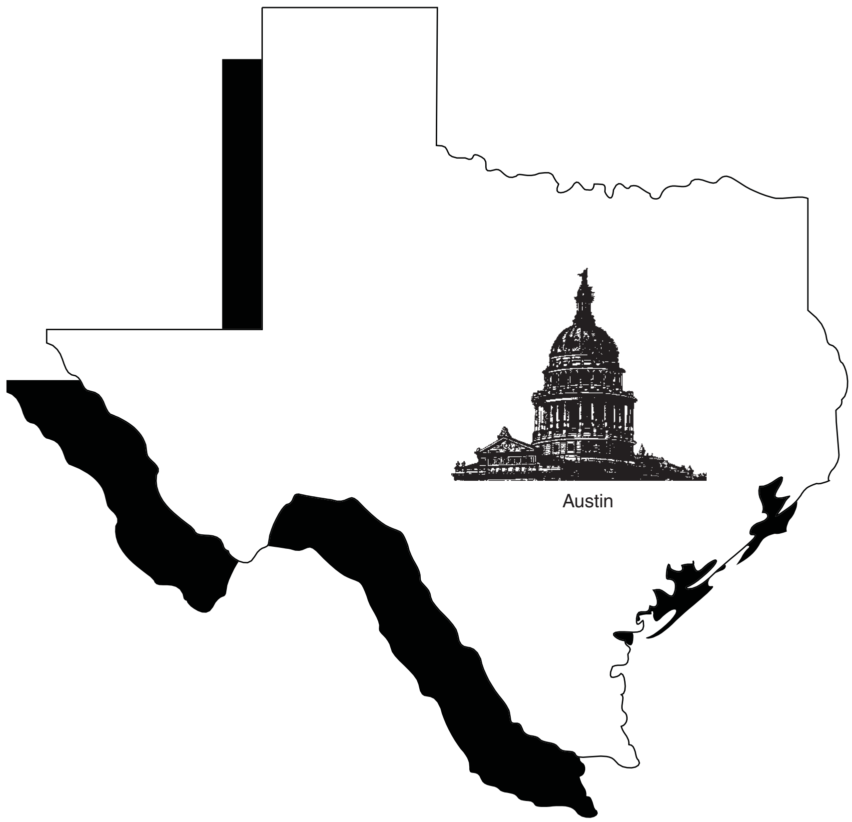
Sunset
Advisory Commission



Finance Commission of Texas
Department of Banking
Savings and Loan Department
Office of Consumer Credit Commissioner

Staff Report

2000

SUNSET ADVISORY COMMISSION

Members

In 1977, the Texas Legislature created the Sunset Advisory Commission to identify and eliminate waste, duplication, and inefficiency in government agencies. The 10-member Commission is a legislative body that reviews the policies and programs of more than 150 government agencies every 12 years. The Commission questions the need for each agency, looks for potential duplication of other public services or programs, and considers new and innovative changes to improve each agency's operations and activities. The Commission seeks public input through hearings on every agency under Sunset review and recommends actions on each agency to the full Legislature. In most cases, agencies under Sunset review are automatically abolished unless legislation is enacted to continue them. This report is the Commission staff's recommendations, which serves as the starting point for the Commission's deliberations.

Finance Commission Agencies

Sunset Staff Report

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Summary

Summary

Overview

The Finance Commission and the three regulatory agencies it oversees – the Department of Banking, the Savings and Loan Department, and the Office of Consumer Credit Commissioner – are professionally regulating the state's financial services industries. Sunset staff concluded, however, that changes are needed to address several key organizational problems and increase consumer protection through stronger regulatory authority. The recommendations in this report would:

- Broaden the representation and strengthen the policy role of the Finance Commission, but eliminate its status as a separate state agency of its own;
- Combine the Department of Banking and the Savings and Loan Department into one agency, the Texas Department of Banks and Thrifts;
- Continue the Office of Consumer Credit Commissioner and strengthen its oversight of sale-leaseback transactions, pay day loans, and car dealer financing; and
- Transfer the licensing of first lien mortgage brokers from the Savings and Loan Department to the Office of Consumer Credit Commissioner.

As part of these reviews, the Legislature also directed the Sunset Commission to review the potential effects of placing the Credit Union Commission under the jurisdiction of the Finance Commission. Sunset staff identified valid reasons both for and against consolidating credit unions under the Finance Commission. These reasons are summarized in Appendix A, *Response to Legislatively Required Analysis of Consolidating the Credit Union Commission Under the Finance Commission*. As the benefits could not be proven to clearly outweigh the possible problems, Sunset staff made no recommendation on this issue.

Finally, recommendations regarding the Department of Banking's funeral-related functions have been postponed until the completion of the Sunset review of the Funeral Service Commission. These include the regulation of prepaid funeral contract sellers and perpetual care cemeteries. The staff report on the Funeral Service Commission is set for release in mid-November 2000.

Issues / Recommendations

Issue 1 The Finance Commission Should Be Continued With Changes to Its Composition, Authority, and Status as an Independent Agency.

Key Recommendations

- Continue the Finance Commission for 12 years.
- Change the composition of the Finance Commission to add a consumer credit industry representative.
- Clarify that the mission and role of the Finance Commission in coordinating financial regulatory policies is to protect consumers and ensure a strong depository and lending system in Texas.
- Vest all rulemaking authority of the three Commissioners in the Finance Commission.
- Eliminate all references to the Finance Commission as an independent state agency.

Issue 2 The State Does Not Need Separate Agencies For Regulating State-Chartered Banks and Thrifts.

Key Recommendation

- Combine the Department of Banking and the Savings and Loan Department into one agency, the Texas Department of Banks and Thrifts.

Issue 3 Licensing of Mortgage Brokers is Unnecessarily Split Between Two Separate Agencies.

Key Recommendation

- Transfer responsibility for licensing first lien mortgage brokers and lenders from the Savings and Loan Department to the Office of Consumer Credit Commissioner.

Issue 4 The Savings and Loan Department Lacks Certain Key Components to Effectively License and Investigate Mortgage Brokers.

Key Recommendations

- Change the agency's authority to obtain criminal background information from the Federal Bureau of Investigation from optional to mandatory.
- Authorize the Department to initiate investigations of mortgage brokers on its own, without a formal written complaint.
- Require the Department to implement a system that ranks complaints according to the order of initial receipt and severity of the alleged violation.

Issue 5 The Banking and Savings and Loan Departments Offer Limited Avenues for Consumers to File Complaints, Particularly With Regard to Privacy.

Key Recommendations

- Require the Finance Commission to develop formal rules to ensure that all entities regulated by the Department of Banking and Savings and Loan Department post information on how consumers may file a complaint.
- Require all privacy notices provided by financial institutions regulated by the Finance Commission agencies to include information on how consumers can file a complaint.
- The consumer complaint handling processes for all agencies beneath the Finance Commission umbrella should be consolidated into one consumer complaint program.
- The consolidated consumer complaint program should collect and report information regarding complaints of violations of privacy by financial institutions regulated by the Finance Commission agencies.

Issue 6 The Departments of Banking and Savings and Loan Do Not Have a Formal Process for Predicting and Responding to an Economic Downturn or Other Industry-Wide Crises.

Key Recommendation

- Require the Department of Banking and Savings and Loan Department to monitor and report to the Finance Commission on the overall condition of Texas' banking system.

Issue 7 Texas Has a Continuing Need for the Office of Consumer Credit Commissioner.

Key Recommendation

- Continue the Office of Consumer Credit Commissioner for 12 years.

Issue 8 Certain Lenders in Texas are Evading State Credit Laws and Regulation by Redefining Loan Transactions.

Key Recommendations

- Define a sale-leaseback transaction as a loan in statute, to be regulated by the Office of Consumer Credit Commissioner.
- Clarify in law OCCC's current regulatory authority over pay day loans.

Issue 9 Authority to Regulate the Financing Activities of Car Dealers Does Not Adequately Address Complaints.

Key Recommendation

- Increase the Office of Consumer Credit Commissioner's authority over the financing activities of car dealers from registration to licensure, and allow the Finance Commission to set reasonable fees to cover the costs of regulation.

Issue 10 The Consumer Credit Commissioner Cannot Require Lenders to Use Plain Language on Credit Contracts.

Key Recommendations

- Require consumer loan contracts to be written in plain language.
- Require the Finance Commission to adopt rules governing consumer loan contracts, including model contracts written in plain language.
- Require the Consumer Credit Commissioner to review the readability of non-standard contracts.

Issue 11 OCCC's Licensing Fees are Outdated, and the Method of Fee Collection is Inefficient.

Key Recommendations

- Repeal the set license fees for regulated lenders and pawnshops, and the process for recovering examination costs; and authorize the Finance Commission to set license fees by rule.
- Authorize the Finance Commission to base fees on the licensee's loan volume, in amounts reasonable and necessary to recover the overall costs of both licensing and examinations.

Fiscal Implication Summary

This report contains several recommendations that would have a minimal fiscal impact to the State overall, but would add 7 FTEs to the Office of Consumer Credit Commissioner. The fiscal impact of these issues is discussed below, followed by a five-year summary chart.

- Issue 1 - Reducing the size of the Finance Commission from nine to seven members would save $6,880 per year, from reduced salary and travel expenses.
- Issue 2 - Consolidating the Department of Banking and the Savings and Loan Department into one agency would have no fiscal impact to the State, as fees are adjusted to cover the actual costs of regulation. Any administrative cost savings to the agency should be redirected to support the agency's examination efforts or result in reduced fees to the regulated industries.
- Issue 3 - Transferring responsibility for first lien mortgage broker licensing from the Savings and Loan Department to OCCC would have no direct fiscal impact to the State, but should help avoid the need for an additional appropriation in FY 2002-2003.
- Issue 9 - Increased regulation of car dealer financing and the addition of 7 FTEs at OCCC would have no net fiscal impact to the State because the costs of regulation are covered by fees charged to car dealers. Sunset staff estimate those costs at $840,000.

Fiscal Year	Savings to the General Revenue Fund	Costs to the General Revenue General Revenue	Net Savings	Change in FTEs from FY 2001
2002	$846,880	$840,000	$6,880	+7
2003	$846,880	$840,000	$6,880	+7
2004	$846,880	$840,000	$6,880	+7
2005	$846,880	$840,000	$6,880	+7
2006	$846,880	$840,000	$6,880	+7

Issues / Recommendations

Issue 1

The Finance Commission Should Be Continued With Changes to Its Composition, Authority, and Status as an Independent Agency.

Summary

Key Recommendations

- Continue the Finance Commission for 12 years.
- Change the composition of the Finance Commission to add a consumer credit industry representative.
- Clarify that the mission and role of the Finance Commission, in coordinating financial regulatory policies, is to protect consumers and ensure a strong depository and lending system in Texas.
- Vest all rulemaking authority of the three Commissioners in the Finance Commission.
- Eliminate all statutory references to the Finance Commission as a separate state agency.

Key Findings

- The composition of the Finance Commission does not reflect an appropriate balance of the financial activities it regulates, particularly in regard to consumer credit.
- State law does not clearly define the Finance Commission's broad role in overseeing and coordinating financial services and ensuring the protection of the interests of Texas consumers.
- The split of rulemaking authority between the Finance Commission and the individual Commissioners reduces its ability to fully oversee the financial regulatory agencies.
- The Finance Commission's role as an independent agency is duplicative, confusing, and unnecessary.

Conclusion

The Finance Commission oversees three separate financial regulatory agencies – the Department of Banking, the Savings and Loan Department, and the Office of Consumer Credit Commissioner. However, the composition of the Finance Commission does not fully reflect the industries overseen by these three agencies. The Finance Commission's limited authority and the independence of its three commissioners impedes effective coordination of financial regulatory policies across agency lines. In addition, the Commission's role is clouded by its dual status as a policy body over three independent agencies and an agency of its own.

The Sunset review studied the mission, composition, and authority of the Finance Commission. The review concluded that the Finance Commission should be continued, but with changes to broaden its composition, clarify its mission, and eliminate its status as an independent agency.

Support

<u>Current Situation:</u> The Finance Commission's primary role is to be the umbrella policy body for Texas' financial regulatory agencies.

- The Finance Commission of Texas is the oversight body for three independent state agencies — the Texas Department of Banking, the Savings and Loan Department, and the Office of Consumer Credit Commissioner. To achieve its oversight purpose, the Finance Commission hires the Banking, Savings and Loan, and the Consumer Credit Commissioners; and adopts rules controlling many of the industries overseen by the Commissioners. The table, *Comparison of the Finance Commission Agencies*, displays the major functions, budgets, and regulatory responsibilities of each of the three independent agencies.

Finance Commission Mission

The mission of the Finance Commission of Texas is to ensure that banks, savings institutions, consumer credit providers, and other businesses or persons chartered or licensed by the State operate as sound and responsible institutions that enhance the financial well-being of Texas.

Comparison of the Finance Commission Agencies

Agency	Budget in $ Millions (FY 99)	FTEs (FY 99)	Financial Industry Regulated	Number	Assets in $ Billions	Average Size in $ Millions
Department of Banking	$10.8	184.5	Banks	370	$52.20	$141.0
			Branches of out-of-state State Charted Banks	6	$34.00	$5,671.1
			Trust Companies	33	$67.20	$2,036.1
			Foreign Bank Agencies	10	$30.80	$3,076.1
			Prepaid Funeral Contractors	438	$2.10	$4.8
			Perpetual Care Cemeteries	227	$.13	$.6
			Currency Exchange Licensees	84	$.04	$.5
			Sale of Check Licensees	49	$473.80	$9,669.1
Savings and Loan Department	$1.2	19	Savings and Loan Associations	1	$.02	$24.3
			Savings Banks	26	$14.10	$525.3
			Mortgage Broker Licensees	8,735	N/A	N/A
Office of Consumer Credit Commissioner	$2.5	47	Pawnshop Licensees	1,539	N/A	N/A
			Pawn Employee Licensees	5,104	N/A	N/A
			Registered Creditors	15,602	N/A	N/A
			Regulated Loan Licensees	3,625	N/A	N/A

N/A = Not Applicable

- The Finance Commission is not only a policy body, but also a separate agency with a part-time Executive Director (currently the Banking Commissioner), separate budget, and statutorily assigned administrative functions – conducting administrative law hearings for the three constituent agencies and researching financial services. The Commission employs an administrative law judge to conduct hearings for appeals of the decisions or enforcement actions of the Commissioners. The Finance Commission accomplishes its research role – which involves studying the availability, quality, and prices of financial services – by contracting with independent researchers. The textbox, *Finance Commission Research*, details the studies that have been completed or are underway.

The Finance Commission is both a policy body for the three financial regulatory agencies and a separate agency itself.

Finance Commission Research

Study	Date Completed	Findings
Consumer Deposits	Fall 1998	Greater consumer personal finance education is needed to give consumers better knowledge of their own financial situation, and confidence to seek the most cost-effective services to meet their needs.
Home Equity Lending	Fall 1999	About 10 percent of homeowners have applied for a home equity loan and about 9 percent have actually obtained a loan. The majority of home equity loans are used to pay off credit card or other debts, or to finance home improvements. The study also identified recommendations for improvements to home equity laws.
Consumer Lending	In Progress	This study will examine the availability, quality, and pricing of consumer loans, and the practices of businesses that make consumer loans.

- The Finance Commission is currently composed of nine members – five public members, one of whom must be a certified public accountant (CPA); two banking representatives; and two thrift representatives. This composition and current membership is displayed in the table, *Finance Commission of Texas.*

Finance Commission of Texas			
Qualification	**Member**	**Residence**	**Term Expires**
Public Members	W.D. Hilton, Jr. Chair	Greenville	February 2002
	Marlene Martin	San Antonio	February 2002
	Victor (Buddy) Puente, Jr.	Pantego	February 2004
	Robert V. Wingo	El Paso	February 2004
Public Member, CPA	Jacqueline G. Humphrey	Amarillo	February 2006
Banking Industry Representatives	Vernon Bryant, Jr.	Weatherford	February 2006
	Deborah H. Kovacevich	Jewett	February 2004
Thrift Industry Representatives	Manuel J. Mehos	Houston	February 2002
	John Snider	Center	February 2000

Need for Function/Structure: Texas has a continuing need for an umbrella policy body to oversee its financial regulatory agencies.

- Texas is unique in having three separate state agencies to oversee banking, thrifts, and consumer credit – linked only by a single policy board, the Finance Commission. In many other states, activities of the agencies overseen by the Texas Finance Commission are consolidated into a single regulatory agency. Thirty-three states have a consolidated agency for banking, thrift, and consumer finance supervision.[1] A number of other states combine even more related functions, such as insurance and securities, into a single regulatory agency. While the need for some consolidation of these agencies will be addressed later in this report, as long as Texas maintains separate financial agencies, the need for an umbrella policy body to link them together will remain critical.

- Financial services, such as the depository and loan services provided by banks, thrifts, and consumer credit providers, are important to the financial health of Texas. Economists have pointed out that economic development depends upon the availability of financial services.[2]

  The primary responsibility of two of the Finance Commission agencies, the Department of Banking and the Savings and Loan Department, is to supervise depository institutions – banks and thrifts. Regulatory supervision of the banking and thrift industries is designed to protect their safety and soundness. Without effective supervision, depository services might become less available to Texans, threatening the state's economy.

The role of the Office of Consumer Credit Commissioner differs from the other two agencies as it does not focus on protecting the soundness of an industry, but on protecting consumers through regulation and education. OCCC's regulation of the credit industry is designed to foster a healthy, lawful credit environment. This credit regulation aids in the economic prosperity by ensuring the fair availability of credit to Texans.

- The Finance Commission's role in overseeing the three agencies is necessary to ensure consistent policy and coordination of related activities. Although the agencies approach regulation in different ways, their ultimate goal is the protection of consumers.

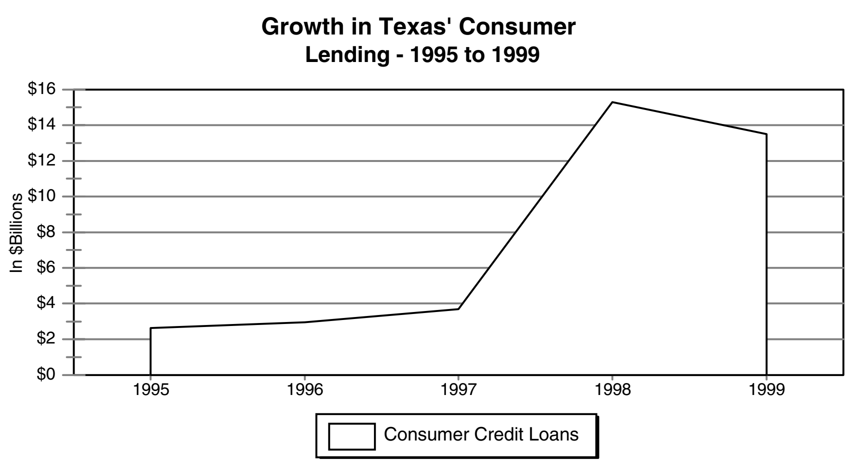
<u>Problem:</u> The composition of the Finance Commission does not reflect an appropriate balance of the financial activities it regulates, particularly in regard to consumer credit.

- The current composition of the Finance Commission – two banking industry representatives, two savings and loan industry representatives, and four public members – fails to include any consumer credit industry representation. Therefore, while banks and thrifts are equally represented, the industries regulated by the Office of Consumer Credit Commissioner have no specific representation.

The $13 billion consumer credit industry is not represented on the Finance Commission.

- The OCCC regulates interest rates and the multi-billion dollar credit-granting industry in Texas. Most consumer loans made outside of depository institutions are regulated by this agency. This includes loans made through more than 3,700 consumer loan businesses; and financing arranged through more than 15,000 registered creditors selling cars, manufactured homes, and other consumer goods. The issues and concerns facing this type of lender or creditor differ significantly from those of banks and savings and loans.

- The lenders regulated by the Office of Consumer Credit Commissioner have also experienced tremendous growth in their industries in recent years. The strength of this growth can be seen in the graph, *Growth in Texas' Consumer Lending – 1995 to 1999*. The jump in the loans evident in 1998 is



due to the addition of home equity lending, which accounted for $11 billion of the $15.3 billion in consumer loans made that year.

- Given the growth in the consumer credit industry, the imbalance in the representation on the Commission will only worsen. A recent study by the Federal Reserve predicts that consumer lending by banks and thrifts will continue to decline, while lending by finance and mortgage companies, which the Office of Consumer Credit Commissioner regulates in Texas, will continue to grow.[3]

Problem: State law does not clearly define the Finance Commission's broad role in overseeing and coordinating financial services and ensuring the protection of the interests of consumers in Texas.

- The Finance Commission is the only Texas policy body that oversees three separate agencies. In many ways, the Commission functions as a policy body for each of the three agencies, with little or no adoption of policy, or coordination of activities between them. In all fairness, the statute does not currently provide for such a role.

  Unlike most laws establishing boards or commissions, the Finance Code does not assign a broad mission, purpose, or directive to the Finance Commission. The statute simply directs the Commission to employ the three Commissioners, a hearings officer, and an internal auditor, and to adopt rules for each of the three agencies.

  The Finance Commission is looked to by many observers as the central point of coordination for the Texas' financial system. For example, the Legislature in 1997 charged the Finance Commission with conducting studies of the availability and adequacy of financial services offered in Texas, including lending and depository services. This change in law is the only directive that encompasses coordination across both the lending and depository services regulated by all three agencies.

State law does not establish a broad mission or purpose for the Finance Commission.

- In addition, the Finance Code does not provide the Commission with any overall directive to set policy in a way that protects the interests of consumers of financial services in Texas. Title 5 of the Finance Code establishes specific protections of consumers in financial services and, in particular, gives the Consumer Credit Commissioner a duty to encourage the establishment of non-profit debt counseling services for consumers. The Finance Commission, however, does not have a statutory role in overseeing these provisions.

<u>Problem:</u> The split of rulemaking authority between the Finance Commission and the individual Commissioners reduces its ability to fully oversee the financial regulatory agencies.

- Despite its oversight responsibility, the Finance Commission is not fully vested with rulemaking authority for all the programs of the umbrella agencies. In some respects, the Finance Commission functions as a policy body overseeing the three agencies. On the other hand, the agencies' Commissioners maintain the rulemaking authority for many of their programs, and only report to the Finance Commission when necessary. The table, *Finance Commission Rulemaking Authority*, cites specific examples of this authority.

- Because the Finance Commission does not have full authority in all areas, it cannot fully oversee the three constituent agencies. For example, the Banking Commissioner may adopt rules to regulate prepaid funeral service contractors without approval of the Finance Commission. Similarly, the Savings and Loan Commissioner may adopt rules governing the mortgage broker industry without approval of the Finance Commission.

- Because the agencies function independently and the Finance Commission's authority is limited, Texas has no real coordination of its financial

Finance Commission Rulemaking Authority

Agency	Program		Rulemaking Authority
Department of Banking	State Banks	State Banks (General)	Finance Commission
		Rules to Override State Bank Parity Provision	Banking Commissioner
	Bank Holding Companies		Finance Commission
	Trust Companies		Finance Commission
	Death Care	Prepaid Funeral Service Contractors	Banking Commissioner
		Perpetual Care Funeral Homes	Banking Commissioner
	Sale of Checks	Check Sellers (General)	Finance Commission
		Investments by Check Sellers	Banking Commissioner
	Currency Exchange	Currency Exchange (General)	Finance Commission
		Currency Exchange Co. deposits made in lieu of bonds	Banking Commissioner
Savings and Loan Department	Thrifts	Savings & Loans	Jointly by Finance Commission and Savings & Loan Commissioner
		State Savings Banks	Jointly by Finance Commission and Savings & Loan Commissioner
	Mortgage Brokers		Savings & Loan Commissioner
Office of Consumer Credit Commissioner	Consumer Credit Lenders	Consumer Credit Lenders (General)	Finance Commission
		Confidentiality of Information	Consumer Credit Commissioner
		Rules Facilitating Registration of Lenders	Consumer Credit Commissioner
	Pawn Industry	Pawnshops Licenses	Consumer Credit Commissioner

regulation and may be poorly prepared to address changes in federal regulation and the modernization of the financial services industry.

<u>Problem:</u> The Finance Commission's role as an independent agency is duplicative, confusing, and unnecessary.

- The current structure, in which the Finance Commission is both a policy body overseeing three independent agencies and a separate agency itself with administrative functions, causes duplication in legislative oversight. For example, each agency is required to submit a separate Legislative Appropriations Request to the Legislative Budget Board and to the Finance Commission. In addition, the Finance Commission submits an LAR to the LBB.
- The current practice, in which one of the Commissioners serves as a part-time Executive Director of the Finance Commission, also may cause observers to question the independence of the Finance Commission. Because the Executive Director position has been assigned to the Banking Commissioner, the position may be perceived by some as giving the Banking Department leverage over the other agencies.
- The Finance Commission's administrative functions, could easily be assigned to one of the three umbrella agencies or transferred to another state agency. The research efforts are already assigned to one of the three agencies to oversee and administer. In the case of the internal audit and administrative hearing functions, both could continue to answer directly to the Finance Commission, with administrative support provided by one of the three agencies.

Recommendation

Change in Statute

1.1 Continue the Finance Commission for 12 years.

This recommendation would reauthorize the Finance Commission for the standard 12-year period, with the agency subject to Sunset review again in 2013.

1.2 Change the composition of the Finance Commission to add a consumer credit industry representative.

Under this recommendation, the Commission would be composed of:

- one member who represents the banking industry;
- one member who represents the thrift industry;
- one member who represents the consumer credit industry; and
- four public members.

This recommendation would add a representative of the consumer credit industry, while establishing a balanced representation across the three key industries overseen by the Commission. It would reduce the size of the Commission from nine to seven members, but would maintain a majority of public members. The current requirement that one public member be a CPA would be continued. The Commission's new seven-member size would be within the structure of the recent constitutional amendment concerning the size of legislatively created boards.

Although the number of banking and thrift industry representatives would be reduced, the point of having industry representation should be to gain expertise and knowledge of industry operations, not to maintain voting strength on the Commission. A single representative from each of the banking, thrift, and consumer credit industries can provide the needed expertise and knowledge.

1.3 Clarify that the mission and role of the Finance Commission, in coordinating financial regulatory policies, is to protect consumers and ensure a strong depository and lending system in Texas.

This recommendation is intended to establish the Finance Commission's statutory role as both the umbrella policy body overseeing the three financial regulatory agencies, and direct it to take a broad view of Texas' financial services industry. The Finance Commission would serve as the single point of accountability for ensuring that Texas' depository and lending institutions function as a system. This coordination should focus on protecting consumers' interests, as well as maintaining a safe and sound banking system, as a means of increasing the economic prosperity of the state. To express its view of Texas' financial future, the Finance Commission should continue to complete a strategic plan that would focus on the Commission's role of coordinating Texas' financial system. While the strategic plan should express the Finance Commission's mission, goals, and strategies, the document would not be used as a budgetary document or submitted to the LBB for the appropriations process. For an example of a non-budgetary strategic planning process, the Finance Commission should draw on the expertise of the Department of Information Resources, as that agency's strategic plan for information resources is a model planning process. The Commission should require the Commissioners to work together to produce the plan.

