporary branch office to a permanent bank location by obtaining the prior written approval of the banking commissioner.

To ensure coordination between entities to restore banking services after an emergency, the banking commissioner could issue interpretive statements to temporarily waive or suspend regulatory requirements that could impede restoration of financial services. The commissioner also could enter into cooperative, coordinating, or information-sharing agreements with:

- state or federal agencies;
- organizations affiliated with state or federal agencies;
- banks or banking trade associations; or
- other organizations affiliated with or representing one or more banks.

The banking commissioner also would coordinate with the Office of the Governor in the performance of duties related to emergencies. The bill would set forth the circumstances under which confidentiality would be maintained with entities that had cooperative agreements with the banking department.

The bill would take effect September 1, 2007.

**SUPPORTERS
SAY:**

HB 2007 would modernize the Finance Code with respect to banking in several important ways. It would require the Department of Banking to encourage and assist banks in providing financial literacy programs for their local communities. It also would encourage people to take advantage of the benefits of mainstream financial services. HB 2007 would add flexibility to examination scheduling requirements by allowing the department to establish standards by rules that could more readily be adapted to changes in federal law.

The bill also would modernize state law regarding deposits eligible for asset pledging to retain parity with competing financial institutions. HB 2007 would enhance regulatory authority to respond flexibly and effectively to industry needs and cooperate with other bank regulatory agencies during a disaster or other emergency. The bill would revise the classification of nonworking mineral or royalty interests to personal property instead of real property for bank regulatory purposes.

Finally, the bill would revise the calculation base for legal limits on loans, investments, and fixed assets to more closely conform to similar federal standards and ease the regulatory burden for banks. The use of capital and certified surplus, which is exclusive to Texas, allows bank boards to arbitrarily determine the amount of funds available for lending and investments. Subsequently, board officers often fail to file or forget to vote on the amount of certified surplus, which causes great confusion when the department attempts to audit an institution. This can result in these responsible parties being harmed for an unintentional oversight because officers and directors incur personal liability for any loss resulting from a loan that exceeds the legal lending limit.

The safety and soundness implications of a slightly increased legal loan and investment limit are marginal and easily could be managed. Other states with equal or greater limits have not experienced unusual difficulties from the higher limits. Specifically, 15 other states and the

U.S. Territory of Guam have lending limits for state banks that equal or exceed the proposed legal lending limit for Texas state banks.

**OPPONENTS
SAY:**

HB 2007 would expose banks to greater risks in the marketplace by basing the calculation of legal loan and investment limits on unimpaired capital and surplus. The change in definition would have the effect of increasing legal lending and investment limits by an incremental amount beyond what a state bank could set for itself under current law. Any increase in lending and investment limits represents an increased risk, because there could be less funds in reserve in the event of an emergency or other market issues.