1.4 Vest all rulemaking authority of the three Commissioners in the Finance Commission.

This recommendation would ensure that the Finance Commission has the full ability to control the policy decisions of the three financial regulatory agencies. The current mix of responsibilities for rulemaking between the Commissioners and the Finance Commission would be eliminated in favor of a clear vesting of all rulemaking authority within the policy body.

1.5 Eliminate all statutory references to the Finance Commission as a separate state agency.

This recommendation would maintain the Commission as a policy body over the three financial regulatory agencies, but eliminate its current status as an independent state agency. It would also eliminate the need for a separate Executive Director position. Under this recommendation, the Finance Commission would continue to be responsible for hiring the Commissioners of the three financial regulatory agencies, and approving budgets and legislative appropriations submissions, but the Commission's separate budget codes and responsibility for filing its own Legislative Appropriations Request would be rescinded. Responsibility for overseeing future studies of the availability of financial services could continue to be assigned by the Commission to one of the three agencies.

Impact

These recommendations would continue the Finance Commission as a policy body responsible for overseeing Texas' three financial regulatory agencies, give the Commission the tools it needs to fully oversee the three constituent agencies, and clear up confusion over whether the Commission is a separate agency. While Texas, unlike the majority of states, has chosen to place its financial regulatory functions into separate agencies under a single umbrella body, the degree of coordination should be increased. The Finance Commission currently functions very much like a separate policy body for each of the three agencies. Ensuring that the Commission's composition is more representative of its functions, granting it full authority over all its agencies, and requiring it to have a broad viewpoint will help ensure that the Commission coordinates the whole financial regulatory system.

Fiscal Implication

These recommendations would have a fiscal impact to the State. Reducing the size of the Commission from nine to seven would eliminate the travel expenses of two Commission members. Based on current projections, costs would decrease by $480 per year. Eliminating the Finance Commission Executive Director position will save $6,400 annually. The remaining recommendations would not have a fiscal impact.

Fiscal Year	Savings to the General Revenue Fund
2002	$6,880
2003	$6,880
2004	$6,880
2005	$6,880
2006	$6,880

[1] Conference of State Bank Supervisors, *FY 1998 Profile of State-Chartered Banking*, p. 1-4.

[2] Strategic Economic Policy Commission, *A Strategic Economic Plan for Texas*, January 1989.

[3] Federal Reserve Bulletin, Recent Changes in U.S. Family Finances: Results from the 1998 Survey of Consumer Finances, (January 2000), p.24.

Issue 2

The State Does Not Need Separate Agencies For Regulating State-Chartered Banks and Thrifts.

Summary

Key Recommendation

- Combine the Department of Banking and the Savings and Loan Department into one agency, the Texas Department of Banks and Thrifts.

Key Findings

- The preservation and growth of the state-chartered banking industry relies upon the oversight of the Department of Banking.
- The safety and soundness of the state-chartered thrift system relies upon the regulatory oversight of the Savings and Loan Department.
- The activities of the Department of Banking and the Savings and Loan Department are similar, resulting in unnecessary administrative and regulatory duplication.
- Separation of regulation between two agencies could foster inappropriate competition between them.
- The current status of the state-chartered thrift industry in Texas fails to justify the maintenance of a separate state agency.
- Consolidation of state regulatory agencies for banks and thrifts has not been proven to harm the preservation of state-chartered thrifts in other states.
- Other financial regulatory agencies regulate more than one type of depository institution without any detriment to the institutions.

Conclusion

Texas does not need its Department of Banking separate from the Savings and Loan Department. Both agencies regulate industries that are very similar and the supervisory and regulatory duties of each Department are essentially the same. Nevertheless, the functions of the Department of Banking and the Savings and Loan Department are required for the continued safety and soundness of Texas' banks and thrifts. The examination functions of both agencies are crucial for the maintenance of institutions' solvency and the protection of consumers' deposits. More importantly, both Departments play a critical role in the preservation of the dual chartering system where banks and thrifts have the option of choosing between a state charter or a national one. This system ensures that Texas consumers can access Texas-chartered banks and thrifts that can serve their financial needs.

The Sunset review concluded that while the functions of the Banking and Savings and Loan Departments are clearly needed, very little reason was found to justify maintaining two separate agencies to perform these similar functions. Consolidating both Departments into one agency would remove unnecessary duplication and create greater regulatory efficiencies. Sunset staff found no evident disadvantage to consolidating state regulatory agencies, particularly with regard to the state chartering system.

Support

Current Situation: The Departments of Banking and Savings and Loan regulate the state's depository institutions.

- The mission of the Department of Banking is to ensure the safety and soundness of the financial services system in Texas. As part of this mission, the Department supervises banks and trust companies and other non-bank entities. The list of entities regulated by the Department is provided in the textbox, *Entities Supervised by Banking Department*. During FY 1999 the Department employed 144 FTEs despite its allocation for 184.5. The Department currently employs 138 staff and has a budget of $9.1 million.

Entities Supervised by Banking Department

Banks and Trusts
- State-chartered banks
- State-chartered trusts
- Bank holding companies
- Bank information service providers
- Interstate branches of state banks
- Foreign bank offices

Non-Bank Entities
- Perpetual care cemeteries
- Prepaid funeral contract sellers
- Check sellers
- Currency exchange businesses

- The Savings and Loan Department monitors the safety and soundness of state-chartered thrifts (savings banks and savings and loans) while ensuring their compliance with state and federal statutes. In addition to regulating state-chartered thrifts, the Department is also responsible for the licensing of mortgage brokers under the Mortgage Broker Licensing Act. The Department currently employs 22 staff and has a budget of $1.2 million.

Current Situation: Banks and thrifts operating in Texas have the option of getting a state or federal charter.

- Texas participates in the dual chartering system. Under this system, banks and thrifts have the option of selecting a charter offered by the Federal government or the State of Texas. Both the state and federal charter allow banks the right to conduct business in all 50 states. Thrifts have the option of the Texas Savings Bank Charter, the Texas Savings and Loan Charter, or the Federal Savings Association Charter. The table below provides detail on the types and number of depository institutions doing business in Texas.

Types of Depository Institutions					
Type of Institution	**Banks**		**Thrifts**		
Types of Charters Available	Texas Charter	National Charter	Texas Savings Bank Charter	Texas Savings & Loan Charter	Federal Savings Association Charter
Number of Institutions in Texas*	376	374	26	1	25
Amount of Assets (in billions)	$86.2	$130.2	$14.1		$45.5
Regulator	Department of Banking and Federal Deposit Insurance Corporation or Federal Reserve Bank	Office of the Comptroller of the Currency	Savings and Loan Department and Federal Deposit Insurance Corporation	Savings and Loan Department and Federal Deposit Insurance Corporation, Office of Thrift Supervision	Office of Thrift Supervision
Advantages of Charter	Locally oriented, Accessible regulator, Cheaper assessments than for nationally-chartered institutions	National regulation, Single regulator	Locally oriented, Accessible regulator, Cheaper assessments than for Federal Savings Associations	Locally oriented, Accessible regulator, Cheaper assessments than for Federal Savings Associations	National regulation, Single regulator
Disadvantages of Charter	Multiple regulators, Inconsistent interstate regulation	National orientation, Less accessible regulator, More expensive assessments	Multiple regulators, Inconsistent interstate regulation	Multiple regulators, Inconsistent interstate regulation	National orientation, Less accessible regulator, More expensive assessments

* Includes branches of out-of-state chartered banks.

- One of the advantages of the dual chartering system is that it gives banks and thrifts a choice between regulators. Nationally-chartered banks are regulated by the U.S. Office of the Comptroller of the Currency, while nationally-chartered thrifts are regulated by the U.S. Office of Thrift Supervision.

  State-chartered banks are regulated by the Texas Department of Banking and either the Federal Deposit Insurance Corporation (FDIC) or the Federal Reserve Bank. State-chartered thrifts are regulated by the Savings and Loan Department jointly with the Federal Deposit Insurance Corporation.

State-chartered banks are reviewed by the Department of Banking and federal regulators on a rotating basis. The examination frequency is based on the size and risk profile of the institution with the time period ranging between six and 18 months. In addition to the alternating examination schedule, the Department of Banking performs joint examinations with federal regulators on large and/or high-risk institutions. If the bank is a member of the Federal Reserve System, then the Federal Reserve Bank of Dallas is the alternating agency. If the bank is not a Federal Reserve member, then the FDIC is the alternating agency.

State-chartered thrifts are monitored by both state and federal regulators and examined jointly on an annual or 18-month cycle, or if circumstances dictate on a more frequent basis. In contrast to the Department of Banking's examination schedule, the Savings and Loan Department does not alternate state-chartered thrift examinations with FDIC. Rather, both the Savings and Loan Department and FDIC always conduct joint examinations of state-chartered thrifts.

Need for Department of Banking Functions: The preservation and growth of the state-chartered banking industry relies upon the oversight of the Department of Banking.

- The state bank charter helps nurture and grow the banking industry within the state, thereby increasing the number of local institutions to serve the credit needs for Texas citizens. Between 1986 and 1992, Texas suffered from widespread failures in the banking industry. Although the banking crisis was felt nationwide, its impact was most severe in Texas. During that time 486 banks— 188 state-chartered and 298 nationally-chartered— failed.[1] These failures accounted for 42 percent of the number of all bank failures in the United States between 1986 and 1992.[2] By the end of the crisis nearly one-third of the banks in Texas had failed.

  This wholesale decline in the number of banks in Texas resulted in both fewer institutions and less capital available for Texans. The magnitude of the Texas banking disaster, coupled with its lasting effects, supports the continuing need for the state banking charter as a means of re-growing Texas' banking industry.

- The state bank charter affords greater local control over a portion of the banking industry. Unlike nationally-chartered banks in Texas, state-chartered banks are required to have a majority of their board of directors be Texas residents. Moreover, the supervisory and regulatory activities of the Department of Banking provide an avenue for the State's policymakers to cultivate the fiscal health of Texas.

Between 1985 and 1992, Texas suffered from widespread failures in the banking industry.

- The state bank charter is an attractive alternative to the National Bank Charter for banks seeking to conduct business in Texas. State-chartered banks have greater access to their primary regulator, the Department of Banking, than do national banks. Furthermore, the cost of state regulation is significantly lower than that for national regulation. Texas state-chartered banks pay between 12 to 57 percent less in regulatory assessments than nationally-chartered banks.[3]
- The Department of Banking evaluates state-chartered banks to ensure that they remain solvent and that citizens have access to their deposits. The Department's bank evaluations check for compliance with the Texas Finance Code, and that banks' operations are administered in a safe and sound manner. Each evaluated bank is given a CAMELS rating. The significance of the CAMELS ratings is described in the textbox, *What is a CAMELS Rating*. Institutions receiving a rating of 3, 4, or 5 are placed on a watch list and an accelerated examination schedule. Those banks with a rating of 4 or 5 are subject to fines, cease and desist orders, or be placed under conservatorship.

  The Department also has the power to close state banks found to be close to insolvency. Historically, the Department used supervisors and conservators long after problem signs arose with a bank. The agency's current posture, however, is to install supervisors or conservators at the earliest detection of serious problems.

What is a CAMELS Rating?

The term, CAMELS, is an acronym for the evaluator components of a typical depository institution exam. The components of a CAMELS examination are: Capital adequacy, Asset quality, Management and administration, Earnings and reserves, Liquidity and funds management, and Sensitivity to market risk. All institutions evaluated with CAMELS criteria are given a rating of between one to five. The significance of each rating is as follows.

Rating Condition
1. Institution is in excellent condition
2. Institution suffers from a few problems
3. Examiners found regulatory concerns with capital and asset quality
4. Examiners found substantial problems
5. Insolvency imminent

- Today, Texas' state-chartered banks are generally in excellent condition. As of August 2000, 97 percent of the banks supervised by the Department of Banking had CAMELS ratings of 1 or 2.[4] Only 2 percent of state-chartered banks had a 3 rating, while the remaining 1 percent had a rating of 4 or 5. Only one state-chartered bank has failed since 1994.

<u>Need for Savings and Loan Department Functions:</u> The safety and soundness of the state-chartered thrift system relies upon the regulatory oversight of the Savings and Loan Department.

- The state's thrift charters provide a valuable alternative for thrifts looking to conduct business in Texas. Texas-chartered thrifts have easier access to their regulator, the Savings and Loan Department, than do national thrifts. In addition, the regulatory assessments for state-chartered thrifts are 50 percent less than those for Federal Savings Associations. The attractiveness of the thrift charter provides a needed incentive for the maintenance and potential growth of state-chartered thrifts. Promotion of the state-chartered thrift industry provides the credit necessary to support the consumer, small business, residential housing and real-estate finance needs of the state economy, facilitating industry growth in Texas.[5]

- The Savings and Loan Department evaluates the safety and soundness of state-chartered thrifts in Texas to ensure that they remain solvent and that the deposits of Texas consumers remain protected. The Department's thrift evaluations also ensure compliance with state and federal laws. Like the Department of Banking, the Savings and Loan Department evaluates thrifts on the basis of CAMELS ratings. At the end of 1999, each of the 27 state-chartered Texas thrifts was considered "well capitalized" under state and federal capital standards. Currently, more than 95 percent of state-chartered thrifts are rated a 1 or 2 by both the Department and federal regulators.[6] If a thrift is found to have a poor CAMELS rating, the Department undertakes disciplinary action in conjunction with the FDIC.

<u>Current Situation:</u> The industries regulated by the Department of Banking and the Savings and Loan Department are very similar.

The Rise of Mortgage Companies

The traditional focus of the thrift industry, that of real-estate lending, has recently been eclipsed by the rise of mortgage companies. In 1990, thrifts accounted for 30 percent of all mortgage loans, while mortgage companies accounted for 35 percent. Seven years later, in 1997, mortgage companies accounted for 56 percent of all loans, while the number that thrifts were responsible for dwindled to 18 percent. This general decline in the stature of the thrift industry as the preeminent real-estate lender has been a national phenomenon.

Source: Mortgage Bankers Association of America

- Historically, thrifts have focused on housing and real-estate lending, while banks covered the broad spectrum of consumer and commercial deposits, loans, real-estate lending, and other financial services. The distinction between these institutions has become blurred as recent changes in state and federal law have permitted banks and thrifts to engage in similar lending and investment activities.[7] Moreover, as observed in the textbox, *The Rise of Mortgage Companies*, thrifts have lost ground in the area of real-estate lending to the growing influence of mortgage lenders.

- The differences between a state thrift and a state bank are not important to the typical consumer. Both institutions take deposits, offer checking accounts, provide automatic teller machines, and underwrite personal and real-estate loans. Moreover, individuals conducting business with a thrift gain the same advantages as they would with a bank. In fact, banks and thrifts both frequently use the word "bank" in their name. For example, the difference between Bank United and Bank of America is that the former is a thrift while the latter is a bank.

- Under Texas law, both banks and thrifts are permitted to receive and pay deposits, borrow money, act as a fiduciary, and, among other powers, engage in interstate branching. A comparison of the powers of state-chartered thrifts and banks is provided in the chart, *Comparison of State Thrift and Bank Powers*. In addition, both state-chartered thrifts and banks have powers equal to those held by national banks.

Comparison of State Thrift and Bank Powers

	Thrift	Bank
Receive and pay deposits	✓	✓
Borrow and lend money	✓	✓
Invest money	✓	✗
Discount and negotiate promissory notes	✓	✓
Exercise incidental powers necessary to the purpose of its charter	✓	✓
Engage in other activities determined by the Commissioner to be closely related to banking	✓	✓
Exercise powers of Texas business corporation necessary to exercise its specific powers	✓	✓
Act as an agent, including receiving and disbursing money and transferring securities in that capacity	✓	✓
Act as a fiduciary	✓	✓
Engage in commerce or own and operate a business as necessary to avoid or minimize loss on prior loan or investment made in good faith	✓	✓
Contribute to charities	✓	✓
Parity with national banks	✓	✓
Conduct interstate business, branching	✓	✓

Under federal law, an institution with a state savings bank charter is regarded as a state bank; and state savings banks are regulated just like state banks, with a state regulator, and FDIC as the primary federal regulator.[8]

- Before November 1999, the unique advantage of the state thrift charter was that it empowered thrifts to form unitary thrift holding companies. These types of holding companies allow state-chartered thrifts to affiliate with other types of financial institutions, such as insurance companies and securities dealers, and private, for-profit corporations. State-chartered banks were not granted this power given to thrifts. In fact, some state-chartered Texas banks switched to the state thrift charter to take advantage of the unitary thrift holding company option. Currently, 11 state-chartered thrifts are owned by unitary thrift holding companies in Texas.

The disparity between the state bank charter and the state thrift charter ended with the passage of the Gramm-Leach-Bliley Act (GLBA) in November 1999. See Appendix B, *The Gramm-Leach-Bliley Act of 1999,* for additional information. The GLBA authorized banks and thrifts to form financial holding companies for affiliations with insurance companies, securities dealers, and any other type of industry deemed "financial in nature" by the Federal Reserve Bank. The GLBA also eliminated the ability of thrifts to form new unitary thrift holding companies. Now, state-chartered thrifts and banks have the equal opportunity to form financial holding companies.

<u>Problem:</u> The activities of the Department of Banking and the Savings and Loan Department are similar, resulting in unnecessary administrative and regulatory duplication.

The Departments of Banking and Savings and Loan operate as separate agencies despite the similarities in the industries they regulate.

- The Department of Banking and the Savings and Loan Department operate as separate agencies despite the similarities in the industries they regulate. Although the two agencies are functionally separate, strong similarities exist between them. For example, both agencies are responsible for ensuring the safety and soundness of the state-chartered depository institutions that they regulate. Each Department is directed by a Commissioner with practically the same powers with regard to depository industry regulation.

- Sunset staff found that the regulatory activities of both agencies are very similar. The application processing procedures and criteria used by both agencies are similar. Both departments conduct examinations of depository institutions under their jurisdiction. The components of these examinations are similar. Both evaluate thrifts and banks on the basis of the CAMELS code. In addition, each agency's examination involves the review of similar records, verification of financial data, evaluation of policies, and the testing for compliance with state and federal laws. Sunset staff's review of the evaluation reports produced by the Departments of Banking and Savings and Loan revealed that the examination procedures and the resultant findings are very comparable.

- Having two agencies conducting similar regulatory activities produces unnecessary administrative duplication. To ensure safe and sound financial institutions, both agencies must maintain regulatory programs based primarily on regular examination of the institutions under the agency's jurisdiction, comprehensive off-site monitoring between examinations, initiation of enforcement actions when problems are identified, review of applications for corporate changes, and investigation of consumer complaints.

Problem: Separation of regulation between two agencies could foster inappropriate competition between them.

- Sunset staff found a degree of competition between the Department of Banking and the Savings and Loan Department with regards to the promotion of their respective charters. For example, the Savings and Loan Department's Web site contains information as to why institutions should adopt a state thrift charter. One document entitled "Thrift Charter Alternatives" lists advantages of the thrift charter compared to the state bank charter.[9] While this is informative, some could view this as attempting to "sell" the state thrift charter. In addition, in its *Self Evaluation Report to the Sunset Commission* the Savings and Loan Department identifies the state thrift charter as "viewed by many as the most progressive and innovative financial institution charter in the State."[10] This approach is highly unusual for a regulatory agency in state government.
- These state agencies also openly compete with the U.S. Office of the Comptroller of the Currency and the U.S. Office of Thrift Supervision to promote the state thrift and bank charters. While competition with federal agencies may work to promote the State's interest through the promotion of the state charter, competition between state agencies does not. Competition between state regulators could promote a laxity in oversight or affinity with the industry that would preclude effective regulation. Staff would clarify that this situation was not detected during the review, but felt that the potential existed.

Problem: The current status of the state-chartered thrift industry in Texas fails to justify the maintenance of a separate state agency.

Between 1929 and 1961, state-chartered thrifts were regulated by the Department of Banking.

- Between 1929 and 1961 state-chartered thrifts were regulated by the Department of Banking. In 1961 the Legislature created the Savings and Loan Department separate from the Department of Banking. At that time, 161 state-chartered thrifts operated with \$1.8 billion in assets (in 1961 dollars). Less than 20 years later the number of state-chartered thrifts in Texas grew to 255 institutions. Then, the size and scope of the state-chartered thrift industry, in addition to its then-predominant real-estate emphasis, arguably justified the maintenance of a separate state agency.
- The savings and loan crisis of the 1980s decimated Texas' thrift industry. In 1986, 235 state-chartered thrifts in Texas reported \$84 billion in assets. Over the next five years, scores of state and nationally-chartered thrifts failed. Although fraudulent activity accounted for some failures, the majority resulted from the collapses

in the Texas oil and real-estate markets. By 1992 only 31 state-chartered thrifts with assets of $8.3 billion remained. While the crisis, coupled with subsequent changes in federal law, all but eradicated the state-chartered thrift industry in other states, a portion of the once massive industry remains in Texas.

- Today, 27 state-chartered thrifts in Texas operate with assets of $14 billion. The number of state-chartered thrifts in Texas has not significantly changed since 1993. While continued regulation of these 27 thrifts is important, Sunset staff found no real justification for maintaining a separate state agency to perform this function, given the diminished size of the state-chartered thrift industry.

<u>Comparison:</u> **Consolidation of state regulatory agencies for banks and thrifts has not been proven to harm the preservation of state-chartered thrifts in other states.**

Texas remains one of two states that still has seperate regulatory agencies for thrifts and banks.

- Texas remains one of two states that still has separate regulatory agencies for thrifts and banks. The majority of other states have placed their bank and thrift regulation in a single department. Even California, which has roughly the same number of state-chartered thrifts as Texas, regulates banks and thrifts through its Department of Financial Institutions.
- The states of Oklahoma, Virginia, and Louisiana consolidated their thrift and bank regulation long before the financial crisis of the 1980s. During the savings and loan crisis of the 1980s, these states, particularly Louisiana and Virginia, lost a significant number of state-chartered thrifts. The failures of the S&L crisis, not the consolidation of regulatory agencies, drastically reduced the number of state-chartered thrifts in these states. After the crisis, these states, like many others, were unable to regrow their state-chartered thrift industries.
- Some states have consolidated their depository institution regulatory agencies in an attempt to promote their thrift charters. For example, in 1994, Missouri merged the responsibility of regulating savings and loans into the Division of Finance. Missouri enacted this merger to decrease the costs for regulating its thrifts, and thereby make its state thrift charter more attractive. Despite the move to increase the attractiveness of its charter, the majority of its thrifts converted to the federal charter. The reasons for this shift are subject to debate.

<u>Comparison:</u> **Other financial regulatory agencies regulate more than one type of depository institution without any detriment to the institutions.**

- The Federal Deposit Insurance Corporation examines both state-chartered banks and thrifts. The FDIC uses a single pool of examiners for these reviews, and relies upon the same CAMELS evaluation criteria for both types of institutions.

- In addition to regulating state-chartered banks, the Department of Banking also regulates state-chartered trusts under the *Texas Trust Company Act*. Currently, 33 public trust companies operate in Texas. Interestingly enough, trust companies are, by nature, very different from state-chartered banks. Despite the significant differences in bank and trust company functions, the Department of Banking maintains their regulators within a single division. Moreover, the Department maintains personnel with expertise on trust company examinations, thereby ensuring thorough and fair examinations for Texas' trusts. Despite the consolidation of regulatory responsibility, both state-chartered banks and trusts continue to thrive in Texas.

Recommendation

Change in Statute

2.1 Combine the Department of Banking and the Savings and Loan Department into one agency, the Texas Department of Banks and Thrifts.

This recommendation would abolish the Departments of Banking and Savings and Loan and recreate them under one agency for the regulation of depository institutions. This would be accomplished as follows.

- Abolish the positions of Banking Commissioner and Savings and Loan Commissioner and replace them with one Commissioner of Banks and Thrifts. This single Commissioner would be hired by and serve at the pleasure of the Finance Commission. The new Commissioner would have executive authority for both banking and thrift regulatory activities.
- Require the Department of Banks and Thrifts to maintain and preserve the Texas State Savings Bank Charter, the Texas State Savings and Loan Charter, and the Texas State Bank Charter. Consolidation of the two state regulatory agencies would not affect the powers inherent in each existing charter.
- Require the Department of Banks and Thrifts to supervise and examine all depository institutions currently regulated by the Department of Banking, and state-chartered thrifts regulated by the Savings and Loan Department. This requires the Department to have appropriate expertise for the fair and effective regulation of both institutions.
- Merge applications processing for the chartering, merging, branching, and, among other activities, conversions for state-chartered thrifts and banks.
- Combine bank and thrift examiners. This would create a single pool of examiners for the oversight of banks and thrifts. Examiners would be appropriately trained for thrift, bank, and trust examinations.

- Create a single complaint program for the handling of consumer complaints regarding banks or thrifts. This is addressed in Issue 5 of this report.
- Designate two industry contact positions. One contact would be available to state-chartered thrifts, while the other would be available to state-chartered banks. The purpose of these contacts would be to handle, hear, and resolve concerns from regulated depository institutions regarding their examinations. This requirement does not necessitate the creation of two FTE positions, but the designation of the appropriate individuals within the agency to fulfill this role.
- Maintain the oversight of the sale of checks and currency exchange industries at the Department of Banks and Thrifts. The new Commissioner should have the same level of authority over these regulatory functions as the Banking Commissioner does now.
- Transfer oversight of mortgage brokers to the Office of Consumer Credit Commissioner. This is discussed in Issue 3 of this report.
- Oversight of prepaid funeral contracts and perpetual care cemeteries industry will be addressed in the Sunset Staff report on the Texas Funeral Service Commission.

Impact

This recommendation would combine the Departments of Banking and Savings and Loan while continuing in the essential safety and soundness functions. This recommendation also preserves the existing thrift and bank charters. Consolidation presents four advantages as discussed below.

- Consolidating regulatory agencies would ensure the consistent regulation of thrifts and banks. This means that the chartering, supervision, and examination of thrifts and banks would happen in a consistent manner. This approach to the regulation of depository institutions would help ensure the fairness and effectiveness in the enforcement of state and federal laws.
- Consolidation would remove the potential for Texas' financial regulatory agencies to compete with each other in the promotion of the state thrift or banking charter.
- Consolidating these two regulatory agencies would allow the State to model its regulatory functions after the increasingly consolidated financial industry, particularly in light of the recent passage of the Gramm-Leach-Bliley Act of 1999. This would place Texas on the appropriate footing for regulating an industry that is becoming more homogenous. In addition, this move would place Texas on par with other states that have consolidated their regulation of depository institutions.
- Combining the Department of Banking with the Savings and Loan Department would reduce duplicative functions and costs. Consolidation could reduce costs in executive management, examiner training, and applications processing. In addition, some administrative costs could be reduced through the consolidation of such support functions as payroll, accounting, personnel, and computer support.

Representatives of the thrift industry contend that the consolidation of the Departments of Banking and Savings and Loan would lessen the importance of the State Savings Bank Charter and ultimately cause its demise. Sunset's analysis found that consolidation would not adversely affect the standing of the State's thrift or banking charters. The powers of both charters are preserved in this recommendation. Consolidation would not diminish the State's ability to expand its state-chartered financial institutions industry.

Thrift industry representatives also argue that consolidating agencies would dilute the level of expertise needed for appropriate thrift examinations, thereby jeopardizing the state thrift charter as a viable option for institutions operating in Texas. Sunset's analysis found that consolidating agencies would not decrease the level of staff expertise required for state-chartered thrift examinations. The experience of FDIC, other states, and the Department of Banking demonstrates that more than one type of industry can be regulated by the same agency, without any harm to the industries. Sunset staff also found no merit in the assertion that consolidating agencies would truly jeopardize the state thrift charter as a viable option for institutions operating in Texas.

Sunset staff also considered the argument that the industry pays for the full cost of its regulation. This is important to the State as a budget issue, but was not compelling as a reason to justify continuation of a separate agency.

Fiscal Implication

These recommendations will have a no net fiscal impact to the State. Consolidating the Department of Banking and the Savings and Loan Department into one Department of Banks and Thrifts would result in a fiscal savings through administrative efficiency. This would be achieved through fewer management positions, functional grouping of departmental activities, consolidation of offices, and common use of examination staff.

Because the Sunset staff did not pursue this recommendation based on cost savings, a detailed estimate was not included in this report. If this recommendation is adopted, staff will develop such an estimate as part of the fiscal note process for the resulting legislation. Any savings generated through administrative efficiency could be redirected to support the agency's examination efforts or result in reduced costs to the regulated industries. Any savings would not be an automatic gain to the General Revenue Fund because fees are set by the two agencies to cover the cost of regulation.

[1] Texas Department of Banking.

[2] Texas Department of Banking.

[3] Texas Department of Banking, *Agency Strategic Plan for Fiscal Years 2001-2005*, June 1, 2000, p. 9.

[4] Texas Department of Banking.

[5] Texas Savings and Loan Department, *Strategic Plan, For the 1999-2003 Period,* p. 4.

[6] Texas Savings and Loan Department, *Self Evaluation Report Update,* p. 11.

[7] A recent report by the FDIC observes that "the distinctions between banks' and thrifts' powers have become blurred. Each has encroached substantially on what was once the other's domain. Both offer essentially an identical array of deposit accounts. In addition, in the aftermath of the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994, both banks and thrifts can branch nationwide." FDIC, "The BIF and SAIF Should Be Merged," p. 54.

[8] Texas Department of Savings and Loan, "Thrift Charter Alternatives,'' October 1998, www.tsld.state.tx.us.

[9] Texas Savings and Loan Department, "Thrift Charter Alternatives," October 1998, www.tsld.state.tx.us.

[10] Texas Savings and Loan Department, *Self Evaluation Report to the Sunset Advisory Committee*, August 1999, p. 38.

Issue 3

Licensing of Mortgage Brokers is Unnecessarily Split Between Two Separate Agencies.

Summary

Key Recommendation

- Transfer responsibility for licensing first lien mortgage brokers and lenders from the Savings and Loan Department to the Office of Consumer Credit Commissioner.

Key Findings

- The Savings and Loan Department licenses mortgage brokers and lenders making first lien mortgages.
- The Office of Consumer Credit Commissioner licenses mortgage brokers and lenders making home equity loans and second lien mortgages with interest rates above 10 percent.
- Many mortgage brokers must go through the same licensing process with two different agencies, if they make or arrange both first lien and second lien mortgage loans.
- Having two agencies license many of the same individuals within the mortgage broker industry is duplicative and inefficient.
- Since mortgage broker licensing differs significantly from thrift regulation, the Department had to divert significant time and resources to implement the program, and anticipates needing even more resources to continue this program.
- Beyond the regulation of second lien mortgage brokers, the overall functions and infrastructure of the Office of Consumer Credit Commissioner are set up to handle licensing, enforcement, and consumer protection activities.

Conclusion

Requiring many mortgage brokers to obtain a very similar state license from two different agencies is duplicative and inefficient. Sunset staff evaluated the overlap between these two programs and the appropriateness of licensing mortgage brokers through a state agency whose primary functions are chartering and examining thrifts.

Sunset staff concluded that mortgage broker regulation would be better housed within one agency. Placing the regulation within the Office of Consumer Credit Commissioner would reduce duplication by merging the regulation into the agency best equipped to handle a growing licensing program.

Support

<u>Current Situation:</u> The Savings and Loan Department licenses mortgage brokers and lenders making first lien mortgages.

- In 1999, the Legislature directed the Savings and Loan Department to license mortgage brokers making or arranging first lien mortgage loans. Due to the complexity of mortgage transactions, consumers often rely on their mortgage broker to explain and disclose a variety of factors affecting the costs and terms of the loan. The purpose of regulating mortgage brokers is to protect consumers from illegal, deceptive or misleading trade practices. The Department's licensing activities include: conducting background checks, ensuring proof of net assets, processing applications, issuing licenses, and requiring continuing education. Currently, the Department devotes six of its 22 staff and $309,794 annually to mortgage broker licensing.

- During the first year of operation in fiscal year 1999, the Department licensed 8,530 mortgage brokers and loan officers. More than 50 new license applications continue to come in weekly. This number of applicants and licensees is much higher than originally anticipated.[1] The Department expects the total number of licensees to reach 10,300 by the end of FY 2003.[2]

  State law provides for a Mortgage Broker Advisory Committee to advise the Savings and Loan Commissioner. The Committee is composed of six members, four appointed by the Commissioner from the mortgage broker industry, and two appointed by the Texas Real Estate Commission from the real estate industry.

What are the Different Types of Home Loan Products?

First Lien Mortgage Loan: A first mortgage secured by a homestead. The mortgage lender generally has first priority rights of foreclosure in the event of default by the borrower.

Second Lien Mortgage Loan: A loan secured in whole or part by a home that is already subject to a first lien or prior mortgage. The second mortgage lender's rights of foreclosure are subject to the rights of the first 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.

Home Equity Loan: A loan of money using up to 80 percent of the value of a home as collateral, as first and second mortgages.

A first mortgage home equity loan is secured by a home where the borrower obtains cash for the equity and refinances the existing mortgage, if any.

A second mortgage home equity loan is secured by a home that already has at least one other mortgage or lien. The borrower obtains cash for equity.

<u>Current Situation:</u> The Office of Consumer Credit Commissioner licenses mortgage brokers and lenders making home equity and second lien mortgages with interest rates above 10 percent.

- The Office of Consumer Credit Commissioner (OCCC) licenses individuals and companies making or brokering second lien mortgages with interest rates above 10 percent, and home equity loans. Licensing aims to protect consumers obtaining second mortgages from improper practices of creditors. OCCC's licensing activities include: conducting background checks, ensuring proof of net assets, reviewing applications, issuing licenses, performing on-site examinations, and providing continuing education. Additionally, OCCC provides education and assistance to consumers.

- In fiscal year 1999, OCCC regulated the mortgage brokering and lending activities of 14,298 individuals and companies in Texas. In fiscal year 1999, this involved more than $10 billion in mortgage and home equity loans.

In fiscal year 1999, OCCC oversaw more than $10 billion in mortgage and home equity loans.

<u>Current Situation:</u> Many mortgage brokers must go through the same licensing process twice, with two different agencies, if they make or arrange both first lien and second lien mortgage loans.

- Many mortgage brokers make or arrange a variety of loans, including first lien mortgages, second lien mortgages, and home equity loans. These brokers must obtain a mortgage broker license from the Savings and Loan Department and also maintain a regulated lender license from the Office of Consumer Credit Commissioner.
- Licensure by the Savings and Loan Department is required for mortgage brokers and loan officers who make or arrange first lien mortgage loans. If these individuals work in businesses that make or arrange second lien mortgage loans with an interest rate over 10 percent, they are also required to have a regulated loan license from OCCC, a requirement since 1967.[3]
- Currently, OCCC estimates that 2,565 loan officers, working in 171 businesses, are regulated by both the Savings and Loan Department and OCCC. Of note, the number of dual licensees will rise significantly if and when interest rates rise. This is because a rise in interest rates generally results in more second mortgage loans that would come under OCCC's authority.

<u>Problem:</u> Having two agencies license many of the same individuals within the mortgage broker industry is duplicative and inefficient.

- Sunset staff found that the licensing functions of mortgage brokers by the Savings and Loan Department and OCCC are very similar. Both processes are aimed at ensuring consumer protection. Both agencies conduct background checks, ensure proof of net assets, process applications, issue licenses, and have continuing education. The only differences between the two programs are that OCCC also does periodic on-site examinations; and has greater enforcement authority over mortgage brokers than the Savings and Loan Department, which is appropriate for oversight of second lien mortgages with interest rates in excess of 10 percent.

- Dual licensing creates two layers of regulation for mortgage brokers. This results in duplication for the State, as both agencies have responsibility for tracking and responding to complaints regarding many of the same individuals. It also results in duplication for mortgage brokers, who have to go through the entire licensing program, and submit much of the same information to two different state agencies.

Problem: Since mortgage broker licensing differs significantly from thrift regulation, the Department had to divert significant time and resources to implement the program, and anticipates needing even more resources to continue this program.

The primary mission of the Department is ensuring the safety and soundness of the state's thrifts.

- The functions tied to licensing thousands of individual mortgage brokers are significantly different than those of chartering and examining thrifts. The primary mission of the Department is ensuring the safety and soundness of the state's 27 thrifts. This involves ensuring that the thrift industry remain solvent and that the more than $14.4 billion in consumer deposits are protected. While the Department clearly has knowledge of the mortgage industry, these two functions remain distinctly different.
- While the Savings and Loan Department should be commended for successfully implementing a completely new licensing program, the agency had to divert significant resources from its thrift regulation.[4] As stated earlier, the total number of licensees exceeded the original estimate of about 5,000 licensees by 37 percent.[5] The Department's limited staff resources were tapped to process, track, and manage the huge volume of applications received during the last year.
- The high volume of telephone calls alone has been a significant drain on staff time and resources. The Department reports receiving more than 100 telephone calls a day regarding the mortgage broker licensing program. As phones calls are handled by any one of the Department's 16 staff in the Austin office, this increased workload may take staff time away from thrift regulation.
- The Department has yet to fully develop its approach to handling and investigating complaints statewide, but this will also require significant time and resources. The Department will have to develop a new system for tracking and investigating complaints. The Department anticipates receiving complaints against 4 to 5 percent of its total number of licensees, or about 500 to 600 complaints each year. At least 10 percent of these complaints will require additional investigation, including on-site visits to review documents.[6]

- In the future, the Department anticipates needing even more resources to continue handling this function. For fiscal years 2002-2003, the Savings and Loan Department has requested an additional appropriation of $230,000 and three FTEs for this program. This is an increase of almost 75 percent above its current funding. Sunset staff concluded that much of this expense is tied to the fact that the Department is starting new functions, unlike the Department's current efforts related to thrift regulation.

<u>Comparison:</u> Beyond the regulation of second lien mortgage brokers, the overall functions and infrastructure of the Office of Consumer Credit Commissioner are set up to handle licensing, enforcement, and consumer protection activities.

- The mission of the Office of Consumer Credit Commissioner is to regulate the credit industry. The agency has general authority over a broad range of consumer credit transactions to ensure that they are handled fairly and lawfully. The functions of the agency focus on consumer protection, largely through licensing, education, and consumer complaint investigation.
- OCCC currently regulates lenders in more than 5,300 locations across the state. The agency receives an average of 4,000 calls per month and resolves most telephone complaints the same day they are filed. The agency employs 46 staff, with 19 field examiners across the state to do examinations and investigate complaints. The agency also devotes significant effort to educating both consumers and the industry on the front-end to avoid problems before they occur.

OCCC currently handles about 4,000 inquiries and complaints per month.

- Based on this comparison, Sunset staff concluded that while either agency is capable of performing these functions, OCCC offers the better match, especially since the primary purpose of mortgage broker regulation is the protection of consumers from illegal, deceptive, or misleading trade practices. In addition, as OCCC is the primary agency responsible for regulating interest rates, Sunset staff determined that moving OCCC's regulation of second lien mortgage loans to the Department of Savings and Loan was not a viable option. This would simply split this program from OCCC's broader oversight of the state's credit laws, and inappropriately place the interpretation of credit laws with the Department.

Recommendation

Change in Statute

3.1 Transfer responsibility for licensing first lien mortgage brokers and lenders from the Savings and Loan Department to the Office of Consumer Credit Commissioner.

This change would combine all licensing and regulation of mortgage brokers in one agency — the Office of Consumer Credit Commissioner. This would make OCCC responsible for the licensing of first lien mortgage brokers under the Mortgage Broker Licensing Act, in addition to OCCC's current regulation of second lien mortgage and home equity lenders. To ensure the full benefits of this merger, the statute should be amended to allow OCCC to use information obtained through one licensing program to meet the requirements of the other. In this way, once a mortgage broker has proved to have the net assets needed or passed a criminal background check, a second review of these components should not be necessary.

Under this transfer, the Mortgage Broker Advisory Committee would continue. It would advise the Consumer Credit Commissioner, rather than the Savings and Loan Commissioner. This would ensure ongoing advice from both the mortgage broker and real estate industry.

The current statutory cap on fees would not change, but the Finance Commission, rather than the Savings and Loan Commissioner, would be responsible for setting reasonable rates, within statutory limits, to cover the costs of regulation.

Management Action

3.2 Require the Savings and Loan Department and the Office of Consumer Credit Commissioner to jointly formulate a transition plan for the transfer of the regulation of first lien mortgage brokers.

This recommendation would ensure a successful transition for the responsibility of administering the Mortgage Broker Licensing Act from the Savings and Loan Department to OCCC. Given that the two agencies are currently housed on the same floor at the Finance Commission, no physical move may be required. The transition plan should determine the administrative costs and appropriately allocate the costs between the two agencies. The plan should include computer integration to address any information technology or data management issues. A timetable for transferring licensing and regulatory duties should be established by October 1, 2001, with the transfer completed by January 1, 2002, or sooner if possible.

Impact

These recommendations are intended to consolidate regulation and licensing of the mortgage industry within a single state agency to ensure efficient and consistent industry regulation. Combining mortgage broker regulation at OCCC would eliminate duplicative functions and costs tied to having two agencies oversee the mortgage activities of many of the same people. Maintaining the Mortgage Broker Advisory Committee would help ensure a smooth transition and keep OCCC aware of any matters of interest or concern to the industry.

Fiscal Implication

Transferring responsibility for administering the mortgage broker licensing program from the Savings and Loan Department to OCCC would result in no fiscal impact to the State, but should help avoid the need for any increased appropriation over the next two years.

Based on the current level of operations, Sunset staff estimates that OCCC, due to its existing licensing and complaint-handling infrastructure, could manage this function with four FTEs, at a total cost of $200,000 annually. In comparison to the Savings and Loan Department's current seven FTEs and annual costs of $310,000, this would result in a net savings of $110,000 and reduction of three FTEs. However, staff assumes that this savings would be used to maintain the current funding and staffing levels to handle the increased growth in the industry. This would eliminate the need for any increased appropriation, as had been requested by the Department for FY 2002-2003.

[1] Savings and Loan Department, *Mortgage Broker Licensing and Regulatory Update*, March 31, 2000. p.2.

[2] Savings and Loan Department, James L. Pledger, *Budget Hearing Testimony*, August 22, 2000, p.3.

[3] Office of Consumer Credit Commissioner , *Self Evaluation Report to the Sunset Advisory Commission*, August 15, 1999. p. 38.

[4] Savings and Loan Department, *Industry Letter*, Volume 00-01, April 2000, p.4.

[5] Savings and Loan Department, *Mortgage Broker Licensing and Regulatory Update*, March 31, 2000. p.1-2.

[6] Savings and Loan Department, James L. Pledger, *Budget Hearing Testimony*, August 22, 2000, p. 3.

Issue 4

The Savings and Loan Department Lacks Certain Key Components to Effectively License and Investigate Mortgage Brokers.

Summary

Key Recommendations

- Change the agency's authority to obtain criminal background information from the Federal Bureau of Investigation from optional to mandatory.
- Authorize the Department to initiate investigations of mortgage brokers on its own, without a formal written complaint.
- Require the Department to implement a system that ranks complaints according to the order of initial receipt and severity of the alleged violation.

Key Findings

- State law severely limits the Department's authority to initiate an investigation of a mortgage broker unless a formal complaint has been filed.
- The Department has been unable to obtain FBI background checks for potential licensees because the statute authorizes such checks, but does not require them.
- The Department does not rank consumer complaints it receives by severity.

Conclusion

The recently passed Mortgage Broker Licensing Act provides needed regulation of first lien mortgage brokers. However, Sunset found several aspects of the Act that, if modified, would enable the Department to better carry out the intent of the Act. Ensuring that the Department obtains FBI background checks, has the authority to initiate investigations, and ranks consumer complaints by severity, would allow for better consumer protection.

Support

<u>Current Situation:</u> The Savings and Loan Department administers the Mortgage Broker Licensing Act.

- In 1999, the 76th Legislature passed the Mortgage Broker Licensing Act (MBLA), to regulate mortgage brokers and loan officers who originate or broker first lien mortgage loans in Texas.
- Mortgage brokers solicit borrowers for mortgage loans, but don't lend their own money, instead they negotiate or place mortgages with a mortgage lender. Mortgage lenders actually lends the money to make a mortgage loan. MBLA regulates individuals that either solicit or lend funds for mortgages, and refers to them both as mortgage brokers.
- The regulation of mortgage brokers is designed to protect consumers in mortgage lending transactions. The rules for mortgage broker licensing are enacted by the Savings and Loan Commissioner, after consultation with its Mortgage Broker Advisory Committee. This Committee, appointed by the Savings and Loan Commissioner and Texas Real Estate Commission, consists of four members actively engaged in the business of mortgage brokering and two members holding a real estate broker or salesperson license.
- When an individual applies for a license and the Commissioner finds the application is complete, the applicant meets the requisite qualifications of the MBLA of experience or education, and has a satisfactory criminal background check, that individual will be provided an appropriate license within 10 days.
- The amount budgeted by the Department for this regulation is $400,000 for FY 2000 and $275,000 for FY 2001. The allocation for FY 2000 is more because of initial start up costs for implementing MBLA.

Except for "immediate harm," the Department can only investigate formal, written complaints.

<u>Problem:</u> State law severely limits the Department's authority to initiate an investigation of a mortgage broker unless a formal complaint has been filed.

- The Savings and Loan Department cannot accept any anonymous complaints against brokers. By law, an investigation cannot be based on an anonymous complaint, whether the complaint is in writing or not.[1]

- Additionally, even if the complainant agrees to be identified, unless a formal complaint is made in writing, the Department cannot investigate it. The only exception is action that may be taken if necessary to prevent an immediate harm.[2] The requirement for an "immediate harm" significantly limits the Department's authority because most violations do not pose an immediate harm.
- These limitations can prevent the Department from taking action even in cases where it is publicly known that a serious problem with a broker exists. The Department may see advertisements in the newspaper for extremely low interest rates or suspect an unlicensed person is making loans in violation of MBLA, but cannot take action.

  In addition, current or former employees of a licensed entity may want to submit complaints anonymously to avoid possible retribution. However, unless what is alleged presents an immediate harm, the Department cannot investigate or take enforcement actions in these cases.

Parties who fear retribution should be able to file complaints anonymously.

- In comparison, many licensing agencies have the authority to initiate an investigation of a licensee if they reasonably believe a problem exists. For example, the Office of Consumer Credit Commissioner (OCCC) investigates anonymous complaints if it believes a statute is being violated. OCCC also initiates investigations by reviewing newspapers and other publications for misleading advertisements and unlicensed lenders.

Problem: The Department has been unable to obtain FBI background checks for potential licensees because the statute authorizes such checks, but does not require them.

- The MBLA authorizes but does not require FBI criminal background checks on all applicants. However, due to limited resources, the FBI refuses to run background checks for state agencies unless statutory language specifically requires the check for licensure.
- The Department does obtain Department of Public Safety background checks that usually contain out-of-state convictions, but sometimes the information is incomplete. FBI checks are important because they provide a complete out-of-state arrest and conviction history for the applicant. This helps ensure that a convicted criminal from another state does not simply relocate to Texas.

Problem: The Department does not rank consumer complaints it receives by severity.

- Consumer complaints received by the Department regarding mortgage brokers are recorded and handled in the order they are received. To date, this has not presented a problem but the program is still relatively new.

- The possibility exists that severe and time-sensitive problems, which need to be addressed quickly, may not receive appropriate attention from the Department. Certain types of problems related to a mortgage closing may deserve immediate attention due to the unique nature of home loans. For example, a consumer may need immediate assistance from the Department if the complaint involves a problem with a broker on a loan that will close escrow in 30 days.
- In comparison, the Office of Consumer Credit Commissioner's system of complaint resolution assesses severity and tracks response time to ensure that complaints don't stagnate, and problems that need immediate attention are handled promptly. For example, if a person's car is being repossessed, the complaint would rise to the top of the list because of the time issue.

Recommendation

Change in Statute

4.1 Change the agency's authority to obtain criminal background information from the Federal Bureau of Investigation from optional to mandatory.

This recommendation would enable the Department to obtain background checks from the FBI to prevent people with a criminal history in another state from moving to Texas and becoming a mortgage broker.

4.2 Authorize the Department to initiate investigations of mortgage brokers on its own, without a formal written complaint.

This recommendation would allow the Department to actively pursue violations of the MBLA and other pertinent laws and regulations applicable to the mortgage broker industry. The Department should be able to investigate whenever it has reason to believe a problem exists.

Management Action

4.3 Require the Department to implement a consumer complaint system that ranks complaints according to the order of initial receipt and severity of the alleged violation.

This recommendation would ensure consumer complaints are responded to appropriately, based on when they are received and the immediacy of the problem presented.

Impact

The intent of these recommendations is to clarify and strengthen the regulatory and licensing authority provided by the Mortgage Broker Licensing Act. This would ensure that consumers are adequately protected and licensees are efficiently regulated. If the recommendations in Issue 2 to transfer mortgage broker licensing to the Office of Consumer Credit Commissioner are adopted, these recommendations would need to be modified to apply to that agency.

Fiscal Implication

The recommendations would have no fiscal impact to the State. The Department should implement the recommendations with existing resources.

[1] Mortgage Broker License Act, Subchapter D. Sec. 156.301. (b).

[2] Ibid.

Issue 5

The Departments of Banking and Savings and Loan Offer Limited Avenues for Consumers to File Complaints, Particularly With Regard to Privacy.

Summary

Key Recommendations

- Require the Finance Commission to develop formal rules to ensure that all entities regulated by the Department of Banking and Savings and Loan Department post information on how consumers may file a complaint.
- Require all privacy notices provided by financial institutions regulated by the Finance Commission agencies to include information on how consumers can file a complaint.
- The consumer complaint handling processes for all agencies beneath the Finance Commission umbrella should be consolidated into one consumer complaint program.
- The consolidated consumer complaint program should collect and report information regarding complaints of violations of privacy by financial institutions regulated by the Finance Commission agencies.

Key Findings

- The Banking and Savings and Loan Departments offer limited avenues for consumers to file complaints about state-chartered banks and thrifts.
- The Finance Commission has no mechanism to monitor any potential abuses of consumers' privacy under changes authorized by GLBA.

Conclusion

Unlike the Office of Consumer Credit Commissioner, the Department of Banking and the Savings and Loan Department do not have clear channels for consumer complaints. Although each agency has a consumer complaint function, information on how these functions may be reached is not readily available to consumers.

The Sunset review identified ways for the Finance Commission agencies to improve their handling of consumer complaints. Consolidating these functions would best serve the inquiries of Texas' citizens. In addition, this approach would help the State better observe the effects of the Gramm-Leach-Bliley Act on consumers' privacy.

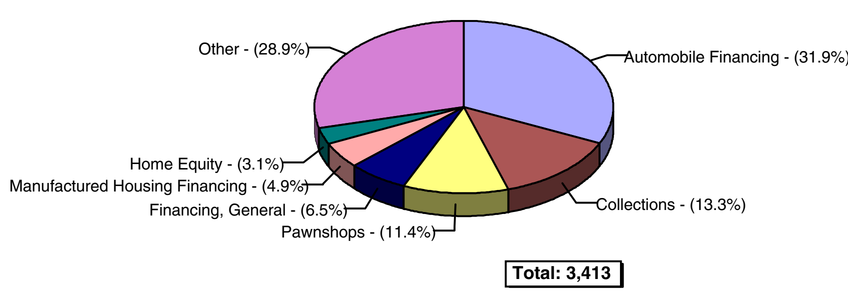
Support

Consumer Complaints

<u>Current Situation:</u> Of the agencies under the Finance Commission umbrella, the Office of Consumer Credit Commissioner (OCCC) offers the most comprehensive consumer complaint program.

- OCCC has a division for the handling of consumer complaints involving the industries that the agency regulates. The majority of the complaints received are through a toll-free consumer hotline. The number for the hotline is required to be printed on every credit contract of a lender subject to OCCC's regulation. Consumers can also submit complaints through the mail or the Internet. Complaints received by OCCC are recorded by complaint type. OCCC also provides mediation on complaints and often obtains restitution for wronged consumers.
- During FY 1999, OCCC resolved over 3,413 complaints through its Consumer Complaint Division. The graph, *Types of Complaints Received by OCCC*, shows the volume and types of complaints received by the agency. Automobile financing, collections procedures, and pawnshops account for the majority of consumer complaints received.

Types of Complaints Received by OCCC
Fiscal Year 1999



- Consumer complaints received by OCCC are generally resolved within five to seven business days. Complaints that OCCC's staff cannot answer, such as those regarding banks or thrifts, are forwarded to the appropriate state or federal agency. During FY 1999, 83 percent of written consumer complaints were resolved by OCCC within seven days. During that same year, the agency returned $1.4 million in restitution to consumers.

<u>Problem:</u> The Banking and Savings and Loan Departments offer limited avenues for consumers to file complaints about state-chartered banks and thrifts.

- Although the Banking and Savings and Loan Departments offer a toll-free phone number and Internet site for the public, many consumers are unaware of these resources. State-chartered thrifts and banks, check sellers, and currency exchange businesses do not post contact information in their lobbies or on contracts. The few complaints that these agencies receive are usually referrals from other state agencies or legislative offices.
- Because no clear channel for complaints exists, consumers may have difficulty making inquiries or informing state regulators of potential problems. Consumer complaints can indicate inappropriate or illegal behavior on the part of regulated industries. The absence of a well-defined and publicized complaint system precludes state banking and thrift regulators from using a valuable resource for detecting problematic players.
- Unlike OCCC, the Banking and Savings and Loan do not have well-defined divisions for handling complaints. Complaints regarding the industries regulated by the Department of Banking are handled by the agency's Ombudsman and Director of Strategic Planning. Although the Savings and Loan Department does have a special division for handing complaints regarding mortgage brokers, it does not have any defined system for complaints about state-chartered thrifts. Consumers calling the toll-free number offered by the Savings and Loan Department have their call answered by any one of the 16 employees working within the agency.

Privacy

<u>Current Situation:</u> The Gramm-Leach-Bliley Act (GLBA) of 1999 grants financial institutions greater access to consumers' private information.

- The GLBA authorizes the consolidation of banks, insurance companies, and securities dealers into financial holding companies. See Appendix B, *The Gramm-Leach-Bliley Act of 1999,* for additional information. The Act also allows financial institutions to affiliate with any other type of entity that the Federal Reserve Bank regards as financial in nature. This means that banks, insurance companies, securities dealers, finance companies and, among other industries, mortgage companies are permitted to operate under one roof.
- GLBA allows financial institutions to share "nonpublic personal information" with their affiliates and nonaffiliated third parties. Under this arrangement a bank may share sensitive information

GLBA allows financial institutions to share "nonpublic personal information" with their affiliates and nonaffiliated third parties.

about its customers with an affiliated insurance company. In addition, a bank may also share such information with such nonaffiliated third parties as banks, insurance companies, securities firms, or even nonfinancial companies, such as car dealers or home builders.

- Although GLBA opens-up the channels through which information about private individuals can flow, it also provides some privacy protections. All financial institutions are required to publish and annually disclose a privacy policy on how personal information will be shared with affiliates and nonaffiliated third parties. The most critical part of GLBA's privacy protections is its requirement for financial institutions to provide their customers an annual opportunity to "opt-out" of having their personal information shared with nonaffiliated third parties. The "opt-out" system is described in greater detail in the textbox below. Lastly, GLBA prohibits financial institutions from sharing information with nonaffiliated third parties for the purposes of telemarketing, direct mail marketing, or the sending of electronic mail to the consumer.

Frequently Asked Questions About GLBA and Privacy

What does "opt-out" mean?
GLBA establishes an opt-out privacy system. Under the opt-out system, consumers who do not want their private information shared with a nonaffiliated third party must affirmatively signal their intent to opt-out of having information shared in such a manner.

How does "opt-out" compare to "opt-in?"
The alternative to GLBA's opt-out system is the opt-in system. Consumers who want their personal information shared by a financial institution with nonaffiliated third parties must signal their consent to having such information shared. Under the opt-in system, private information is shared only at the consumers' request.

What is "nonpublic personal information?"
Nonpublic personal information is personally identifiable information that is either provided by the consumer to the financial institution, results from a transaction, or is otherwise obtained by the financial institution. This information includes an individual's name, home address, social security number, credit background, and, among other things, account history.

What is a nonaffiliated third party?
A nonaffiliated third party is a business that does not own or is owned by another financial institution.

Does GLBA allow sharing of private information between affiliates?
Yes. Under the financial holding company structure permitted by GLBA, financial company affiliates are allowed to share information with each other without restraint.

Which agency is in charge of protecting consumers' privacy?
The Federal Reserve Bank is responsible for ensuring that all financial institutions comply with the privacy requirements of GLBA.

What responsibility does the State of Texas have for enforcing GLBA's privacy provisions?
None. The Act does not require state regulators to ensure that state-regulated financial institutions comply with its privacy provisions. GLBA does, however, allow for states to enact stronger privacy protections, such as an "opt-in" requirement.

<u>Problem:</u> The Finance Commission has no mechanism to monitor any potential abuses of consumers' privacy under changes authorized by GLBA.

- Much recent attention has focused on the potential threats that GLBA presents to consumers' privacy. Some observers argue that the level of information sharing authorized by the Act can work to the detriment of consumers. For example, information within an individual's bank account history might be used as a basis for denying insurance coverage. Another example of potential abuse is that increasing the number of entities and individuals with access to personal information increases the potential for identity theft.

  Opponents of GLBA's privacy provisions also argue that the opt-out requirement unfairly burdens consumers' expectations of privacy. Unlike the traditional method of privacy protection, where consumers correctly assumes that their information will be kept private, the opt-out method nullifies that assumption by requiring individuals to take action to keep personal records private.

GLBA allows states to enact stronger privacy protections such as the opt-in system.

- Sunset staff were unable to determine if consumers' privacy will be adequately protected in the opt-out privacy system. This is because the privacy provisions of GLBA do not become effective until November 2000. Consequently, the effects of GLBA, and its authorization for financial institutions to share information with each other, have yet to be realized. Nevertheless, since the opt-out privacy system places the burden of privacy protection on the consumer, the new system could create confusion and misunderstanding. In addition, GLBA does create potential for the abuse of consumers' personal information.

Changes in federal law authorize the sharing of certain personal information unless individuals specifically opt-out.

- Although GLBA establishes some safeguards for the protection of consumers' privacy, the Act allows for states to enact stronger privacy protections such as the opt-in system. Currently, the Finance Commission does not have any plans for collecting complaints from consumers regarding privacy violations. Nor do any of the agencies advise consumers on how to complain if their privacy has been violated. Without an established privacy complaint function, the Finance Commission will not be able to effectively monitor the effects of GLBA's privacy provisions and ensure that consumers are protected.

Recommendation

Change in Statute

5.1 Require the Finance Commission to develop formal rules to ensure that all entities regulated by the Department of Banking and Savings and Loan Department post information on how consumers may file a complaint.

Under this recommendation, the Finance Commission would determine, through rules, the most appropriate way to provide consumers with access information. This could include posting of a toll-free number in the place of business, or requiring that the information be provided to the consumers during transactions. This recommendation addresses the Department of Banking and the Savings and Loan Department because the Finance Code already requires businesses to put OCCC's address and phone number on all loan contracts. In addition, mortgage brokers and loan officers licensed by the Savings and Loan Department are required to provide consumers with written disclosure of the Department's address and telephone number at the time of every loan application.

5.2 Require all privacy notices provided by financial institutions regulated by the Finance Commission agencies to include information on how consumers can file a complaint.

This recommendation would require all financial institutions regulated by the Finance Commission agencies to provide complaint contact information on the opt-out privacy notices that they are required to post for the sharing of information. The industries affected by this recommendation include banks, thrifts, consumer lenders, check sellers, and currency exchange places.

Management Action

5.3 The consumer complaint handling processes for all agencies beneath the Finance Commission umbrella should be consolidated into one consumer complaint program.

This recommendation would place the responsibility for the initial handling and processing of consumer complaints in one place. The consumer complaint function could be centralized in OCCC's Consumer Complaint Division, which is the most comprehensive system already in place among the three agencies. However, this recommendation would not empower OCCC to investigate and resolve complaints relating to banks and thrifts. The Banking and Savings and Loan Departments would still retain that authority. The OCCC Consumer Complaint Division would refer substantive complaints to the appropriate Finance Commission agency.

5.4 The consolidated consumer complaint program should collect and report information regarding violations of privacy by financial institutions regulated by the Finance Commission agencies.

Sunset staff concluded that a "wait and see" policy would be best with regard to consumer privacy enforcement. This approach would, however, allow the State to monitor the effects of GLBA's privacy provisions among state-chartered banks, thrifts, and credit providers once they are in effect. This recommendation would also require the complaint program to collect information and report to the Finance Commission on GLBA's impact on consumers' privacy.

Impact

These recommendations would draw upon the complaint handling experience of OCCC to better serve Texas consumers. A consolidated system for handling complaints would improve consumers' access to the appropriate state regulatory agencies when they have a complaint. Moreover, a consolidated complaint system would help better inform state regulators and policy-makers about potential problems within Texas' financial industries. Lastly, these recommendations establish an appropriate framework for the Finance Commission agencies to monitor Texas financial institutions' compliance with the privacy components of GLBA.

Fiscal Implication

The consolidation of complaint processing can be done with existing resources. Depending on how it is structured, the Finance Commission could require the respective agencies to share the cost of the consolidated program.

Issue 6

The Departments of Banking and Savings and Loan Do Not Have a Formal Process for Predicting and Responding to an Economic Downturn or Other Industry-Wide Crises.

Summary

Key Recommendation

- Require the Department of Banking and Savings and Loan Department to monitor and report to the Finance Commission on the overall condition of Texas' banking system.

Key Findings

- The Departments of Banking and Savings and Loan do not have forward-looking processes to predict future weaknesses in the Texas banking system.
- Other federal bank regulators have early warning procedures in place that are more prospective.

Conclusion

The Departments of Banking and Savings and Loan have no formal mechanism to review industry-wide economic conditions and their effect on the financial institutions they regulate. The regulatory efforts of both agencies focus on safety and soundness, but more on a bank-by-bank basis, rather than a statewide or industry-wide approach. The recommendation to maintain in-house expertise would provide a mechanism for increased awareness and improved regulatory response to trends or changes, which can provide early warning signs of major financial changes. This would help Texas to possibly avert a financial disaster among Texas commercial banks and savings banks similar to the one experienced in the 1980s.

Support

Between 1980 and 1994, 599 Texas banks and thrifts failed.

<u>Background:</u> Changes in banking practices, coupled with declining economic conditions during the 1980s, led to multiple bank and thrift failures in Texas.

- The 1980s set the stage for a banking crisis that continues to affect the state today. Between 1980 and 1994, 599 Texas banks and thrifts failed.[1] These institutions held $60 billion or 44 percent of the state's banking assets. The Texas banking crisis was so severe that only one of the state's ten largest banks operating in 1980 remains intact today.
- One of the primary reasons for the banking crisis was the rapid decline in Texas' economic conditions. The fall in oil prices, coupled with the collapse of the state's real-estate market, caused banks' loan portfolios to become unprofitable.
- Changes in regulatory practices during the 1980s allowed for a large number of new banks to be chartered. Previous chartering guidelines, which required the applicants to prove a public need for the new institution, were replaced by a free entry into the system, with little regard to what effect unlimited competition might have on the financial system. As a result of increased competition, loan underwriting standards were relaxed by a majority of Texas banks. This resulted in a large number of poor-quality loans, which defaulted when the state's economy soured. Consequently, more than 30 percent of banks chartered between 1980 and 1990 failed.
- History has shown that regulators, as well as bank and savings and loan executives, did not have an adequate grasp of the effects of new banking practices and the economic decline. Regulators even reduced the number of on-site examinations between 1983 and 1986. This reduced regulatory vigilance precluded state and federal regulators from taking appropriate steps to stem the number of bank failures. As the 1980s crisis came to a climax, the FDIC, which had no interest in the preservation of the Texas dual banking system, took virtual control of the state's banking system.

<u>Current Situation:</u> The current examination processes of the Departments of Banking and Savings and Loan focus on the condition of individual banks and thrifts.

- The Department of Banking and Savings and Loan Department each have the responsibility to ensure that Texas has a safe and sound financial services system. Each Department accomplishes this through their statutory duties of chartering, supervision, and examination of state-charted financial institutions.

- The Department of Banking has regulatory authority over 371 state banks with total assets of $51 billion. The Savings and Loan Department supervises 27 state institutions with $14 billion in assets.
- Safety and soundness examinations are the most important responsibility of the Departments. The examinations focus on the functions of the bank that affect the financial health of the individual institution, and thus protect the depositors and the FDIC insurance fund. The Departments' safety and soundness examinations focus on five key areas affecting the health of the institution: Capital adequacy, Asset quality, Management, Earnings, Liquidity and Sensitivity-to-market-risk. This examination procedure is used by all bank regulators and is referred to as a CAMELS rating.[2] Identifying institutions with deteriorating conditions is the general focus of the current examination process.

<u>Problem:</u> The Departments of Banking and Savings and Loan do not have a forward-looking process to help predict future weaknesses in the Texas banking system.

- Safety and soundness examinations do not provide a holistic picture of banking conditions in Texas. These examinations do not include much analysis of the effects of new banking practices and economic trends before they become a serious problem to financial institutions.
- Texas regulators rely on the CAMELS rating system to detect failure trends. Trends are projected by comparing previous CAMELS ratings with current ones. This system, by its nature, does not consider local or regional economic developments, which may cause banking system problems well before they are reflected in CAMELS ratings. The economic conditions that an institution will experience in the future should be a major part of measuring risk within the system.
- Current problem and failure forecasts are based upon projecting trends that indicate whether a particular institution has characteristics of banks that have failed in the past. This practice mostly relies on the underlying assumption that economic conditions will remain the same, overlooking the fact that economic conditions are always changing. The changing nature of economic conditions, both national and state, are not formally built into current forecast techniques.
- The Departments do have informal mechanisms for following economic trends, and regularly participate in meetings with federal and other states regulators. However, review of economic data,

Safety and soundness examinations of individual banks and thrifts do not provide a holistic picture of banking conditions in Texas.

and consolidation of those findings with information gained in the examination process into a formalized conclusion of the condition of the Texas banking system, does not take place.

Comparison: Other federal bank regulators have early warning procedures in place that are more prospective.

Federal regulators use the Canary system to predict the impact of economic trends, risks, and supervisory issues on the banking system as a whole.

- The Comptroller of the Currency, the federal regulator of national banks, has an early warning system referred to as Canary, which is more forward-looking. It is used in concert with the current situation shown in the CAMELS rating. This is used to predict a probability that the institution's CAMELS ratings will be downgraded.

  An examiner using the Canary system has use of computer models, which allow the examiner to make assumptions about the economic outlook and compute what effect these changes would have on bank risk. The modeling includes widely used economic indicators and market barometers, including current commentary. This process provides the basis for assessing the condition of the banking system as a whole. The results of aggregate trends, systemic risk concerns, and emerging supervisory issues, are reported to the Comptroller's National Risk Committee.

- The Federal Deposit Insurance Corporation, the insurer of bank deposits, has developed various analysis methods that attempt to predict future failures. Its systems have been a better-than-average predictor of CAMELS downgrades, two to three years in advance of the event.

- At the Federal Reserve Bank, the regulator of member banks, researchers have developed statistical models using a large number of economic variables to predict bank failures. The Federal Reserve Bank continues to make improvements to its entire surveillance system.

Recommendation

Change in Statute

6.1 Require the Department of Banking and Savings and Loan Department to monitor and report to the Finance Commission on the overall condition of Texas' banking system.

This requirement would place joint responsibility with both Departments for the formal on-going review of all available economic forecasts, both national and state, including an analysis of new legislation and changing banking practices. After considering all available information, the Departments would periodically report to the Finance Commission on the current and projected condition of the banking system.

Management Action

6.2 The Departments of Banking and Savings and Loan should jointly maintain in-house expertise for the purpose of monitoring the condition of Texas' financial system.

This action would ensure that the Departments have the qualified expertise to do the necessary analysis to accomplish the added responsibilities outlined in Recommendation 6.1. The Departments could accomplish this objective by hiring a specialist, designating an existing employee with this responsibility, or contracting for services with another entity.

Impact

These recommendations would enable the Department of Banking, Savings and Loan Department and the Finance Commission to become better informed of events that may have an adverse effect on the banking system so they can direct their resources in the most effective way to improve upon their safety and soundness mission. This recommendation would also help to possibly avert a financial disaster among Texas commercial and savings banks, similar to the one experienced in the 1980s.

Fiscal Implication

This recommendation would not have a cost to the State. If the departments elect to hire a specialist or contract-out for this function, then they would have to request an appropriations increase. Any additional cost would be included in the examination assessments made to regulated institutions and would not have a fiscal impact to the General Revenue Fund.

[1] FDIC, *History of the Eighties,* Volume 1, 15.

[2] Banks are assigned a rating in each component from 1 to 5. A 1 rating is the highest and 5 the lowest. A composite safety and soundness rating is then assigned and the result is the institutions CAMELS rating. Institutions with 3 or above ratings receive increased supervision. The regulators of FDIC insured financial institutions use this same rating system.

Issue 7

Texas Has a Continuing Need for the Office of Consumer Credit Commissioner.

Summary

Key Recommendation

- Continue the Office of Consumer Credit Commissioner for 12 years.

Key Findings

- Texas has a continuing interest in regulating credit transactions to ensure a healthy, but fair credit environment.
- OCCC has generally accomplished its mission of protecting consumers through effective regulation and enforcement.
- Sunset found no benefit from having any other federal or state agency perform OCCC's functions.

Conclusion

The Office of Consumer Credit Commissioner performs an important mission, to regulate the credit industry and educate consumers and creditors to produce a fair, lawful, and healthy credit environment for Texas. While changes in the Finance Code could improve the agency's operations, the State has benefitted from its enforcement programs and no other federal or state agency has the means to provide these functions.

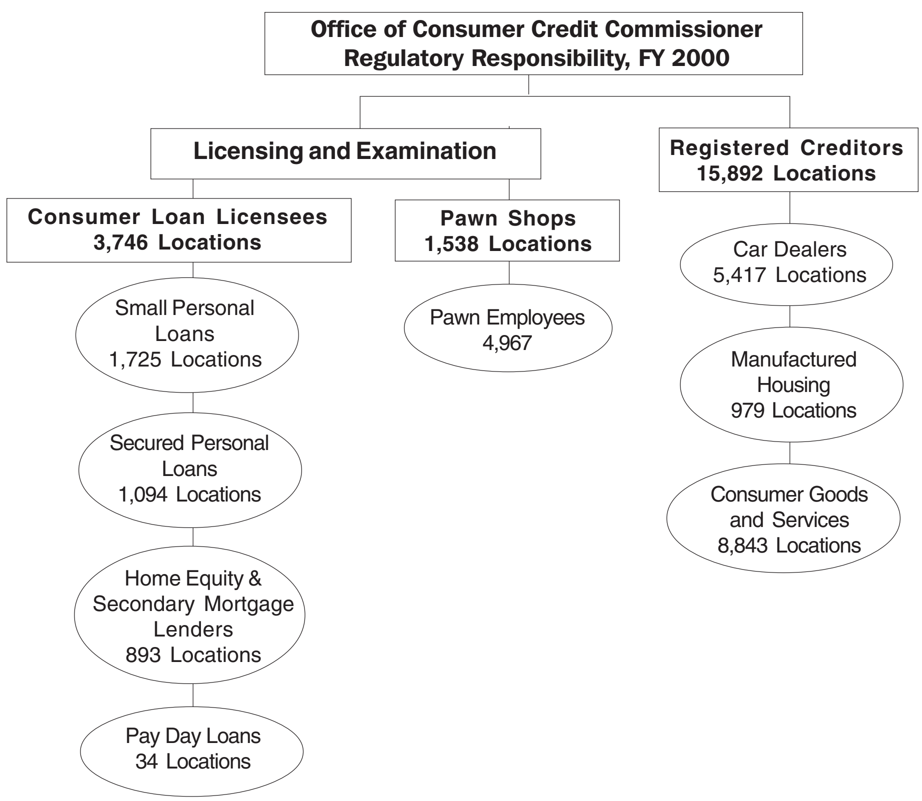
The Sunset review evaluated the continuing need for an independent agency to enforce Texas Credit Laws. The review assessed whether OCCC's functions could be successfully transferred to another agency and looked at how other states provide for this function. The review concluded that OCCC should be continued as an independent agency for 12 years.

Texas has regulated interest rates since 1840.

Support

<u>Current Situation:</u> The Office of Consumer Credit Commissioner's mission is to regulate the credit industry.

- Texas has regulated interest rates since 1840. In the 1960s, the Legislature also began regulating consumer credit by creating a state agency for this function. Credit was seen as an essential element of the Texas economy, but subject to deceptive and excessively costly practices.
- Because of these factors, OCCC has an important role in ensuring compliance with credit laws. The agency regulates lenders that are not part of depository institutions, such as banks. This includes mortgage lenders, consumer loan companies, pawnshops and their employees, and companies that finance the sale of their goods and services. The regulated industry ranges from small, independent lenders to publicly traded corporations. Depository creditors - banks, savings and loans, and credit unions - must abide by state credit laws, but are overseen by their respective regulatory agencies. The chart, *Office of Consumer Credit Commissioner, Regulatory Responsibility,* outlines the wide range and number of entities regulated.



- OCCC's four key functions are ensuring compliance with credit laws, licensing and registering "non-depository creditors," responding to consumer complaints on lenders and creditors, and educating consumers and the industry on credit use. The agency ensures compliance through licensing standards and examination and enforcement of laws, and the consumer help line assists consumers in the resolution of complaints. Finally, the agency uses publications and presentations to assist consumers in informed credit use.

<u>Need for Agency Functions:</u> Texas has a continuing interest in regulating credit transactions to ensure a healthy, but fair, credit environment.

The median debt owed by Texas families has jumped more than 42 percent in the past six years.

- The consumer credit industry in Texas is a rapidly growing, multi-billion dollar industry. A recent study by the Federal Reserve cited that consumer lending by banks and thrift institutions continues to decline, and lending by the finance and mortgage companies, which OCCC regulates, continues to increase. Further, the median amount of debt owed by a family has jumped more than 42 percent, and bankruptcy filings have increased by 55 percent in the past six years in Texas.[1] Consequently, the best interests of consumers and the industry are served by regulating credit, thereby supporting economic prosperity for Texans.

- Texans have a need for credit, but the choices and conditions of credit transactions can be limited, particularly for those in difficult economic circumstances. Texas' credit laws are designed to protect consumers and give them rights and recourse if laws are violated.

- While Texas needs credit laws, the State should not over-regulate the credit industry. OCCC aims to strike a balance between protecting consumers and fostering an environment conducive to business operations, thereby contributing to the growth of the state's economy.

- OCCC's credit education program helps to protect consumers. Studies have shown that consumers, particularly young people, have an alarmingly low level of knowledge about credit. Consumers benefit from education on the front end to promote prudent and beneficial use of consumer credit. The agency's education efforts also target the industry to ensure a clear understanding of the law, resulting in better compliance.

Agency Effectiveness: OCCC has generally accomplished its mission of protecting consumers through effective regulation and enforcement.

- Both consumers and the industry have benefitted from OCCC's regulatory efforts and programs. Through examinations, OCCC returned $1.4 million in restitution to consumers in FY 1999. The agency is also a valuable resource on advising lenders and providing interpretations of the highly technical Texas Finance Code.
- The agency has achieved most of its performance measures on a consistent basis. The chart, *OCCC Performance Measures for FY 1999*, highlights a few of OCCC's measures.

OCCC Performance Measures for FY 1999

Goal	Measure	Projected	Actual
Consumer Protection	Restitution returned to consumers licensed lenders	$250,000	$1.4 million
	Percentage of examinations reporting acceptable level of compliance	95%	98.5%
Effective Enforcement	Percentage of written complaints resolved within seven calendar days	95%	94%
Educate Consumers	Percentage of Texans reached through public service announcements, press releases, and distribution of pamphlets	10%	16.5%

- In FY 1999, the agency handled more than 33,000 calls and 3,400 complaints through its help line. In this program, OCCC offers mediation on credit issues between consumers and industry members. Without the mediation OCCC provides, there would likely be more costly, lengthy litigation. Furthermore, the help line assists the agency in identifying industry-wide compliance issues and unlicensed lenders operating in Texas.

Need for Agency Structure: No benefit would result from having any other federal or state agency perform OCCC's functions.

- The Department of Banking and Savings and Loan Department regulate depository institutions and their lending practices, but have no role with pawnshops or other creditors. In addition, the mission of safety and soundness, which is key to both Departments, differs from OCCC's mission of consumer protection. The Finance Commission provides a link between OCCC and these two other financial regulators, but Sunset found no benefit to merging OCCC with the Department of Banking or Savings and Loan Department.

- The Federal Trade Commission has a role in consumer credit but leaves most enforcement to the states. Federal laws govern the basics of equal credit and fair lending, but do not involve regulation of interest rates or consumer credit lenders.
- Before the creation of a state agency for consumer credit regulation, the Office of the Attorney General (OAG) enforced credit laws. While OAG is still involved in consumer complaints and enforcing laws at an industry-wide level, Sunset found no benefit from moving OCCC's functions to OAG.
- Sunset also examined, but found no benefit from moving OCCC to the Texas Department of Licensing and Regulation (TDLR), the State's umbrella licensing agency. TDLR oversees a variety of businesses, industries, trades, and occupations. While Sunset found that TDLR performs many similar licensing functions, OCCC is better housed under the Finance Commission umbrella to ensure oversight and consistency on financial regulatory issues.

Comparison: **While organizational structures vary, most states use a state agency to regulate consumer credit transactions and oversee interest rates.**

- Forty-three states have a state agency to enforce credit laws, and duties and powers in other states are substantially similar to Texas' OCCC. While most other states have consolidated financial services regulation, Sunset, as explained earlier, did not find any major benefit from consolidating OCCC with the Department of Banking or the Savings and Loan Department.

Recommendation

Change in Statute

7.1 Continue the Office of Consumer Credit Commissioner for 12 years.

Impact

This recommendation would continue the Office of Consumer Credit Commissioner as an independent agency responsible for regulating the credit industry and protecting consumers.

Fiscal Implication

If the Legislature continues the functions of OCCC, using its existing organizational structure, OCCC's current annual appropriation of $2.5 million would continue to be required to maintain the operation of the agency.

[1] Office of Consumer Credit Commissioner, *Strategic Plan 2001 - 2005,* (Austin, TX: Finance Commission, June 2000), p. 8-10.

Issue 8

Certain Lenders in Texas are Evading State Credit Laws and Regulation by Redefining Loan Transactions.

Summary

Key Recommendations

- Define a sale-leaseback transaction as a loan in statute, to be regulated by the Office of Consumer Credit Commissioner.
- Clarify in law OCCC's current regulatory authority over pay day loans.

Key Findings

- Small consumer loans, including sale-leaseback transactions and pay day loans, are a fast growing segment of the financial services market.
- OCCC has authority to regulate loans, but sale-leaseback operations that redefine their loan products may evade regulation.
- The Finance Commission adopted rules for OCCC on pay day loans, but the agency may still face challenges to its authority in this area.

Conclusion

Sunset staff found that in recent years different types of lending businesses have attempted to evade regulation by using terms other than "loan" and "interest." Sale-leaseback and pay day loans are two of these types of transactions, which have very high interest rates, and cause many problems for consumers. The lack of consumer protection for pay day loans, in particular, has caused concern nationwide.

Sunset staff agrees with the Texas Senate Committee on Economic Development's Subcommittee on Consumer Credit Laws' recommendation to regulate sale-leaseback transactions. This recommendation would authorize a product that many Texas consumers may want and need, but also ensure better consumer protection. The Subcommittee's recommendation, which is mirrored in this report, would help control unlawful interest rates on sale-leasebacks and ensure that important consumer protections, such as the federal Truth in Lending law, are upheld. Further, the recommendation to statutorily authorize OCCC to regulate pay day loans would strengthen the agency's current authority in this area.

Support

Current Situation: Small consumer loans, including sale-leaseback transactions and pay day loans, are a fast growing segment of the financial services market.

> **What is a Sale-Leaseback?**
>
> A sale-leaseback is a transaction in which a consumer seeking a cash advance presents a serial number of an appliance to a "lender" and the lender then "sells" the item back to the consumer. The consumer then makes payments to the lender with high interest rates and fees. Usually no verification or exchange of goods occurs and there is no intention by the lender to take the goods into possession if the consumer fails to pay.

> **What is a Pay Day Loan?**
>
> A pay day loan is a transaction in which a consumer submits a personal check as security for a cash advance. After two weeks, the initial cash advance plus an "associated fee" is due or the check may be turned over to a court for criminal prosecution. The fees range from $15 to $33.50 per $100 loaned and the average interest rate on these transactions is 474 percent, far above the interest rates allowable in state usury law.

- Small consumer loan companies are growing, and the increase in the number and dollar volume of loans has exceeded the growth of licensees. In addition, according to a recent study by the Federal Reserve Board, consumer lending by banks and thrift institutions continues to decline, while lending by finance and mortgage companies continues to increase.[1] In fact, lending by mortgage companies has surpassed lending by banks. The growth in the number of lenders regulated by OCCC supports the claim by a former Texas Comptroller that financial services will be provided more often by nonbank institutions in the future.[2] The textboxes, *What is a Sale-Leaseback?* and *What is a Pay Day Loan?*, describe two types of alternative lending operations that are growing rapidly, nationwide and in Texas.
- Approximately 10,000-15,000 pay day lending operations exist across the U.S. The industry predicts that the number of pay day loan outlets will grow between 20,000 to 25,000 nationally in the next six to eight years.[3] Pay day lenders operate as pay day loan companies, check-cashing businesses, independent operators, or pawnshops. The exact number of pay day lenders in Texas is unknown since the State has only recently begun to address this issue.

Current Situation: OCCC is responsible for regulating all consumer loans in Texas that are outside of traditional financial institutions, such as banks.

- The law gives OCCC broad authority to regulate lenders and enforce Texas Credit Laws. Credit laws provide guidelines for lenders on interest rates, disclosures, and debt collection practices. The Texas Finance Code defines a loan 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." Any loan within this description is subject to OCCC regulation, unless the loan is made through a depository institution such as a bank, thrift or credit union.

<u>Problem:</u> OCCC has authority to regulate loans, but sale-leaseback operations that redefine their loan products may evade regulation.

- The Texas Senate Committee on Economic Development's Subcommittee on Consumer Credit Laws researched the issue of sale-leasebacks extensively and issued a report in September 2000. The Subcommittee determined that sale-leaseback transactions are indeed loans, and currently cause problems for consumers due to high interest rates and unclear terms. The Subcommittee's report recommended that Texas law be amended to define a sale-leaseback transaction as a loan, and that federal Truth in Lending disclosures be required.[4]

- Sunset staff found the same problems with sale-leaseback transactions. Although the Finance Code states that "a person may not use any device, subterfuge, or pretense to evade the application of this article," sale-leaseback operators have used a pretense by labeling their loan transactions as leases or deferred presentments. Sale-leaseback operators claim they are not making loans with interest, but charging fees. However, these types of businesses often advertise in the loan section of the yellow pages and have used the word "interest" in their advertising. The table, *Rate Comparison of Various Loans in Texas,* illustrates that sale-leasebacks and pay day loans have far higher rates than other types of loans.

Sale-leasebacks are often done to solve short-term cash flow problems, but end up as long-term financial obligations.

Rate Comparison of Various Loans in Texas

Loan Type	Maximum Annual Percentage Rate	Authorized By
Loan from financial institution	18%	Texas Credit Law
Credit card cash advance	25%*	National Bank Act
Secured loan from a consumer finance company	32%	Texas Credit Law
Loan from small loan company	180%	Texas Credit Law
Pawnshop loan	240%	Texas Pawnshop Act
Sale-leaseback and Pay day loan	650% - 2000%	Unregulated loan

*Typical rate, but not the maximum.

- Sale-leaseback transactions are considered short-term solutions to cash-flow problems, but studies show that consumers are actually making long-term financial commitments. A study in Indiana showed that 77 percent of customers rollover existing loans, and the average duration of a loan, including extensions, is between 3 and a half to 4 and a half months.[5] Consumers are often unable to pay the entire amount, extend the loan several times, and end up paying high amounts in service charges and interest. An example

> **Actual Complaint to OCCC on a Sale-Leaseback Problem**
>
> On Christmas Eve 1999, a woman went to a sale-leaseback company seeking a short-term loan to allow her to purchase Christmas presents. Instead of a typical payment for pawned goods, the woman entered into a sale-leaseback agreement. In this agreement, she sold her stereo, television, and VCR to the company for the sum of $200 but she was allowed to keep her property. She then entered into a property rental agreement whereby she was to pay rent on the property in the amount of $54.13 every 15 days. Although the lease contract expired on January 7, 2000, the contract specified this date to be the first day of rent payment. The $54.13 rent charge automatically renewed every 15 days along with a $4 late charge and a $10 reinstatement fee. By July 2000, the woman had paid more than $950 for a loan of $200 in December. Although interest at a rate of almost 700 percent was paid, the company claimed that additional interest was still due.
>
> *Source: Complaint to Office of Consumer Credit Commissioner, August 3, 2000.*

of a sale-leaseback case is outlined in the textbox, *Actual Complaint to OCCC on a Sale-Leaseback Problem*. Some consumers have even received threats or warrants for their arrest. Without regulation, consumers have little protection from deceptive and unfair practices.

<u>Problem:</u> The Finance Commission adopted rules for OCCC on pay day loans, but the agency may still face challenges to its authority in this area.

- Under general provisions of Chapter 342 of the Finance Code on consumer loans, the Finance Commission adopted rules in June 2000, that prescribe standards of conduct for pay day loan transactions. See the textbox, *OCCC Pay Day Loan Rules*, for an overview of the key provisions addressed in the new rules.

> **OCCC Pay Day Loan Rules**
>
> - Sets maximum charge for pay day loans
> - Establishes minimum term of seven days
> - Establishes procedures for loans, including disclosures
> - Limits duplicate and multiple loans

- OCCC has licensed 34 pay day lenders since the rules went into effect in June. Complaints on pay day loans have increased, primarily due to licensed lenders bringing unlicensed lenders to the attention of OCCC. The agency is beginning to take administrative action and issue cease and desist orders to some of these unlicensed lenders. However, because the new pay day loan regulation is in rule and not in law, the agency believes its enforcement authority over pay day lending may be challenged by the industry.
- The Texas Senate Committee on Economic Development's Subcommittee on Consumer Credit Laws also researched pay day lending in Texas. The Subcommittee supported OCCC's efforts to regulate these loans, but recommended that the full Committee continue to monitor the implementation of the newly-promulgated rules.

<u>Comparison:</u> The Texas Legislature has previously acted to regulate sale-leaseback and pay day loan transactions.

- Another form of sale-leaseback was clearly defined as a loan by the Legislature in 1985. Instead of an appliance, lenders were purchasing and leasing homesteads as a loan mechanism. The Legislature addressed this issue by amending the Texas Property Code to state that a buyer of a property that executes a lease of the property to the seller at lease payments that exceed the fair rental value of the property, is considered to be a loan.[6] The Code further states that this type of activity is illegal.

<u>Comparison:</u> Other states' laws on sale-leaseback transactions and pay day lending vary widely from no regulation to complete prohibition.

- Twenty three states, including Florida, Ohio and North Carolina, have specific pay day loan laws or regulations that permit payday loans, but set maximum fees, amount, length of the loan, and other terms.[7] Eight states permit pay day loans and have no rate cap. Eighteen states prohibit pay day loans due to small loan interest rate caps.[8]
- Louisiana's Attorney General published an opinion in August 2000 which stated that a sale-leaseback company should be subject to licensure by Louisiana's Office of Financial Institutions.

Recommendation

Change in Statute

8.1 Define a sale-leaseback transaction as a loan in statute, to be regulated by OCCC.

This recommendation would regulate sale-leaseback operations under the Texas Finance Code Subchapter F usury limits. Regulation would involve licensure and examination of these businesses, and requirements would be similar to other consumer lenders that OCCC currently oversees. OCCC's current fee authority would extend to these businesses as licensed lenders.

This recommendation mirrors that of the Texas Senate Committee on Economic Development Subcommittee on Consumer Credit Laws. More specifically, the Subcommittee suggests defining a sale-leaseback transaction in law as "an agreement to defer the payment of a debt and an absolute obligation to repay a debt." Sunset staff concur that this or similar language would help ensure that these transactions are clearly considered a loan and, as such, subject to regulation by OCCC.

8.2 Clarify in law OCCC's current regulatory authority over pay day loans.

OCCC should continue to regulate pay day lenders under Subchapter F of the Texas Finance Code, with its current rules as guidelines to the industry on what is required. Clarifying OCCC's authority in law should help avoid timely and costly lawsuits on pay day loans.

Impact

This recommendation would authorize a product many Texas consumers may want and need due to a lack of available credit, but would also ensure better consumer protection through regulation. OCCC regulation would help control unlawful interest rates and ensure that important consumer protections, such as the federal Truth in Lending law, are upheld. The specific addition of sale-leaseback and pay day loan transactions to OCCC's statutory authority should not be construed as limiting current law to these transactions. As businesses come up with new ways to potentially evade Texas' consumer credit laws, OCCC should be able to develop rules and regulate, just as the agency did with pay day loans.

Fiscal Implication

Authorizing OCCC to regulate sale-leaseback transactions would have no impact on the General Revenue Fund. Costs would be recovered by licensing and examination fees. The agency would need to request appropriation authority from the Legislature to spend the fee revenue for the increased workload resulting from these recommendations.

[1] Federal Reserve Bulletin, *Recent Changes in U.S. Family Finances: Results from the 1998 Survey of Consumer Finances,* (January, 2000), p. 24.

[2] Office of Consumer Credit Commissioner, *Strategic Plan 2001 - 2005,* (Austin, TX: Finance Commission, June 2000), p. 10.

[3] Texas Legislature, House Financial Institutions Committee Hearing, "Pay day loans," testimony by Leslie L. Pettijohn, April 6, 2000.

[4] Texas Senate, Committee on Economic Development, Subcommittee on Consumer Credit Laws, *Interim Report, 76th Texas Legislature,* September 2000.

[5] Texas Legislature, House Financial Institutions Committee Hearing, "Pay day loans," testimony by Leslie L. Pettijohn, April 6, 2000 and R.L. Polk, *Demographic Analysis,* Illinois Title Loan Company.

[6] V.T.C.A., Bus. & Commerce, sec. 41.006

[7] Consumer Federation of America, *Show me the Money: A Survey of Payday Lenders and Review of Payday Lender Lobbying in State Legislatures,* (February, 2000), p. 4.

[8] Ibid., p. 23.

Issue 9

Authority to Regulate the Financing Activities of Car Dealers Does Not Adequately Address Complaints.

Summary

Key Recommendation

- Increase the Office of Consumer Credit Commissioner's authority over the financing activities of car dealers from registration to licensure, and allow the Finance Commission to set reasonable fees to cover the costs of regulation.

Key Findings

- Car dealers in Texas are licensed by TxDOT, but must also register with OCCC if they finance the sale of vehicles.
- OCCC's current authority to simply register car dealers is inadequate to address the significant number of complaints regarding car dealer financing activities.
- Many other states have stronger regulation of car dealer financing activities than Texas, and consumer groups indicate significant problems with car dealers nationally.

Conclusion

Sunset found that the high number of complaints at OCCC indicates that consumers encounter many problems with the financing activities of car dealers in Texas. However, the agency's limited registration program is inadequate to address these problems effectively. Sunset recommends significantly increasing OCCC's authority over car dealer financing, to include licensure and on-site inspections. This would enable OCCC to better protect consumers and ensure car dealers' compliance with credit laws.

Support

<u>Current Situation:</u> Car dealers in Texas are licensed by TxDOT, but must also register with OCCC if they finance the sale of vehicles.

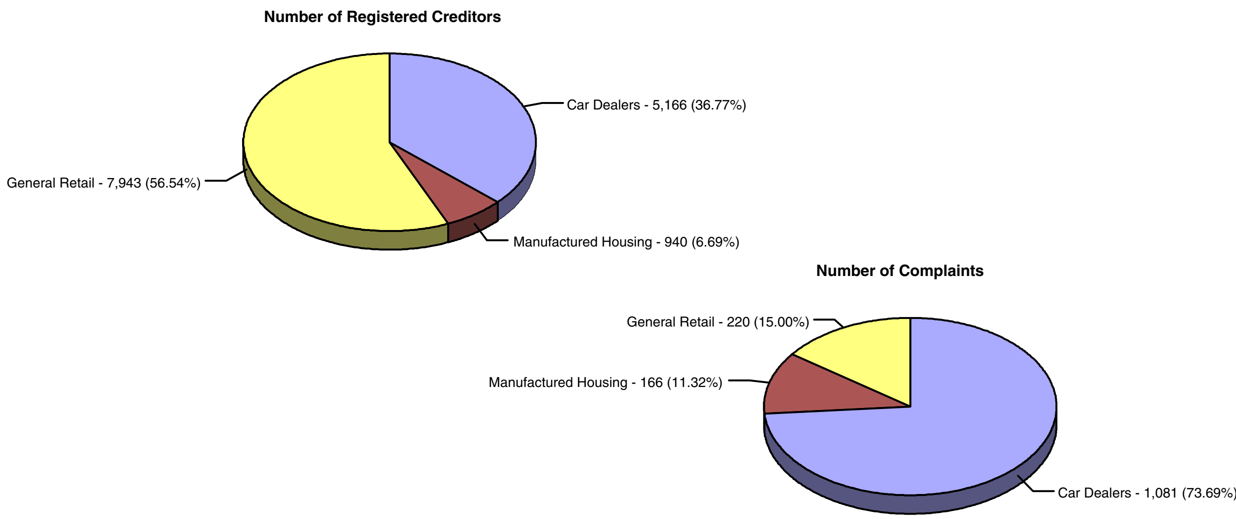
- All car dealers must obtain a license by the Texas Department of Transportation's Motor Vehicle Division. TxDOT licenses car dealers to ensure that the businesses are sound, and to prevent fraud and unfair practices in the distribution and sale of cars. TxDOT licenses 16,910 car dealers and has some authority over financing, but its licensing requirements do not address installment contracts or the extension of credit.
- Car dealers who finance the sale of vehicles must also register with OCCC because the Finance Code requires all creditors who finance the sale of their goods and services to register. The Legislature requires registration of creditors to provide notice to the State of creditors engaged in this activity.
- OCCC registers 5,712 car dealers, or about a third of the total number of dealers that TxDOT licenses. Registration calls for few requirements, including a short application, a $25 annual fee, and the display of a sticker with OCCC's phone number to call with any complaints. OCCC can investigate complaints against car dealers, and has the authority to assess fines. Car dealers operating without a valid registration also risk fines. In fiscal year 1999, car dealers paid approximately $140,000 in registration fees to OCCC, and the agency has .5 FTE dedicated to registration. OCCC collected about $30,000 in late filing fees in FY 1999.

OCCC's current authority over car dealer financing is limited to responding to complaints, after a problem has occurred.

<u>Problem:</u> OCCC's current authority to simply register car dealers is inadequate to address the significant number of complaints regarding car dealer financing activities.

- As can be seen in the chart, *OCCC Registered Creditors - FY 1999,* car dealers represent only 37 percent of the number of registered creditors that OCCC oversees, but they account for 74 percent of the complaints received.

OCCC Registered Creditors - FY 1999



- Buying a car is a major purchase for most consumers and generally involves some type of financing. OCCC staff state that many of the complaints about motor vehicle dealers revolve around issues of finance charges and total cost disclosure, and many involve an error by the dealer. Consumers can be misled by high-pressure sales tactics, and have little recourse in dealing with problems.

  Frequently, consumers are promised financing by the dealer, and the consumer signs a contract and is able to drive the vehicle off the lot. When financing cannot be obtained for the consumer, the dealer demands that the consumer return the vehicle. According to the Consumer Credit Commissioner, this practice is illegal, as the dealer is bound by the contract. It causes a great deal of problems for the consumer who may have already traded in an old vehicle and put a down payment on the new one.

> Consumers can be mislead by high-pressure sales tactics when buying a car.

- Because OCCC does not have the authority to license and inspect these businesses, the agency cannot ensure fair credit practices on the front-end, and cannot adequately detect and rectify ongoing violations of credit laws. Registration does not involve qualifications like licensure, or routine inspections to ensure compliance.

<u>Comparison:</u> Many other states have stronger regulation of car dealer financing activities than Texas, and consumer groups indicate significant problems with car dealers nationally.

- Consumer credit agencies in 24 states license motor vehicle dealers to regulate their credit transactions. Texas is one of five states that only registers these creditors. Twenty-one states have no involvement by a consumer credit agency.

- According to the Council of Better Business Bureaus, more complaints concern car dealers than any other business, with over 23,000 complaints in 1999.[1] The Houston Better Business Bureau alone had approximately 600 complaints about car dealers in 1999, and new car dealers were ranked as the number one area of complaint.[2]
- The Federal Trade Commission, which receives complaints and investigates trends in violations with car dealers, encounters many issues with dealers, particularly with violations of the Truth in Lending law.[3]

Recommendation

Change in Statute

9.1 Increase OCCC's authority over the financing activities of car dealers from registration to licensure, and provide for periodic on-site inspections.

This recommendation would give OCCC authority to inspect car dealers' financing activities more closely, seek restitution to consumers for violations of the Finance Code, and apply administrative penalties. This authority would be limited to conducting announced inspections during regular business hours. The Finance Commission should adopt rules outlining more specifically the requirements of the program based on proposed rules from OCCC. Licensing requirements would focus on ensuring an appropriate sales finance program and a review of forms and contracts. Inspections of financing operations would be conducted on a four-year cycle or as needed to ensure compliance. Inspection would include the review of contracts to ensure that car dealers are complying with credit laws.

9.2 Authorize licensure fees in place of the current registration fees for car dealers, and allow the Finance Commission to set reasonable fees to cover the costs of regulation.

The Finance Commission should set fees in rule that are reasonable and necessary to recover the overall costs of the licensure and inspection of car dealers. If recommendation 11.2 in this report is adopted regarding an assessment methodology for fee collection, the license and inspection fees for car dealers should be included.

9.3 Authorize OCCC to share information on car dealer licensing and enforcement with TxDOT.

Because OCCC's statute prohibits this sharing of information, this recommendation would help avoid duplication and overlap in licensing information collected by the two agencies. OCCC would share any information necessary to ensure consistent enforcement, and to decrease the regulatory burden on the industry. Information shared between the agencies would remain confidential.

Impact

This recommendation would improve consumer protection by having better oversight over an area that is the subject of many consumer complaints and would help increase compliance by the industry. Increasing OCCC's statutory authority would improve the oversight of car dealers by allowing the agency to conduct regular inspections, and allowing TxDOT to dedicate more resources to its more primary function of overseeing the general distribution and sale of cars. Allowing the sharing of information would increase coordination between the agencies and help eliminate any potential duplication.

Fiscal Implication

This recommendation would have no net impact on the General Revenue Fund because the costs of the regulation would be covered by fees charged to car dealers. The Finance Commission would set fees, by rule, at a level to recover the cost of regulation.

Sunset staff, based on information provided by OCCC, estimated the costs of regulation at $840,000. This would cover the licensing and periodic on-site inspection of car dealers, and includes an additional seven FTEs at OCCC. The estimate assumes a license fee of $75 plus the cost of inspection. Inspection costs, based on a four-year inspection cycle, would include a $150 base fee; and a $240 charge, which results from having a four-hour inspection, at $60 per hour.

Fiscal Year	Gains to the General Revenue Fund	Costs to the General Revenue Fund	Change in FTEs from FY 2001
2002	$840,000	$840,000	+7
2003	$840,000	$840,000	+7
2004	$840,000	$840,000	+7
2005	$840,000	$840,000	+7
2006	$840,000	$840,000	+7

[1] *1999 Annual Inquiry and Complaint Summary,* (Arlington, VA: Council of Better Business Bureaus, 2000), p. 4.

[2] Telephone interview with Deana Wade, Director of Investigations, Better Business Bureau of Metropolitan Houston (Houston, Texas, September 5, 2000).

[3] Interview with Jannette Gosha, Contact Representative, Federal Trade Commission (Dallas, Texas, July 14, 2000).

Issue 10

The Consumer Credit Commissioner Cannot Require Lenders to Use Plain Language on Credit Contracts.

Summary

Key Recommendations

- Require consumer loan contracts to be written in plain language.
- Require the Finance Commission to adopt rules governing consumer loan contracts, including model contracts written in plain language.
- Require the Consumer Credit Commissioner to review the readability of non-standard contracts.

Key Findings

- Loan contract information is often confusing and difficult for consumers to understand.
- Difficult-to-read loan contracts put consumers at risk of making poor financial choices.
- Other state regulatory statutes require consumer contracts to be written in plain language and federal loan contracts have been re-written into plain language.
- Some private lenders and a federal agency have simplified loan contracts by rewriting them in plain language.

Conclusion

Many consumers are not able to understand or read their loan contracts because the contracts are complex, long, and are written in legal language. One common complaint received by the Office of Consumer Credit Commissioner is that consumers often are forced to unnecessarily purchase credit insurance because they did not understand the terms of their contract. In recent years, some private lenders and governmental agencies have tried to simplify their contracts by rewriting them into plain language.

The Sunset review concluded that giving the Consumer Credit Commissioner a role in creating easy-to-read loan contracts would enable consumers to make better informed decisions and reduce confusion and complaints.

Support

<u>Current Situation:</u> The Office of Consumer Credit Commissioner has limited authority over loan contracts.

- The Texas Finance Code gives OCCC authority to investigate potential violations of law in the actions of registered creditors and licensed lenders. This authority extends to violations that may be present in loan contracts. When conducting inspections of licensed lenders, the agency examines samples of loan contracts.
- The Finance Code also gives OCCC authority to require certain information on loan contracts. Currently this authority is limited to requiring information on how borrowers can contact OCCC. Federal statutes, such as the Truth In Lending Act, also require loan contracts to contain certain information such as finance charge disclosures. OCCC has some authority under state law to enforce these federal disclosure provisions.
- The Finance Commission's rules currently lay out model provisions for certain loan contracts, but compliance with these rules is optional for lenders to follow. For example, a Commission rule gives motor vehicle installment lenders a model provision for disclosure of financing.[1]

The inability to understand a loan can substantially affect a consumer's finances.

<u>Problem:</u> Loan contracts that are confusing and difficult to understand put consumers at risk of making poor financial choices.

- Consumer groups have complained that many loan contracts are confusing and hard to read. Consumer groups have also pointed out that the lack of standardization of loan contracts makes it difficult for consumers to compare contract terms among several lenders.[2]
- A Sunset staff review of loan contracts for a range of loans found many examples of contracts that are complex and difficult to understand. Loan contracts reviewed included home equity loans, motor vehicle installment contracts, and small consumer loans.
- The inability to understand a loan contract can have substantial consequences to a consumer's financial situation. For example, OCCC staff have documented that many consumers have been deceived into incurring additional expenses, such as purchasing loan insurance, because they do not understand their loan contract.

<u>Comparison:</u> Other Texas regulatory statutes require consumer contracts to be written in plain language.

- The state law regulating rental purchase agreements, which are similar to loan contracts overseen by OCCC, requires all agreements to be written in plain language.[3] Under the statute, the Attorney General is required to provide model agreements to be used by rental companies.

- The Legislature has also required private insurers, through provisions of the Insurance Code, to create contracts written in plain language.[4] These provisions also give the Department of Insurance the role of approving the readability of policies. TDI's efforts have resulted in insurance contracts that are easier to understand and are more readily comparable.[5]

The State requires plain-language contracts in several other areas, including insurance policies.

<u>Comparison:</u> **Some private lenders and a federal agency have gained recognition and reduced consumer complaints by simplifying loan contracts.**

- Ford Credit, the automobile loan division of the Ford Motor Corporation, recently introduced simpler contracts that are written in plain language.[6] In making this change, the company announced that a trial run of the easier-to-read contracts reduced consumer questions and complaints by half. Consumers were also more likely to read the contract written in plain language than the older contracts.

- As part of an initiative to require federal agencies to rewrite governmental documents in plain language, the Federal Home Loan Mortgage Corporation rewrote its mortgage contracts to be simpler and easier to read. The State Bar of Michigan, which gives annual Clarity Awards, recently noted that although real estate financing documents are one of the most difficult types of legal documents to write in plain language, the Federal Home Loan Mortgage Corporation's contracts are "especially well-written."[7]

Recommendation

Change in Statute

10.1 Require consumer loan contracts to be written in plain language.

10.2 Require the Finance Commission to adopt rules governing consumer loan contracts, including model contracts written in plain language.

10.3 Require the Consumer Credit Commissioner to review the readability of non-standard contracts.

Impact

These recommendations are designed to help consumers to better understand their loan contracts. OCCC currently has authority to take action against lenders who commit violations, but ensuring that loan contracts are clearly written would lower the number of complaints from consumers who did not understand the terms of their contracts. The agency would then be able to better focus its time on actual violations. For the convenience of lenders, the Finance Commission would establish model contracts in rule and would post the contracts on its Web site.

The Office of Consumer Credit Commissioner would review the contracts of lenders who choose not to use the model contracts. The task of reviewing non-standard contracts is somewhat simplified because many lenders purchase contracts from form-printing companies. However, because so many different types of contracts exist, the agency could have a significant workload. Because of the potential magnitude of the task, the agency should not be bound by specific time constraints in reviewing the non-standard contracts. Lenders, whose non-standard contracts are under review, would be able to use unreviewed contracts without penalty. In addition, Sunset staff should point out that the successful review of a contract for readability by the Consumer Credit Commissioner should not be viewed as an endorsement of the contract by the Department.

Fiscal Implication

These recommendations will not result in a fiscal impact to the State. Adopting rules governing the readability of consumer loan contracts, and the establishment of model contracts, would not result in a fiscal impact. The review of non-standard contracts by the Consumer Credit Commissioner can be done within existing resources, if the agency is not bound by specific time constraints in its review.

1 Texas Administrative Code Title 7 §1.1307.

2 Telephone interview with Rob Schneider, Senior Staff Attorney, Consumers Union, (Austin, Tx., September 12, 2000).

3 Business and Commerce Code, §35.72.

4 These requirements include provisions for title insurance in Insurance Code Article 9.07A (e), automobile insurance in Insurance Code Article 5.06 (7), and prescription drug formularies for group health benefit plans in Insurance Code Article 21.52J §3(1).

5 Telephone interview with Rob Schneider, Senior Staff Attorney, Consumers Union, September 12, 2000.

6 Ford Credit, *Press Release,* www.theautochannel.com/news/date/19961023/news02337.html. Accessed: August 3, 2000.

7 George H. Hathaway, State Bar of Michigan, *Plain Language Clarity Awards for Fall 1999,* www.michbar.org/commitees/penglish/columns/156.html. Accessed August 3, 2000.

Issue 11

OCCC's Licensing Fees are Outdated, and the Method of Fee Collection is Inefficient.

Summary

Key Recommendations

- Repeal the set license fees for regulated lenders and pawnshops, and the process for recovering examination costs; and authorize the Finance Commission to set license fees by rule.
- Authorize the Finance Commission to base fees on the licensee's loan volume, in amounts reasonable and necessary to recover the overall costs of both licensing and examinations.

Key Findings

- Regulated lenders and pawnshops licensed by the Office of Consumer Credit Commissioner pay licensing and examination fees to offset the costs of regulation.
- Annual license fees are fixed in law and, except for a small increase in pawnshop fees, have not changed in almost 30 years.
- Hourly billing for the costs of examinations is cumbersome for the agency, and makes it difficult for licensees to predict and budget their costs.
- Other financial regulatory agencies in Texas, and other states, have adopted fee systems based on assets or loan volume size as a more predictable way to cover regulatory costs.

Conclusion

Having license fees fixed in statute limits both OCCC's and the Legislature's ability to make adjustments in these fees when necessary. This recommendation would remove the statutory fee restriction, as well as change the way the agency recovers its costs through fees. Instead of a separate license and variable examination fee, licensees would pay a fee based primarily on their loan volume. This change should result in more predictable regulatory costs. The fee schedule would allow companies to anticipate their exact cash flow needs and better plan their budgets. Further, OCCC would be able to stabilize revenue collection and better recover the overall costs of regulation.

Support

Current Situation: Regulated lenders and pawnshops licensed by the Office of Consumer Credit Commissioner pay licensing and examination fees to offset the costs of regulation.

- OCCC licenses and examines regulated lenders and pawnshops to ensure that they are qualified lenders, and that they comply with credit laws. The Legislature established license fees in law, while the Finance Commission sets examination fees in rules.[1] In FY 1999, OCCC regulated 3,454 consumers lenders and 1,554 pawnshops, and conducted about 2,600 examinations. That year, the agency received about $1.1 million in license fees and close to $1.2 million in examination fees. All fees go directly into the General Revenue Fund.
- Examination fees include a $150 administrative fee plus $60 an hour for the length of the exam. OCCC bills licensees for each examination, and must manage a large volume of individual checks and revenue throughout the year. The chart, *OCCC Licensing and Examination Fees, FY 1999*, provides more details about the fees regulated lenders and pawnshops pay to OCCC.

OCCC Licensing and Examination Fees, FY 1999*

Description		Factor	Fee	Number of Payers	Fee Revenue
License Fees	Regulated Loan Licensees	If Loan Balance<$100,000 If Loan Balance>$100,000	$100/year $200/year	4,370	$650,857
	Pawnshop Licensees		$100 for 1st year $125 for renewals	1,539	$455,002
Examination Fees	Regulated Loan Licensees	Exam Fee Administrative Charge + Hourly Rate	$150 + $60/hour	1,526	$815,117
	Pawnshop Licensees	Exam Fee Administrative Charge + Hourly Rate	$150 + $60/hour	1,048	$364,704

* Does not include pawnshop employee licensing fees.

- In comparison, OCCC's licensing fees are approximately $300 less than licensing fees in other states. Michigan, Tennessee, Maryland, and Delaware all have regulated lender license fees of $300 to $1000, which is for the license fee alone, and does not include examinations. Most states also have higher pawnshop license fees. South Carolina's license fee is $275, Indiana's license fee is $500, and Louisiana's license fee is $700; again, this is for license fees only and does not include examinations.[2]

Problem: Annual license fees are fixed in law and, except for a small increase in pawnshop fees, have not changed in almost 30 years.

- The Legislature fixed the exact amount of the lender license fee in 1967 and the pawnshop license fee in 1971. Therefore, neither OCCC nor the Legislature have the flexibility to easily adjust the fees to reflect changing needs. Consequently, many regulated loan licensees have been paying the same $100 fee since 1967.

Having license fees fixed in law limits the Legislature's ability to easily adjust them to reflect changing needs.

Problem: Hourly billing for the costs of examinations is cumbersome for the agency, and makes it difficult for licensees to predict and budget their costs.

- OCCC's flow of revenue from examinations is unstable. The agency cannot always anticipate how quickly lenders will pay OCCC for an examination. Since OCCC collects examination fees on an ongoing basis throughout the year, the hourly billing method of collection is inefficient and time-intensive for staff to process.

Comparison: Other financial regulatory agencies in Texas, and other states, have adopted fee systems based on assets or loan volume size, as a more predictable way to cover regulatory costs.

- Many states base their license fees on some characteristic of the licensee. Consumer credit regulators in states such as Michigan, South Carolina, and Louisiana base their fees upon the number or total dollar value of loans made by the lender. Instead of charging flat fees to the industry, the regulator calculates a fair and reasonable fee that is intended to capture the impact of the licensee's workload on regulatory efforts.
- Most bank regulators base their license fees upon asset size. The larger the bank's assets, and the more time it takes for examination, the higher the total fee. For example, both the Department of Banking and the Savings and Loan Department have successfully implemented an annual assessment based on asset size and condition, billed in quarterly installments. According to the Department of Banking, the new process allows banks to budget for the assessment and avoid any additional charges or fees throughout the year.[3]

Recommendation

Change in Statute

11.1 Repeal the set license fees for regulated lenders and pawnshops, and the process for recovering examination costs; and authorize the Finance Commission to set license fees by rule.

Under this recommendation, all the fixed fees would be deleted from statute. The Finance Commission would be authorized to set the fees at rates necessary to recover costs and meet the agency's budget requirements set by the Legislature.

11.2 Authorize the Finance Commission to base fees on the licensee's loan volume, in amounts reasonable and necessary to recover the overall costs of both licensing and examinations.

OCCC should develop an assessment methodology that combines license and examination fees and allows regulated lenders and pawnshops to pay one up-front fee per year. Fees would vary depending on the dollar amount of the licensees' transactions, but the actual amount paid per year is not anticipated to change significantly.[4] All fees would continue to go directly into the General Revenue Fund.

Impact

This recommendation should result in a more efficient process of collecting fees from the industry. Overall fees to a licensee should not change significantly and the assessment methodology should provide for a more predictable cost of regulation. The fee schedule would allow companies to anticipate their exact cash flow needs and better plan their budgets. Further, OCCC would be able to stabilize revenue collection and better recover the overall costs of regulation.

Fiscal Implication

The adoption of an assessment-based funding system in the place of the current fee-based system should be implemented in a revenue-neutral manner. The development of an assessment tool and the application to lenders' loan volume data would be a minimal increase on the agency's workload and would not require additional resources.

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[1] Tex. Fin. Code Ann. ch. 342, sec 342.154 (1999); and Tex. Fin. Code Ann. ch 371, sec 371.055 (1999).

[2] Phone interview with staff of the Office of Consumer Credit Commissioner, (Austin, Texas, October 4, 2000).

[3] Texas Performance Review, *Gaining Ground,* (Austin, TX: Texas Comptroller of Public Accounts, November, 1994), p. 522.

[4] OCCC estimates that annual fees for pawnshops would average $345, but fees could range from as low as $325 to as high as $654. The average combined annual license and examination fee for pawnshops is currently $575. Small consumer lenders would pay an average of $434, but could range from a low of $300 to a high of $1,400 annually. Currently, the average annual fee for small consumer lenders is $550. To address larger lenders with higher fees, annual fees would be capped at $2,700. (Mortgage lenders currently pay an average of $1500 a year).

Across-the-Board Recommendations

Finance Commission of Texas	
Recommendations	**Across-the-Board Provisions**
	A. GENERAL
Update	1. Require at least one-third public membership on state agency policymaking bodies.
Update	2. Require specific provisions relating to conflicts of interest.
Already in Statute	3. Require that appointment to the policymaking body be made without regard to the appointee's race, color, disability, sex, religion, age, or national origin.
Already in Statute	4. Provide for the Governor to designate the presiding officer of a state agency's policymaking body.
Update	5. Specify grounds for removal of a member of the policymaking body.
Apply	6. Require that information on standards of conduct be provided to members of policymaking bodies and agency employees.
Apply	7. Require training for members of policymaking bodies.
Apply	8. Require the agency's policymaking body to develop and implement policies that clearly separate the functions of the policymaking body and the agency staff.
Apply	9. Provide for public testimony at meetings of the policymaking body.
Apply	10. Require information to be maintained on complaints.
Update	11. Require development of an equal employment opportunity policy.
Apply	12. Require information and training on the State Employee Incentive Program.

Office of Consumer Credit Commissioner	
Recommendations	**Across-the-Board Provisions**
	A. GENERAL
See Finance Commission	1. Require at least one-third public membership on state agency policymaking bodies.
Update	2. Require specific provisions relating to conflicts of interest.
See Finance Commission	3. Require that appointment to the policymaking body be made without regard to the appointee's race, color, disability, sex, religion, age, or national origin.
See Finance Commission	4. Provide for the Governor to designate the presiding officer of a state agency's policymaking body.
See Finance Commission	5. Specify grounds for removal of a member of the policymaking body.
Update	6. Require that information on standards of conduct be provided to members of policymaking bodies and agency employees.
See Finance Commission	7. Require training for members of policymaking bodies.
See Finance Commission	8. Require the agency's policymaking body to develop and implement policies that clearly separate the functions of the policymaking body and the agency staff.
See Finance Commission	9. Provide for public testimony at meetings of the policymaking body.
Update	10. Require information to be maintained on complaints.
Update	11. Require development of an equal employment opportunity policy.
Apply	12. Require information and training on the State Employee Incentive Program.

Office of Consumer Credit Commissioner	
Recommendations	**Across-the-Board Provisions**
	B. LICENSING
Not Applicable	1. Require standard time frames for licensees who are delinquent in renewal of licenses.
Not Applicable	2. Provide for notice to a person taking an examination of the results of the examination within a reasonable time of the testing date.
Not Applicable	3. Authorize agencies to establish a procedure for licensing applicants who hold a license issues by another state.
Not Applicable	4. Authorize agencies to issue provisional licenses to license applicants who hold a current license in another state.
Apply	5. Authorize the staggered renewal of licenses.
Already in Statute	6. Authorize agencies to use a full range of penalties.
Modify	7. Revise restrictive rules or statutes to allow advertising and competitive bidding practices that are not deceptive or misleading.
Not Applicable	8. Require the policymaking body to adopt a system of continuing education.

Savings and Loan Department	
Recommendations	**Across-the-Board Provisions**
	A. GENERAL
See Finance Commission	1. Require at least one-third public membership on state agency policymaking bodies.
Update	2. Require specific provisions relating to conflicts of interest.
See Finance Commission	3. Require that appointment to the policymaking body be made without regard to the appointee's race, color, disability, sex, religion, age, or national origin.
See Finance Commission	4. Provide for the Governor to designate the presiding officer of a state agency's policymaking body.
See Finance Commission	5. Specify grounds for removal of a member of the policymaking body.
Apply	6. Require that information on standards of conduct be provided to members of policymaking bodies and agency employees.
See Finance Commission	7. Require training for members of policymaking bodies.
See Finance Commission	8. Require the agency's policymaking body to develop and implement policies that clearly separate the functions of the policymaking body and the agency staff.
See Finance Commission	9. Provide for public testimony at meetings of the policymaking body.
Apply	10. Require information to be maintained on complaints.
Apply	11. Require development of an equal employment opportunity policy.
Apply	12. Require information and training on the State Employee Incentive Program.

Savings and Loan Department		
Recommendations		**Across-the-Board Provisions**
		B. LICENSING
Apply	1.	Require standard time frames for licensees who are delinquent in renewal of licenses.
Not Applicable	2.	Provide for notice to a person taking an examination of the results of the examination within a reasonable time of the testing date.
Apply	3.	Authorize agencies to establish a procedure for licensing applicants who hold a license issues by another state.
Apply	4.	Authorize agencies to issue provisional licenses to license applicants who hold a current license in another state.
Already in Statute	5.	Authorize the staggered renewal of licenses.
Already in Statute	6.	Authorize agencies to use a full range of penalties.
Already in Statute	7.	Revise restrictive rules or statutes to allow advertising and competitive bidding practices that are not deceptive or misleading.
Already in Statute	8.	Require the policymaking body to adopt a system of continuing education.

Department of Banking	
Recommendations	**Across-the-Board Provisions**
	A. GENERAL
See Finance Commission	1. Require at least one-third public membership on state agency policymaking bodies.
Update	2. Require specific provisions relating to conflicts of interest.
See Finance Commission	3. Require that appointment to the policymaking body be made without regard to the appointee's race, color, disability, sex, religion, age, or national origin.
See Finance Commission	4. Provide for the Governor to designate the presiding officer of a state agency's policymaking body.
See Finance Commission	5. Specify grounds for removal of a member of the policymaking body.
Apply	6. Require that information on standards of conduct be provided to members of policymaking bodies and agency employees.
See Finance Commission	7. Require training for members of policymaking bodies.
Apply	8. Require the agency's policymaking body to develop and implement policies that clearly separate the functions of the policymaking body and the agency staff.
See Finance Commission	9. Provide for public testimony at meetings of the policymaking body.
Apply	10. Require information to be maintained on complaints.
Apply	11. Require development of an equal employment opportunity policy.
Apply	12. Require information and training on the State Employee Incentive Program.

Department of Banking Sale of Check Licensing Program	
Recommendations	**Across-the-Board Provisions**
	B. LICENSING
Not Applicable	1. Require standard time frames for licensees who are delinquent in renewal of licenses.
Not Applicable	2. Provide for notice to a person taking an examination of the results of the examination within a reasonable time of the testing date.
Not Applicable	3. Authorize agencies to establish a procedure for licensing applicants who hold a license issues by another state.
Not Applicable	4. Authorize agencies to issue provisional licenses to license applicants who hold a current license in another state.
Not Applicable	5. Authorize the staggered renewal of licenses.
Already in Statute	6. Authorize agencies to use a full range of penalties.
Not Applicable	7. Revise restrictive rules or statutes to allow advertising and competitive bidding practices that are not deceptive or misleading.
Not Applicable	8. Require the policymaking body to adopt a system of continuing education.

Department of Banking Currency Exchange Licensing Program	
Recommendations	**Across-the-Board Provisions**
	B. LICENSING
Already in Statute	1. Require standard time frames for licensees who are delinquent in renewal of licenses.
Not Applicable	2. Provide for notice to a person taking an examination of the results of the examination within a reasonable time of the testing date.
Not Applicable	3. Authorize agencies to establish a procedure for licensing applicants who hold a license issues by another state.
Not Applicable	4. Authorize agencies to issue provisional licenses to license applicants who hold a current license in another state.
Already in Statute	5. Authorize the staggered renewal of licenses.
Already in Statute	6. Authorize agencies to use a full range of penalties.
Not Applicable	7. Revise restrictive rules or statutes to allow advertising and competitive bidding practices that are not deceptive or misleading.
Not Applicable	8. Require the policymaking body to adopt a system of continuing education.

Agency Information

Finance Commission of Texas

Agency at a Glance

The Finance Commission of Texas oversees the Texas Department of Banking, the Savings and Loan Department, and the Office of Consumer Credit Commissioner. The mission of the Finance Commission is to ensure that banks, savings institutions, consumer creditors, and other businesses or persons chartered or licensed by the State operate as sound and responsible institutions that enhance the financial well-being of Texas. To achieve its purpose, the Finance Commission:

- oversees three independent state agencies;
- selects and oversees a Commissioner to run each of the three financial regulatory agencies;
- adopts rules relating to the industries overseen by the three agencies; and
- employs an administrative law judge to hear cases brought before each of the three Departments.

Key Facts

- **Funding.** The Finance Commission's total expenditures for fiscal year 1999 were $175,000. The Finance Commission is funded by General Revenue appropriations and interagency transfers for goods and services provided by the Commission to the three Departments.
- **Staffing.** The Finance Commission has 1.5 budgeted full-time equivalent employees. One employee is the administrative law judge and the part-time employee is the Banking Commissioner who serves as the Finance Commission's Executive Director.
- **Research Reports.** The Legislature has required the Finance Commission to conduct research on the availability, quality, and pricing of financial services in Texas. To complete these reports, the Finance Commission contracts with private researchers and has broken the topic into smaller projects to be completed over a number of years.

Major Events in Agency History

1943 The Legislature created the Finance Commission composed of nine members, to oversee the Banking Department. The Commission was divided into a Banking Section comprised of four banking executives and two public members, and the Building and Loan Section with two savings and loan executives and one public member.

1963 The Legislature separated the supervision of savings and loans from the Department of Banking as a new agency under the Finance Commission. The Legislature also created the Office of Regulatory Loan Commissioner granting it independent rulemaking authority under the Finance Commission. This office was later renamed to the Office of Consumer Credit Commissioner.

1969 The Legislature created the Texas Credit Union Department and transferred responsibilities over credit unions from the Banking Department.

1989 In restructuring the Finance Commission, the Legislature increased public representation to a majority of five and reduced the number of industry members to four.

Organization

Policy Body

The Commission consists of nine members — five public members, two banking executives, and two savings institution executives — all appointed by the Governor, who also designates one member to serve as Chair. One public member must be a certified public accountant. Commission members serve staggered six-year terms. The chart, *Finance Commission of Texas*, identifies each Commission member, terms of office, qualifications, and place of residence.

Finance Commission of Texas			
Name	**Position**	**Residence**	**Term Expires**
W.D. Hilton, Jr. Chair	Public Member	Greenville	February 2002
Vernon Bryant, Jr.	Banking Executive	Weatherford	February 2006
Jacqueline G. Humphrey	Public Member, CPA	Amarillo	February 2006
Deborah H. Kovacevich	Banking Executive	Jewett	February 2004
Marlene Martin	Public Member	San Antonio	February 2002
Manuel J. Mehos	Savings Executive	Houston	February 2002
Victor (Buddy) Puente, Jr.	Public Member	Pantego	February 2004
John Snider	Savings Executive	Center	February 2000
Robert V. Wingo	Public Member	El Paso	February 2004

Staff

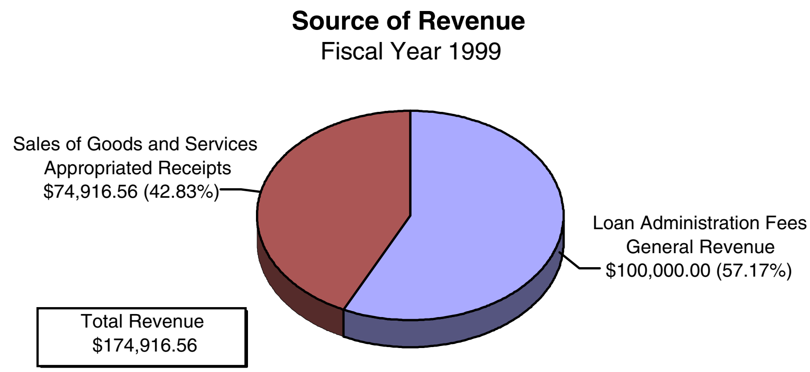
The Finance Commission employs only 1.5 full-time employees. The Banking Commissioner serves as a part-time Executive Director for the Finance Commission and a full-time administrative law judge conducts hearings for the three constituent agencies. The Commission's employees are all stationed in Austin. Because of the small staff, no organizational chart is provided and no analysis was prepared comparing the agency's workforce composition to the overall civilian labor force.

The Commission itself only has 1.5 employees.

Revenue

In fiscal year 1999, the Commission's revenue totaled about $175,000. The main revenue source is 50 cents taken out of a $25 statutory fee placed on certain consumer loans made in Texas, collected by the State Comptroller. This dedication actually yields some $132,000 per year, but the amount available to the Commission is capped at $100,000, and the remaining amount accrues to the General Revenue Fund.

The Commission also derives revenues from interagency reimbursements for administrative functions. In fiscal year 1999, such revenues amounted to about $75,000, or 43 percent of the Commission's total revenue. The pie chart, *Source of Revenue, Fiscal Year 1999*, illustrates these funding methods.



Expenditures

In fiscal year 1999, the Finance Commission expended $175,000 on its one strategy, ensuring the safety and soundness of Texas' financial system. The Finance Commission spends these funds to pay its administrative law judge, supplement the Banking Commissioner's salary for acting as the part-time Finance Commission Executive Director, reimburse travel expenses for Finance Commission members, and conduct legislatively mandated studies regarding Texas's financial services. In fiscal year 2000, by appropriation act rider, the Finance Commission was permitted to use its unexpended balances for its credit research project. Because the Commission has only one strategy, this report does not provide a pie chart for the Commission's operating budget. In addition, the Finance Commission's use of Historically Underutilized Businesses (HUBs) is not provided because the amount of funds spent in purchasing goods and services is too small.

Agency Operations

The Commission's main function is to set policy for the three agencies under its jurisdiction.

The Finance Commission's primary function is to set policies for the three agencies under its jurisdiction. The chart, *Comparison of the Finance Commission Agencies,* compares the three independent agencies and the industries they oversee. The Finance Commission also provides administrative functions across the three agencies and perform research activities. Administrative hearings and internal audits are the Finance Commission's only required administrative functions. The Finance Commission contracts with a private auditing firm for the internal audit function of the three constituent agencies. The Commission also provides print shop and building services through interagency transfers with the three financial regulatory agencies.

Comparison of the Finance Commission Agencies

Agency	Budget in $ Millions (FY 99)	FTEs (FY 99)	Financial Industry Regulated	Number	Assets in $ Billions	Average Size in $ Millions
Department of Banking	$10.8	184.5	Banks	370	$52.20	$141.0
			Branches of out-of-state State Charted Banks	6	$34.00	$5,671.1
			Trust Companies	33	$67.20	$2,036.1
			Foreign Bank Agencies	10	$30.80	$3,076.1
			Prepaid Funeral Contractors	438	$2.10	$4.8
			Perpetual Care Cemeteries	227	$.13	$.6
			Currency Exchange Licensees	84	$.04	$.5
			Sale of Check Licensees	49	$473.80	$9,669.1
Savings and Loan Department	$1.2	19	Savings and Loan Associations	1	$.02	$24.3
			Savings Banks	26	$14.10	$525.3
			Mortgage Broker Licensees	8,735	N/A	N/A
Office of Consumer Credit Commissioner	$2.5	47	Pawnshop Licenses	1,539	N/A	N/A
			Pawn Employee Licenses	5,104	N/A	N/A
			Registered Creditors	15,602	N/A	N/A
			Regulated Loan Licenses	3,625	N/A	N/A

N/A = Not Applicable

Administrative Hearings

The Finance Commission conducts all administrative law hearings for the three constituent agencies. These hearings are held for disputes that arise concerning the decisions of the three Commissioners, in appeal of administrative penalties or enforcement actions imposed by one of the Commissioners, or to challenge a licensing application. Historically, hearing officers reported to each of the Commissioners. In 1992, the Legislature transferred the Savings and Loan and Consumer Credit hearing officers to the State Office of Administrative Hearings (SOAH). In that same year, the Finance Commission took over the Banking Department's hearing officer. In 1995, the Legislature granted the Finance Commission authority for the administrative hearings for all three agencies.

Research Functions

The Legislature has charged the Finance Commission with conducting research in the availability, quality, and pricing of financial services in the state, and in the practices of lenders as they relate to agriculture, small business, and consumers. In response to this charge, the Finance Commission has chosen to segment this research into smaller studies and to contract with independent research centers to do the work. The text box, *Finance Commission Research*, details the studies that have been completed or are underway.

Finance Commission Research

Study	Date Completed	Findings
Consumer Deposits	Fall 1998	Greater consumer personal finance education is needed to give consumers better knowledge of their own financial situation, and confidence to seek the most cost-effective services to meet their needs.
Home Equity Lending	Fall 1999	About 10 percent of homeowners have applied for a home equity loan and about 9 percent have actually obtained the loan. The majority of home equity loans are used to pay off credit card or other debts, or to finance home improvements. The study also identified recommendations for improvements to home equity laws.
Consumer Lending	In Progress	This study will examine the availability, quality, and pricing of consumer loans, and the practices of businesses that make consumer loans.

Department of Banking

Agency at a Glance

The Department of Banking oversees the safety and soundness of Texas' financial system. The Department's primary role in accomplishing this function is to charter, supervise, and examine state-chartered banks. The Department also oversees other depository institutions and their affiliates such as bank holding companies, trust companies, foreign bank offices, and banks chartered in other states. The Department's oversight activities are not limited to banking. Texas' Department of Banking also oversees companies selling money orders and checks, foreign currency exchange and transmission businesses, perpetual care cemetery trust funds, and prepaid funeral contract sellers.

Key Facts

- **Funding.** The Department expended $9.7 million in FY 1999. Its revenues for that year equaled $10.9 million.
- **Staffing.** During FY 1999, the Department employed 144 FTEs.
- **Bank and Trust Regulation.** The Department is authorized by the Texas Finance Code and the Texas Trust Company Act to oversee state-chartered banks and trust companies. The Department currently oversees 370 state-chartered banks and 33 trust companies. The Department is also responsible for regulating foreign bank offices and interstate branches of state banks.
- **Non-Bank Regulation.** The Department is responsible for regulating perpetual care cemeteries, prepaid funeral contract sellers, check sellers, and currency exchange and transmission businesses. Currently, the Department regulates 227 perpetual care cemeteries, 438 prepaid funeral contract sellers, 49 check sellers, and 84 currency exchange and transmission businesses.

The Department currently oversees 370 state-chartered banks and 33 trust companies.

Major Events in Agency History

1923 The Legislature created the office of the Banking Commissioner and separated the Department of Banking from the Department of Banking and Insurance.

1955 The Legislature directed the Banking Commissioner to oversee perpetual care cemetery trust funds and prepaid funeral services.

1963 The Legislature created the Savings and Loan Department, which was originally a division within the Department of Banking. During that same year, the Legislature granted authority to the Banking Commissioner to regulate sellers of money orders and travelers' checks through the Sale of Checks Act.

Between 1985 and 1990, 440 state and national banks in Texas failed.

1985-1990 Oil and real estate prices drop, contributing to the failure of some 440 state and national banks and the closure of 22 trust companies in Texas.

1991 The Legislature gave the Banking Commissioner responsibility for regulating currency exchange companies.

1995 The Legislature updated the state's banking laws, abolished the State Banking Board and transferred its responsibilities to the Commissioner.

1999 The U.S. Congress passed the Gramm-Leach-Bliley Act of 1999, which permitted greater consolidation of the financial services industry. The Texas Legislature approved interstate branch banking.

Organization

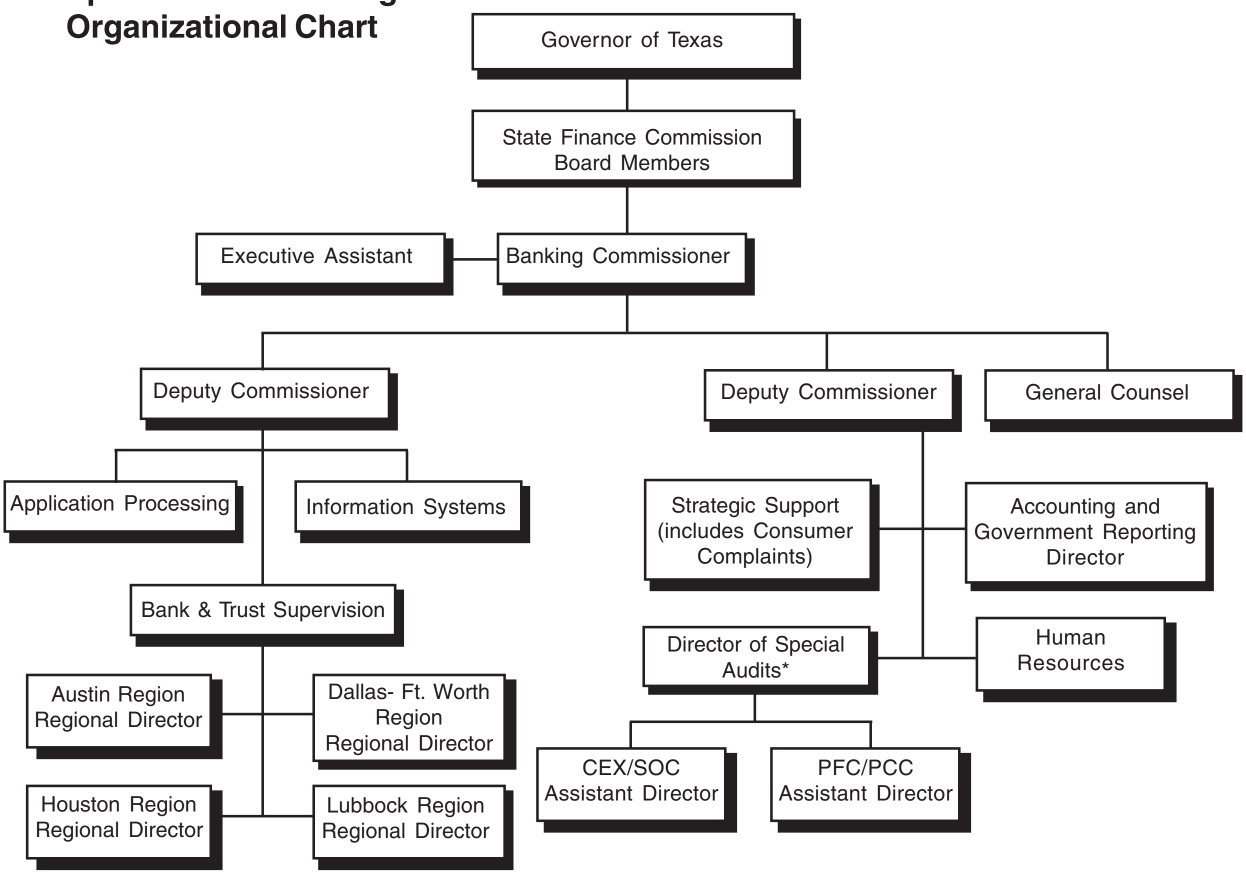
Policy Body

The Department of Banking is governed by the Finance Commission of Texas. The Finance Commission appoints the Banking Commissioner and adopts rules for most of the Department's regulatory activities. The Banking Commissioner has some rulemaking authority independent of the Finance Commission, primarily in the area of funeral services. A description of the organization structure of the Finance Commission is provided on page 96.

Staff

The Banking Commissioner oversees the daily operations of the Department. Two Deputy Commissioners are below the Banking Commissioner. One Deputy Commissioner oversees the Bank and Trust Supervision Division, Application Processing Division, and Information Systems Division. The other Deputy Commissioner oversees the Strategic Support, Accounting, Human Resources, and Special Audits Divisions of the Department. The Special Audits Division of the Department consists of its prepaid funeral, perpetual care cemetery, sale of checks, and currency exchange and transmission programs. This Division has its own Director of Special Audits. The chart, *Department of Banking Organizational Chart*, depicts the agency's organization in greater detail.

Department of Banking Organizational Chart



* This position includes oversight over prepaid funerals, perpetual care cemeteries, sale of checks, and currency exchange businesses.

The Department budgeted 150 FTE employees for fiscal year 1999. One-third of the Department's staff works in its Austin headquarters. The Department's field staff work out of regional offices in San Antonio, Austin, Houston, Arlington, McAllen, and Lubbock.

Appendix C, *Equal Opportunity Employment Statistics, 1996 to 1999*, compares the Department's workforce composition to the minority civilian labor force for fiscal years 1996 to 1999. In general, the Department meets or exceeds the state goals for professional, technical, and administrative support jobs.

Funding

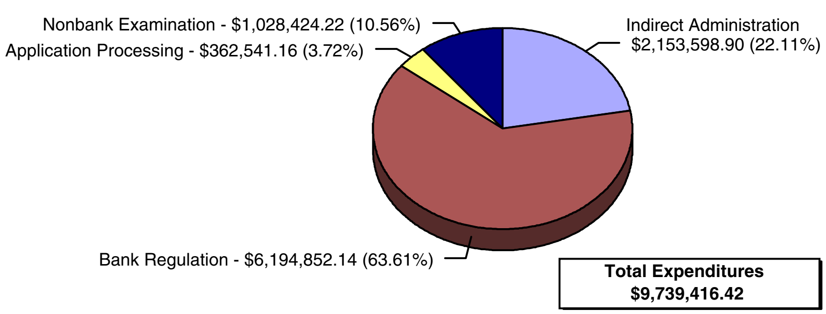
Revenues

The Department of Banking, through assessments and fees it collected from the entities it supervises, received $10.9 million in revenue for fiscal year 1999. For FY 1999 the Legislature appropriated $10.7 million to the Department, 98 percent of its budget. Federal grants, claims settlements, and the sales of goods and services make up the remaining two percent of the Department's revenues.

Expenditures

The Department spent $9.7 million in fiscal year 1999. The chart, *Expenditures by Strategy, Fiscal Year 1999*, provides a snapshot of the agency's expenditures. About 64 percent of the Department's expenditures are dedicated towards bank and trust examinations, while 14 percent of expenditures are for non-bank examinations and application processing. The remaining 22 percent of the Department's expenditures are for indirect administration, which includes information resources, accounting, legal counsel, human resources, central administration, and operations and support.

Expenditures by Strategy
Fiscal Year 1999



Appendix F, *Historically Underutilized Business Statistics, 1996 to 1999*, shows the agency's use of Historically Underused Businesses (HUBs) in purchasing goods and services. The agency exceeded state goals for professional services and commodities in fiscal year 1999. The goals for special trade and other services were not met that year.

Agency Operations

The Department's programs fall into three categories: application processing, bank and trust examination, and non-bank regulation.

Application Processing

The Application Processing Division has two functions. First, Division staff review and process all application and notice filings by state-chartered banks, trust companies, foreign banks, and bank holding companies operating in Texas. Some of the types of applications filed include applications for new bank charters, mergers, the establishment of branch locations, and conversions from state to national charters. Staff also processes applications for sale of checks and currency exchange licensees in the state.

Entities Subject to the Department of Banking's Supervision

Banks & Trusts	State-chartered banks	370
	Trust companies	33
	Bank information service providers	19
	Foreign bank Agencies	10
Non-Bank Entities	Perpetual care cemetery trust funds	227
	Prepaid funeral contract sellers	438
	Check sellers (money orders, traveler's checks)	49
	Currency exchange, transmission and tranportation business	84

The Division's second function is the receipt and review of all statutory document filings from state-regulated banks and trust companies, including articles of association, articles of merger, and amendments to articles of association.

Bank and Trust Examination

This Division is the Department's largest. Its principal function is to examine and supervise banks and trust companies chartered by Texas, to ensure their safety and soundness. The Division also examines foreign banks, bank holding companies, and bank information systems providers.

The Department's examinations focus on an institution's overall financial health, management practices, and compliance with state and federal laws. All banks are examined using the CAMELS rating system. The CAMELS system, which is also used by federal regulators and the Savings and Loan Department, grades an institution's Capital adequacy, Asset quality, Management, Earnings and reserves, Liquidity and funds management, and Sensitivity to market risk. All state-chartered banks evaluated with the CAMELS criteria are given a rating of between one and five, with one being the best and five the worst.

The Department's examinations focus on an institutions' overall financial health, management practices, and compliance with state and federal law.

The Department examines all regulated banks and trusts at least every 18 months. Banks with more than $250 million in deposits or with previously noted management weaknesses are examined annually. Banks with poor CAMELS ratings are examined every six months. Problem institutions are monitored quarterly and are required to submit periodic reports indicating the action taken to remedy deficiencies. In addition to its on-site examinations using the CAMELS criteria, the Department uses its Offsite Monitoring Program to monitor and identify weaknesses in the State's banking system.

The Department routinely monitors the activities and financial performance of each state-chartered bank, investigating areas of unsafe and unsound activity or adverse financial indicators, such as declining capital, increasing classified assets, and operating losses. For these purposes, the Department maintains a supervisory history on each institution. In addition, examination reports, independent audits, and all written correspondence with state-chartered banks are reviewed.

State-chartered banks and trust companies found to be in poor condition are subject to enforcement actions by the Department. Most enforcement actions result from the Department's examination and monitoring activities. The Department coordinates all enforcement actions with the Federal Deposit Insurance Corporation (FDIC), and actions are taken jointly whenever possible to ensure uniform regulatory action by state and federal regulators. The Department may take formal or informal action depending on the nature and seriousness of the problem, and the institution's past responsiveness to regulatory concerns. Informal actions include written notices directing an institution to stop certain actions. Formal actions are orders that the Banking Commissioner enforces in a federal District Court, and include cease and desist orders, orders requiring divestiture of control, and orders requiring administrative penalties of up to $25,000.

The Department is not the only government agency that oversees state-chartered banks. Because all state banks have federal depository insurance, and some elect to be members of the Federal Reserve System, the Federal Reserve Bank and/or the FDIC also supervise state-chartered banks. The Department has entered into formal agreements with the FDIC and Federal Reserve to provide bank examinations on an alternating basis. Although the examinations performed by the FDIC and the Federal Reserve are similar to those by the Department, federal regulators do not check for compliance with all state laws.

Non-Bank Regulation

Prepaid Funeral Contract Program - The Department licenses, regulates, and examines prepaid funeral contract sellers to ensure the protection of consumers and compliance with state law. Licensees must demonstrate adequate financial conditions, business experience, and character to maintain their license. The Department conducts annual on-site examinations of prepaid funeral contract licensees to ensure timely deposits of collected funds, proper contract disclosure and compliance with statutory guidelines for investments, and that contract beneficiaries receive the contracted services at the time of need. The Division currently oversees 438 prepaid funeral licensees.

What is a Prepaid Funeral Contract?

Prepaid funeral contracts are arrangements that consumers make for funeral services and merchandise, before the time of death. The consumer prepays for certain benefits as part of the contract. Two types of contracts are available to consumers, trust-funded and insurance-funded. Trust-funded contracts are regulated solely by the Department of Banking. Insurance-funded contracts are regulated by the Department, but TDI involvement is required to resolve contract disputes.

Perpetual Care Cemetery Program - A perpetual care cemetery requires an advance payment from a consumer for the maintenance of a grave site for perpetuity. The Department oversees the use of perpetual care cemetery funds to ensure that consumers receive the services for which they contracted. State law requires operators of perpetual care cemeteries to be licensed by the Department. Perpetual care cemetery operators must meet minimum net worth and location limitations and provide an initial perpetual care fund deposit to be licensed. The Department examines perpetual care cemeteries to ensure that perpetual care fees are deposited in a timely manner; trust funds are prudently invested; property is properly dedicated, platted, and filed with the county clerk's office; lawn crypts are properly constructed; and contracts contain required disclosures and signatures. Annual examinations of perpetual care cemeteries are statutorily mandated. The Division currently supervises 227 licensees.

The Department oversees 438 prepaid funeral contract licensees and 227 perpetual care cemeteries.

Currency Exchange Program - The Currency Exchange Program involves the identification and on-going regulation of businesses offering currency exchange, transmission, and transporting services. Currency exchange licensees are examined annually for compliance with state and federal laws. Examinations focus on cash transactions in excess of $1,000 for proper identification and record keeping to avoid money laundering. Currently, 84 currency exchange, transportation, and transmission businesses operate in Texas. This program is partially funded through a High Intensity Drug Trafficking Area grant from the U.S. Office of National Drug Control Policy.

Sale of Checks Program - The Sale of Checks Program examines businesses that sell money orders, travelers checks, foreign currency drafts, and third party gift certificates. Non-bank entities engaged in check selling must be licensed by the Department and are examined annually. Currently, 49 businesses engage in the check selling business in Texas.

Savings and Loan Department

Agency at a Glance

The Texas Savings and Loan Department protects the depositors of Texas by ensuring the safe and sound operation of state-chartered thrifts. In 1999, the Legislature gave the Department responsibility for licensing mortgage brokers. The Department's major functions include chartering, examining, and supervising state-chartered thrifts and licensing mortgage brokers and their loan officers.

Key Facts

- **Funding.** The Department's $1.2 million annual budget in FY 99 came from the General Revenue Fund and appropriated receipts. The Department contributed $1,131,300 to the General Revenue Fund from fees that year.
- **Staffing.** The Department currently employs 22 FTEs. Sixteen work in the Austin office. Six examination staff work in various locations around the state and designate their homes as their headquarters.
- **Savings and Loan Regulation.** The Texas Savings Bank Act and the Texas Savings and Loan Act authorize the Department to conduct regular examinations of state-chartered thrifts, initiate enforcement actions, and review applications for changes in charter. The Department currently regulates 27 thrifts.
- **Regulation of Mortgage Brokers and Loan Officers.** In 1999, the Legislature assigned responsibility for licensing mortgage brokers to the Savings and Loan Department. The Mortgage Broker License Act, which established Texas' first licensing requirement for first lien mortgage brokers, does not require regular examinations. Consequently, the investigations of mortgage brokers and loan officers are based solely driven by consumer complaints. As of October 2000, the Department had licensed 8,735 mortgage brokers and their loan officers.

The Department currently regulates 27 thrifts and 8,735 mortgage brokers and loan officers.

Major Events in Agency History

1963 The Legislature created the Savings and Loan Department, which was originally a division within the Department of Banking. At the time, Texas had 161 state-chartered thrifts. The enactment of the Texas Savings and Loan Act established a complete system of laws governing state savings and loan associations.

1982 The federal Garn-St Germain Depository Institutions Act gave savings and loan associations authority to lend up to 100 percent of the appraised value of real estate, and expanded their authority to make commercial real estate loans, leading to speculative activities.

1986 The Federal Savings and Loan Insurance Corporation (FSLIC) was declared insolvent, forcing insolvent Texas thrifts to stay open up to three years after reporting insolvency. State-chartered thrifts in Texas had increased to 235.

1988 The Southwest Plan was established by the Federal Savings and Loan Insurance Corporation, resulting in the closure of scores of insolvent thrifts in Texas and multiple conversions to the federal thrift charter.

1989 The Financial Institutions Reform, Recovery, and Enforcement Act (FIRREA) was enacted, abolishing the FSLIC and shifting its deposit insurance activities to the Federal Deposit Insurance Corporation (FDIC). Insolvent institutions were placed under the control of the Resolution Trust Corporation. All state-chartered institutions were placed under the triple regulatory structure of the FDIC, Office of Thrift Supervision, and the Department.

1991 The last insolvent state-chartered S&L of the 1980s was closed by the FDIC. Only 31 state-chartered thrifts were left in Texas.

1993 The enactment of the Texas Savings Bank Act established a new financial institution charter; with a mandatory level of housing-related loans and investments, and a regulatory structure more consistent with state commercial banks. The Act also provided broader consumer and commercial lending authority than the previous savings and loan charter.

1999 The Legislature assigned responsibility for licensing mortgage brokers to the Savings and Loan Department.

2000 The Texas Savings and Loan Department now regulates 27 state-chartered thrifts.

Organization

Policy Body

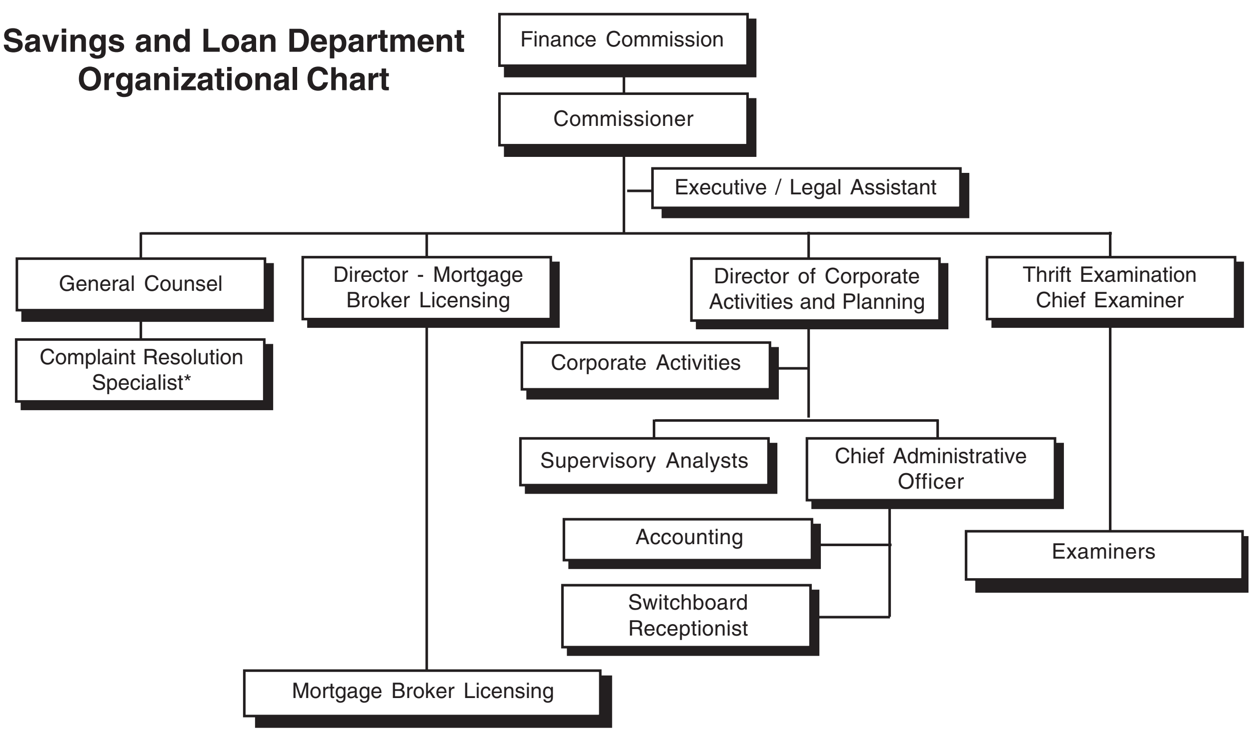
The Finance Commission oversees the Department's operations and adopts rules for savings institutions. The Finance Commission also appoints the Savings and Loans Commissioner, to serve at the Commission's pleasure. The Commissioner adopts rules for the licensing and regulation of the mortgage broker industry after consultation with the Mortgage Broker Advisory Committee. A description of the organization structure of the Finance Commission was provided earlier in this section of the report.

Staff

The Savings and Loan Commissioner oversees the Savings and Loan Department's operations. In fiscal year 2000, the Department employed 22 staff, 16 of which are located in Austin. The remaining FTEs constitute the examination staff and are located throughout the state. The chart, *Savings and Loan Department Organizational Chart*, depicts the Department's organization structure. Appendix D, *Equal Employment Opportunity Statistics, 1996 to 1999*, compares the Department's workforce composition to the minority civilian labor force.

In fiscal year 2000, the Department employed 22 staff, with six located throughout the state to do examinations of thrifts.

Savings and Loan Department Organizational Chart



* Qualified financial institution examiner, assist with thrift holding company examinations.

FUNDING

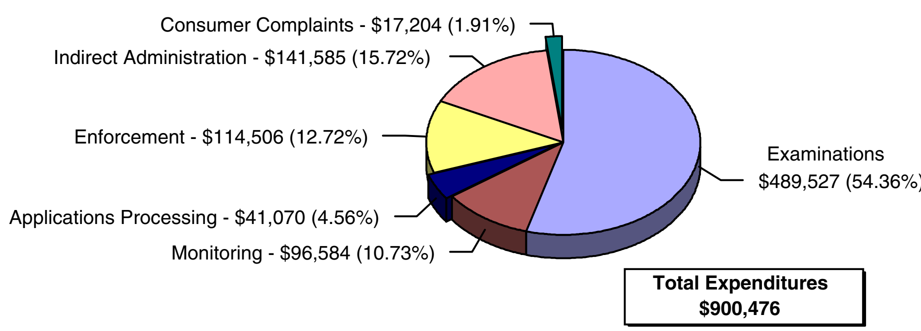
Revenues

The Department received $1,131,303 in FY 1999 in fees from the industries it regulates. Before the inception of the mortgage broker licensing in FY 2000, most of the Department's revenue was comprised of quarterly assessments from regulated thrift institutions. In FY 1999 revenue consisted of $1,032,390 in assessments, $83,900 in applications fees, and $15,013 in appropriated receipts.

Expenditures

The Department's $900,476 expenditures in fiscal year 1999 were distributed among the agency's six strategies, with examinations receiving the most funding. The chart, *Expenditures by Strategy, Fiscal Year 1999,* provides additional details on the agencies strategies and expenditures.

Expenditures by Strategy
Fiscal Year 1999



Appendix G, *Historically Underutilized Businesses Statistics, 1996 to 1999*, shows the Department's use of Historically Underused Businesses (HUBs) in purchasing goods and services. The Department's spending on commodities exceeded state goals.

Agency Operations

The Savings and Loan Department's primary goals fall into three categories: thrift application processing, thrift examination and monitoring, and mortgage broker supervision.

Thrift Application Processing

The Savings and Loan Commissioner has the authority to charter thrifts. The Department processes and evaluates applications for new charters, new branch offices, mergers, acquisitions and subsidiary investments; and maintains thrift institution corporate records, and logs for application submission and approval. When an application is deemed complete, a hearing may be set to receive public comments. The Commissioner may waive the hearing if no protest of the application is received.

Thrift Examination and Monitoring

The Department performs full and limited scope examinations of state-chartered thrifts every 12 to 18 months, depending on the size and management rating of the institution. Since all state-chartered thrifts have depository insurance through the Federal Depository Insurance Corporation (FDIC), the Department performs joint examinations with the FDIC.

The Department's examinations of thrifts focus on overall financial health, management practices, and compliance with state and federal law.

The Department's examinations of thrifts focus on an institution's overall financial health, management practices, and compliance with state and federal laws. All thrifts are examined using the CAMELS rating system. The CAMELS system, which is also used by federal regulators and the Department of Banking, checks an institution's Capital adequacy, Asset quality, Management, Earnings and reserves, Liquidity and funds management, and Sensitivity to market risk. All state-chartered thrifts are given a CAMELS rating of between one and five, with one being the best and five the worst.

Examiners normally spend a week in the agency or FDIC field office reviewing information requested from the institution in advance and establishing examination scope. Examiners then spend two to four weeks in the institution examining records, verifying financial data, evaluating policies and systems, testing compliance with statutes, and reviewing the institution's operations. A report is prepared and agreed to by both the Department and FDIC examiner-in-charge, and then forwarded to the FDIC Regional Office, and the agency, for final review and editing.

The Department routinely monitors the activities and financial performance of each state-chartered thrift, investigating areas of unsafe and unsound activity or adverse financial indicators, such as declining capital, increasing classified assets, and operating losses. For these purposes, the Department maintains a supervisory history, institution profile, and supervisory plan for each institution. In addition, analysts review examination reports, independent audits, and all written correspondence with state-chartered thrifts. The Department prepares quarterly supervisory reports summarizing the activities of all institutions under its jurisdiction.

Most enforcement actions result from the Department's examination and monitoring activities. The Department coordinates all enforcement actions with the FDIC and actions are taken jointly whenever possible to ensure uniform regulatory action by the state and federal agencies. The Department may take formal or informal action depending on the nature and seriousness of the problem, and the institution's past responsiveness to regulatory concerns. Informal actions include written notices directing the institutions to cease certain actions. Formal actions are orders that can be enforced in District court and include: cease and desist orders, orders requiring divestiture of control, and orders requiring administrative penalties of up to $25,000 per day for certain violations.

Mortgage Broker Supervision

Mortgage brokers and loan officers, except those specifically exempt (such as banks, thrifts, credit unions, mortgage bankers and their employees), are required to be licensed by the Department. In granting a license, the Department determines whether applicants meet statutory requirements for education, training, experience and criminal history. The Commissioner establishes criteria for the continuing education of mortgage brokers and approves the course work and providers for such programs. Fifteen hours of continuing education are required every two years.

The Department licenses mortgage brokers but investigates their activity only in response to complaints.

The Mortgage Broker License Act does not provide for examination of mortgage broker operations to ensure compliance with statutory requirements. Rather, mortgage brokers are investigated only in response to consumer complaints. After receiving a complaint, the Department investigates the complaint, initiates needed corrective actions, and may impose an administrative penalty, issue a cease and desist order, require restitution, or take disciplinary action.

The Savings and Loan Commissioner adopts rules to regulate mortgage brokers, subject to the review of the Finance Commission. The statute also establishes the Mortgage Broker Advisory Committee to advise the Commissioner on rules, procedures, and interpretation, implementation, and enforcement of the Act. The committee is composed of six members, four appointed by the Commissioner from the mortgage broker industry, and two appointed by the Texas Real Estate Commission from the real estate industry. Members serve staggered three-year terms. The Commissioner may remove a committee member for lack of qualification or failure to discharge responsibility.

Office of Consumer Credit Commissioner

Agency at a Glance

The mission of the Office of Consumer Credit Commissioner (OCCC) is to regulate the credit industry and educate consumers and creditors to produce a fair, lawful, and healthy credit environment for Texas. OCCC regulates businesses that advance cash or loan money; and that sell merchandise on credit, including pawnshops and their employees.

Key Facts

- **Funding.** OCCC's budget for fiscal year 1999 was about $2.2 million. The agency collects all of its revenue from fees levied from the regulated industries.
- **Staffing.** OCCC employs 46 full-time employees, with 27 working at the agency's headquarters in Austin; and 19 in the Dallas, Houston, San Antonio, and the Rio Grande Valley.
- **Licensing and Registration.** OCCC licenses regulated lenders, pawnshops, and pawnshop employees. OCCC also registers creditors who finance the sales of their goods and services. In fiscal year 1999, the agency processed more than 4,100 applications and registered 1,525 new creditors.
- **Examination and Enforcement.** OCCC examines licensed lenders; and investigates creditors, licensees, and some license applicants. Examinations focus on consumer protection and compliance with the Texas Finance Code. The agency currently regulates about 5,300 licensed lending locations. Examinations generally take place every 12 to 18 months.
- **Consumer Complaint.** OCCC assists consumers in resolving complaints with creditors, and provides mediation when necessary. Complaints are usually received on a toll-free number that the agency operates. Most complaints (32 percent in fiscal year 1999) involve car dealers, who are governed by a law authorizing limited enforcement action.
- **Education.** OCCC informs consumers on credit use and promotes consumer resources and assistance, including the agency's consumer help line. The agency uses training videos, newsletters, and educational displays to fulfill its mission. In fiscal year 1999, the education efforts reached 16.5 percent of Texans.

Major Events in Agency History

1840 Republic of Texas established a maximum interest rate of 12 percent.

1959 The Texas Legislative Council reported to the Legislature that "Small loans are the most expensive of all types of loans to make and service." The Council recommended that Texas enact a small loan law citing three primary abuses of borrowers: excessive charges, pyramiding of loans, and harassment of borrowers in collection practices.

1960 Texas voters passed a constitutional amendment authorizing the Legislature to set maximum rates of interest, classify loans and lenders, and license and regulate lenders.

1963 The Legislature, acting under new constitutional authority, established the Office of Regulatory Loan Commissioner to regulate consumer credit.

1967 The Legislature passed the Texas Credit Code, a comprehensive law governing consumer credit transactions, and renamed the Office of Regulatory Loan Commissioner as the Office of Consumer Credit Commissioner.

1971 The Legislature authorized the Consumer Credit Commissioner to regulate pawnshops.

1997 Texas voters approved a constitutional amendment authorizing home equity loans, requiring an increase in the duties and staff size of OCCC.

Organization

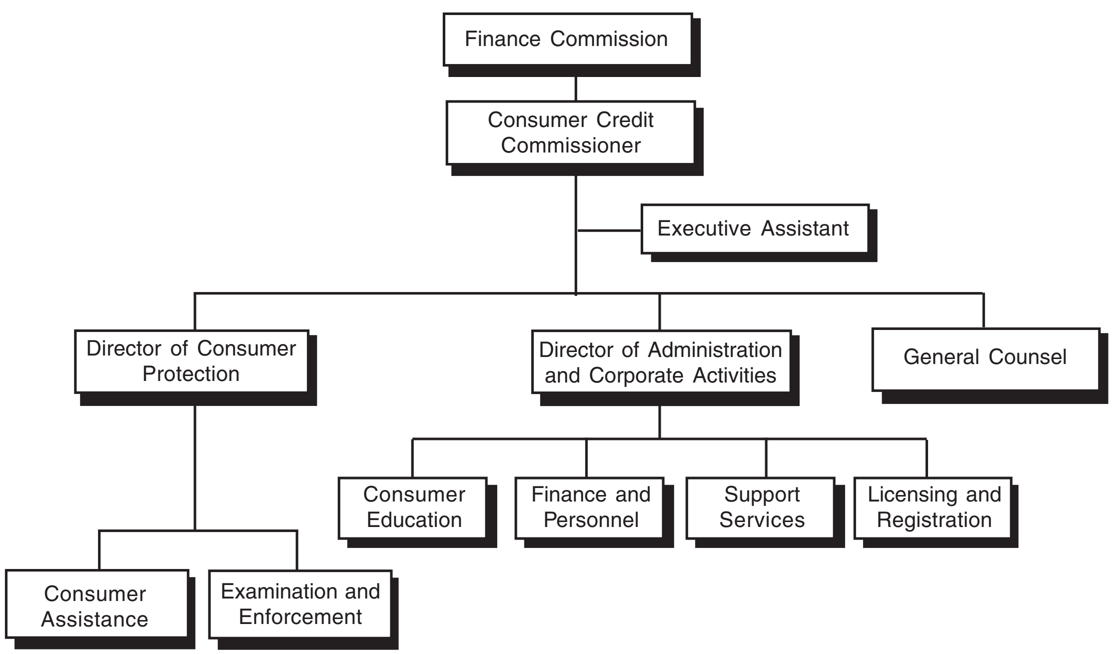
Policy Body

OCCC is governed by the Finance Commission of Texas. The Finance Commission appoints the Consumer Credit Commissioner and adopts rules for most of the agency's regulatory activities. A description of the organization structure of the Finance Commission is provided in the Finance Commission section.

Staff

The Consumer Credit Commissioner oversees the agency's operations. OCCC has a total of 46 full-time equivalent employees — 27 employees work in the agency's headquarters in Austin; and 19 are field examiners in Dallas, Houston, San Antonio, and the Rio Grande Valley. The agency does not maintain field offices, but examination staff are in the field 50 percent of the time. The chart, *Office of Consumer Credit Commissioner*, *Organizational Chart,* shows the agency's structure. Appendix E compares the agency's workforce composition to the minority civilian labor force. OCCC generally meets or exceeds state goals in all categories except for African American employment, which has been consistently below the benchmark.

Office of Consumer Credit Commissioner
Organizational Chart

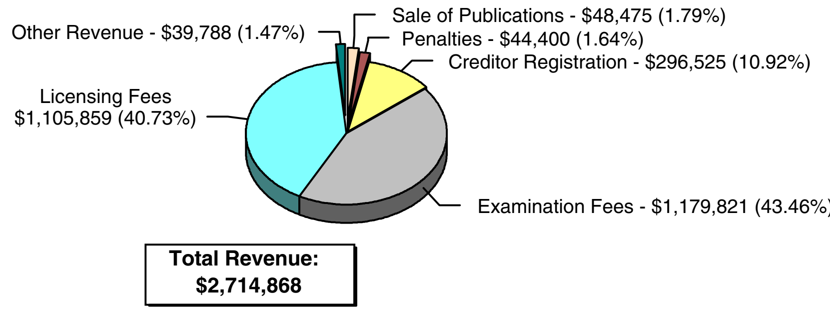


Funding

Revenues

OCCC receives funding through the collection of fees, which totaled $2.7 million in fiscal year 1999. Most of the revenue is collected from licensing, examination, and creditor registration fees. All fees go directly into the General Revenue Fund. The chart, *Sources of Revenue - Fiscal Year 1999,* provides additional funding details.

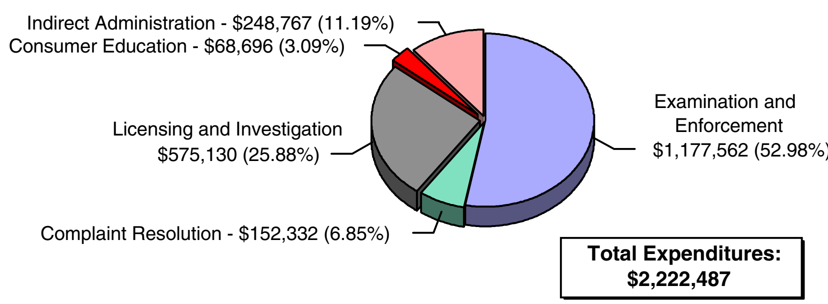
Sources of Revenue
Fiscal Year 1999



Expenditures

OCCC's $2.2 million expenditures in fiscal year 1999 were distributed among five strategies. The examination and enforcement strategy received the most funding, followed by licensing and registration. The chart, *Expenditures by Strategy - Fiscal Year 1999,* provides additional details.

Expenditures by Strategy
Fiscal Year 1999



Appendix H describes OCCC's use of Historically Underutilized Businesses (HUBs) in purchasing goods and services. The percentage of HUB spending in commodities and other services has increased in recent years, but the agency had no expenditures in special trade and professional services in 1999.

Agency Operations

The Office of Consumer Credit Commissioner's regulation of the credit industry aids in the economic prosperity of the State by promoting a lawful and healthy credit environment. To achieve this goal, OCCC performs four core functions: licensing and registration, examination and enforcement, consumer complaint, and education. State law requires lenders, other than banks, thrifts, and credit unions, to be licensed with OCCC. The agency ensures that these lenders meet the requirements of their licenses by examining their businesses and taking enforcement actions when necessary. OCCC's consumer complaint function provides mediation between consumers and creditors on credit complaints. Finally, the agency seeks to help consumers avoid credit problems by providing credit education. The following material highlights OCCC's activities in these areas.

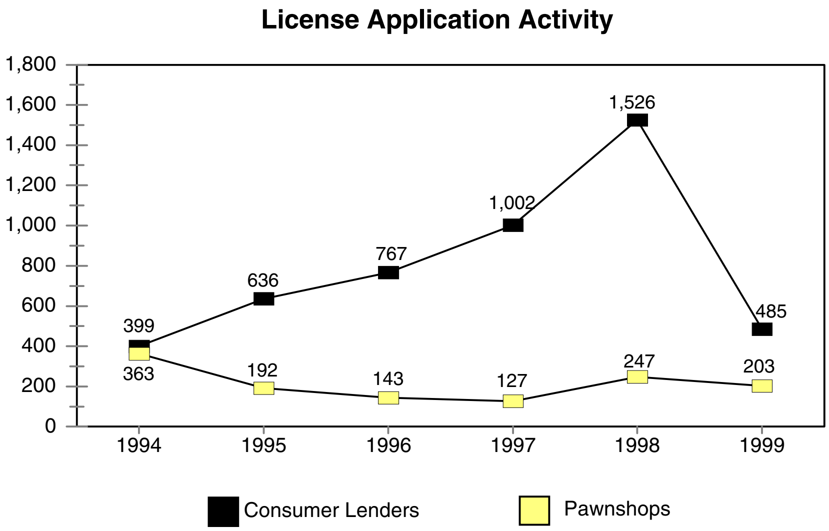
OCCC's regulation promotes a lawful and healthy credit environment.

Licensing and Registration

The Office of Consumer Credit Commissioner's primary task is to license and register consumer loan offices, pawnshops and pawnshop employees. The purpose of this program is to protect consumers by requiring lenders to meet basic requirements. Licensing requirements include the following:

- review of business experience and business plan;
- financial information and minimum net asset requirement; and a
- criminal background check.

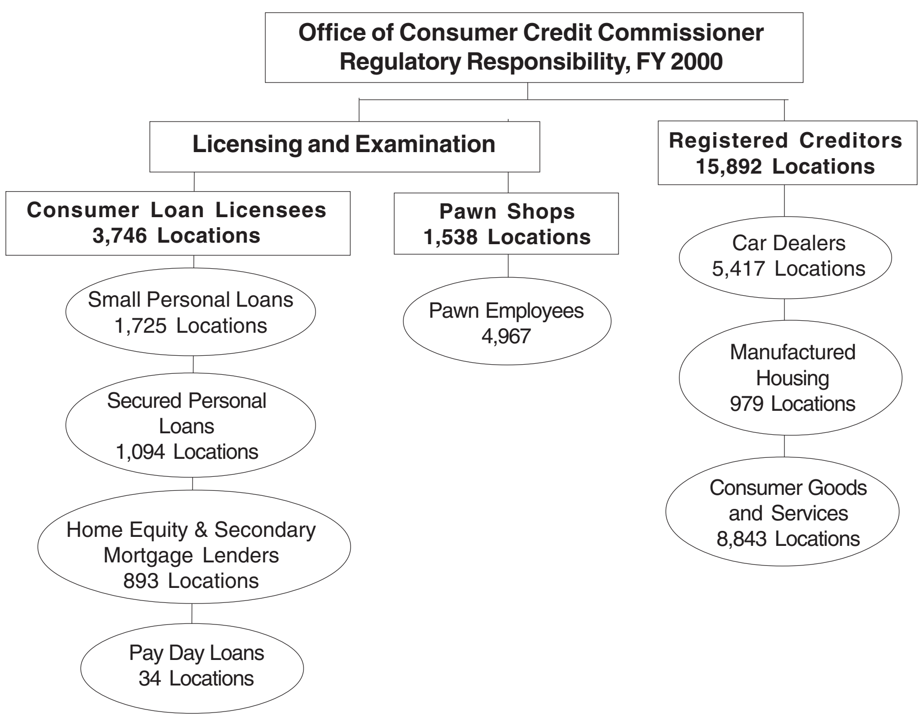
OCCC expended about $600,000 in fiscal year 1999 for licensing and registration. OCCC reviews applications from small consumer loan companies, pawnshops, and secondary mortgage lending companies. Pawnshop employees are also licensed by OCCC. In 1999, the average processing time for all applications was 38 days. The chart, *License Application Activity,* provides details on the number of applications processed in recent years. The 1998 peak was caused by the initial filing of home equity lending applications after legislation passed in 1997 to authorize this activity.



The Licensing and Registration Division also registers creditors that finance the sale of goods and services, such as department stores and car dealers. The Legislature established the registration program to better track creditors engaged in financing activity. Registration requires few qualifications, including a short application and a nominal fee of $10 for retail sales, $15 for manufactured housing sales, and $25 for car dealers.

Examination and Enforcement

OCCC's largest program is the examination and enforcement of consumer credit laws, accounting for about $1.2 million or 50 percent of the total budget in fiscal year 1999. The vehicle for enforcement of the credit code is OCCC's examination of licensed lenders. Examinations are carried out by 19 field examiners in Dallas, Fort Worth, Houston, San Antonio, and the Rio Grande Valley. The chart, *Office of Consumer Credit Commissioner Regulatory Responsibility, FY 2000,* details the primary industries that OCCC regulates.



OCCC's examinations of licensed lenders include a review of the lender's procedures, transactions, compliance with credit laws, and an observation of interaction between lenders and consumers. Examinations are conducted usually on a 12 to 18 month cycle. If an examination results in a determination that a licensee has an unacceptable level of compliance, a reexamination is scheduled in six to nine months.

The examination function serves both consumers and lenders. Some examinations result in consumers receiving a refund or credit for any overcharges on their loans. Lenders also benefit because examination reports provide a risk management tool that assists them in achieving better compliance with the law, thereby reducing the risk of liability associated with private litigation.

OCCC receives an average of 4,000 consumer calls per month, resolving most the same day they are filed.

Consumer Complaint

The agency's complaint process and toll-free telephone number are used in several agency programs. The 1-800 number is used to process complaints, educate consumers, and enforce laws through mediation. State law requires the toll-free number to be printed on all contracts subject to the agency's oversight. OCCC receives an average of 4,000 calls per month, and resolves most telephone complaints the same day they are filed.

Education

The Credit Education Division was created because regulation alone was not adequate to protect consumers. Studies released over the last decade consistently show that many consumers lack knowledge of credit. This deficiency crosses all demographic lines and shows little improvement in recent years.

The Education Division's key audience is consumers, targeting youth, seniors, low-income groups, and internet-based learning. The one employee assigned to this program does presentations to community groups and collaborates with private, public, and non-profit organizations. OCCC also requires licensees to maintain an educational display with contact information for the agency. Finally, the agency educates creditors about their responsibilities as licensed lenders and registered creditors.

APPENDICES

Appendix A

Response to Legislatively Required Analysis of Consolidating the Credit Union Commission Under the Finance Commission.

Approach

Because of recurring questions about consolidation of Texas' financial regulatory agencies, the Legislature directed the Sunset Commission to review the potential effects of placing the Credit Union Commission under the Finance Commission.

- In the 1980s, two separate state oversight bodies studied the question of whether the state's financial depository institutions — banks, savings and loans, and credit unions — should be combined into a single state agency. The 1988 study, conducted by the Special Committee on Organization of State Agencies, concluded that the issue of consolidation of the Credit Union Commission under the Finance Commission should be deferred for further legislative consideration. The 1990 study by the State Auditor recommended the consolidation of depository institution regulation along with that of consumer credit.

- During the interim before the 75th Legislature in 1997, the Sunset Commission reviewed the Texas Credit Union Commission. The review considered consolidating the agency under the jurisdiction of the Finance Commission, noted the Legislature's long interest in the issue, and concluded that the question would be better studied within the context of the Sunset review of the Finance Commission.[1]

- Through an instructional provision in the Credit Union Commission Sunset bill of the 1997 legislative session, the Legislature required the Sunset Commission to review the effects of placing the regulation of Credit Unions under the jurisdiction of the Finance Commission. The text of this provision is shown in the textbox, *SB 358, 75th Legislature — Instructional Provision Directing Sunset Review of Credit Union Consolidation.*

SB 358, 75th Legislature — Instructional Provision Sunset Review of Credit Union Consolidation

The Sunset Advisory Commission, as part of its evaluation of agencies preceding the meeting of the 77th Legislature in 2001, shall:

(1) evaluate the organizational structure of the state's financial regulatory agencies; and

(2) study the potential effects of placing the Credit Union Commission under the jurisdiction of the Finance Commission of Texas.

- To assist the Sunset staff in its analysis of consolidation, the Legislature also required the Credit Union and Finance Commissions to compare authority of the Commissions and Commissioners in regulating the credit union, banking, and thrift industries. Before the start of the staff review of the Finance Commission, the Commissions jointly submitted a report, *Comparison of Authority: Credit Union Commission & Finance Commission,* to the Sunset Commission. Sunset staff used many of the facts in the joint effort in preparing this Sunset report. In addition, an analysis of the joint report reveals many similarities in state regulatory authority across the three agencies.

Analysis

Valid arguments exist both for and against the consolidation of credit unions under the Finance Commission.

- As a result of its analysis, Sunset staff concluded that valid arguements can be made both for and against consolidation. On the side of consolidation, the regulation of credit unions is very similar to that of other depository institutions. All of the state agencies involved in regulation — the Credit Union Commission, Department of Banking, and Savings and Loan Department — essentially perform the same type of regulatory supervision. Likewise, the businesses and products provided by credit unions, banks, and thrifts are similar. In addition, because services provided by depository institutions aid in economic development, the State has an interest in seeing that its regulatory efforts are coordinated. Finally, greater efficiency could result from a consolidated agency, and these savings could be used to improve regulation.[2] These facts could lead to the conclusion that all financial institutions should be regulated by a single agency, or at least under the jurisdiction of the Finance Commission.[3]

Federal law creates most of the differences in taxation and regulation between the credit union and banking industries.

- Sunset staff also concluded that strong arguments can be made against consolidation. While the regulation of and services provided by depository institutions are similar, credit unions are fundamentally different. Owned by their members, credit unions operate on a non-profit basis. As a result, credit unions enjoy certain tax and regulatory advantages over banks and thrifts.[4] These differences have led to a climate of competition and distrust between the industries. Even though most of the taxation and regulation differences exist as a result of federal law, the credit union industry argues that placing its regulation under the Finance Commission could jeopardize the continued success of the credit union industry.

Conclusion

Based on the Legislature's directive, the Sunset staff reviewed the effects of consolidating the Credit Union Commission under the Finance Commission. The review found advantages and disadvantages that could result from this consolidation. The advantages include more consistent regulation of credit unions, banks, and thrifts; and greater efficiency in governmental operations. However, as member-owned, non-profit institutions, credit unions are distinct from banks and thrifts. This distinction leads to differences in taxation and regulation, mostly in federal law. Further, the credit union industry expresses serious concerns about competitive challenges from the banking industry, and argues that this competition could render harm to credit unions in any type of consolidated agency.

The advantages of consolidating the Credit Union Commission under the Finance Commission do not clearly outweigh the disadvantages.

Sunset staff makes no recommendation on the question of placing the regulation of credit unions under the jurisdiction of the Finance Commission. For the staff to make a recommendation to consolidate the regulation of credit unions under the Finance Commission, the advantages should clearly outweigh the disadvantages. Staff concluded that identified benefits cannot be proven to clearly outweigh the down sides.

[1] An earlier Sunset staff review of the Credit Union Commission, in 1983, outlined three alternatives that each included transferring credit union regulation to the Finance Commission. None of these alternatives was adopted by the Sunset Commission.

[2] For example, the Credit Union Commission's high examiner turnover has led it to reduce the qualifications required for examiners. According to the agency's strategic plan, the strategy did not meet with success and led to the separation of six examiners. Texas Credit Union Commission, *Agency Strategic Plan for 2001-2005,* p. 18.

[3] As detailed in Issue 2 of this report, a similar set of facts did lead to the conclusion that the Department of Banking should be consolidated with the Savings and Loan Department into a single Department of Banking and Thrifts. While the advantages of this consolidation are similar to that of credit unions, banks and thrifts do not operate with such sharp distinctions in federal law.

[4] Most of the Credit Unions tax advantages exist within federal tax code and could not be affected through state oversight. Similarly, many of the regulatory differences exist because credit unions participate in a separate, federal insurance fund not overseen by the Federal Deposit Insurance Corporation.

Appendix B

The Gramm-Leach-Bliley Act of 1999

In 1999 the U.S. Congress passed the Gramm-Leach-Bliley Act. The Act repealed the 66-year old Glass-Steagall Act, which prohibited commercial banks from selling insurance and investment products, and blocked insurers and investment companies from owning banks.[1] GLBA allows banks, insurance companies, and brokerage firms to affiliate and diversify. Now, all three businesses are permitted to operate under one roof, providing consumers with "one-stop financial shopping" for loans, investments, and insurance policies.

Key Points About GLBA

- GLBA authorizes the affiliation between banks, securities firms, and insurance companies. A financial institution must qualify as a financial holding company to engage in other financial activities such as selling insurance policies, or facilitating securities transactions. The Act requires institutions forming financial holding companies to be well-capitalized, well-managed, and receive a satisfactory or better Community Reinvestment Act rating.
- Each subsidiary of a financial holding company is required to have its own capital and management. Should one subsidiary of a financial holding company fail, it would not threaten the solvency of the entire holding company. The Federal Deposit Insurance Corporation (FDIC) will not use federal funds to support subsidiaries of troubled banks.
- GLBA allows affiliates to share consumer information among themselves, provided they inform customers of their financial sharing policies. This allows banks to share personal information about customers with their affiliates as well as with outside companies they have formed alliances with to sell financial products. Consumers only have the choice to "opt out" of having their information shared with non-affiliated third parties for marketing purposes.
- The purpose of the Act is to promote further competition and allow both companies and customers to take full advantage of emerging technology. Proponents of the Act contend that diversified financial institutions can offer customers more choices and better services with greater efficiency at a lower cost. Additionally, they expect the Act will allow financial institutions to compete more equitably in the global economy. [2]
- Through mergers totaling $676 billion over the past decade, big banks are extending their reach by buying insurance companies, mutual fund firms, and brokerage houses with the goal of becoming one-stop sellers of every form of financial product, from auto loan to variable annuities.[3] For example, Wells Fargo now makes 11 percent of its earnings from sales of investments, brokerage services, and insurance products, about double what it earned from those sources five years ago.[4]
- GLBA authorizes the functional regulation of insurance, banking, and securities activities, ending duplicate regulation of similar activities. The Federal Reserve Bank will have increased authority to examine financial institutions, including financial holding companies. GLBA also gives the Federal Reserve Board umbrella authority over financial holding companies.

[1] http://www.sia.com/legal regulatory/html/gramm-leach-bliley.html

[2] http://www.finmod.state.tx.us/content/q&A.htm

[3] Consumer Reports Online, *The new face of banking,* June 2000 p.1.

[4] Ibid p.4.

Appendix C

Department of Banking

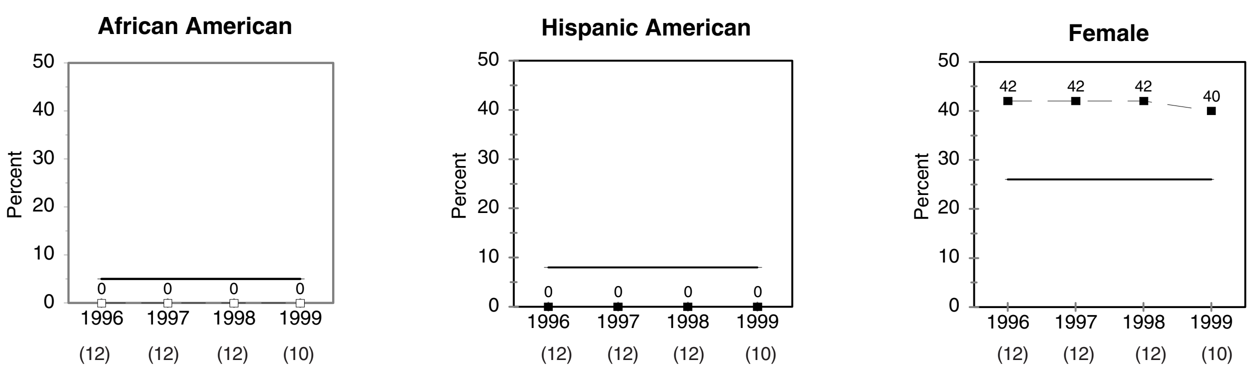
Equal Employment Opportunity Statistics

1996 to 1999

EEO Information

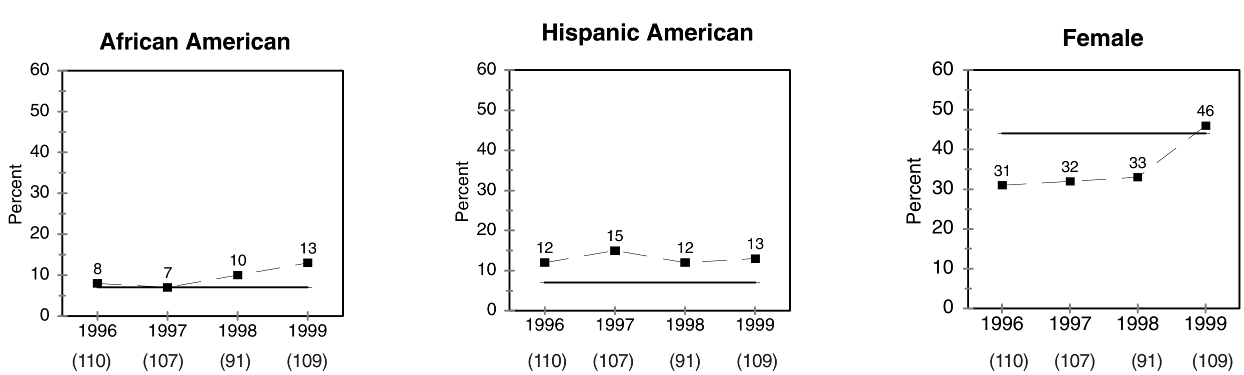
The following material shows trend information for the agency's employment of minorities and females in accordance with the requirements of the Sunset Act.[1] The agency maintains and reports this information under guidelines established by the Texas Commission on Human Rights.[2] In the charts, the flat lines represent the percentages of the statewide civilian labor force that African Americans, Hispanic Americans, and females comprise in each category. These percentages provide a yardstick for measuring agencies' performance in employing persons in each of these groups. The dashed lines represent the agency's actual employment percentages in each job category from 1996 to 1999. Finally, the number in parentheses under each year shows the total number of positions in that year for each job category.

State Agency Administration



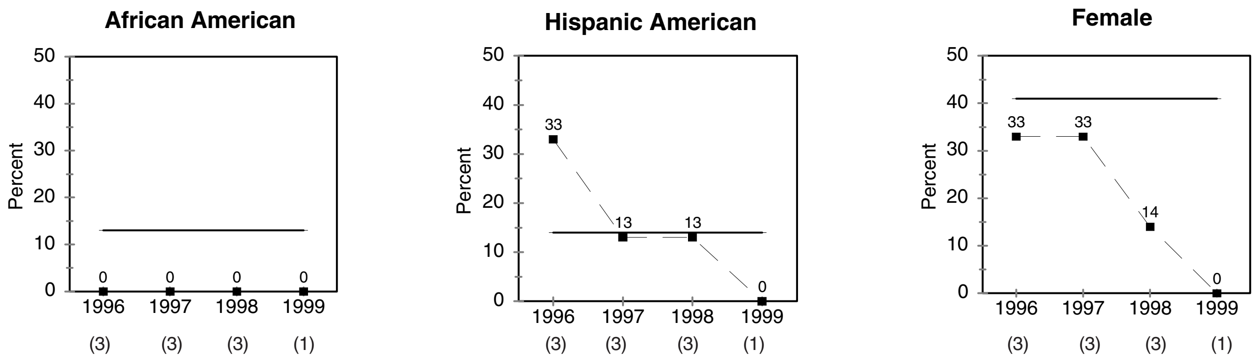
The Department fell below the civilian labor force percentage for African Americans and Hispanic Americans. The agency exceeded labor force percentages for females in this category.

Professional



The Department generally exceeded the civilian labor force percentages for Hispanic American and African Americans, and made improvements among females.

Technical

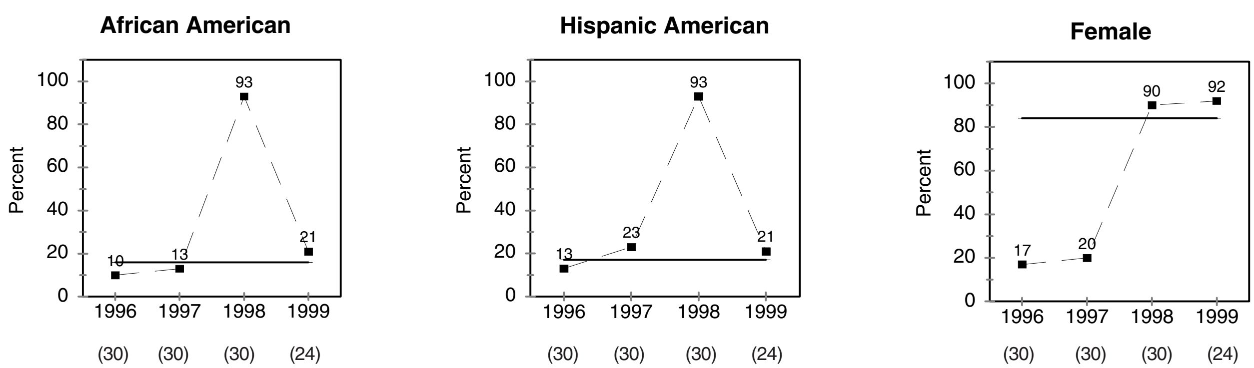


The Department fell below the civilian labor force percentages for all three categories.

Paraprofessional

The Department did not provide job opportunities in the Paraprofessional category.

Administrative Support



The Department generally exceeded the civilian labor force percentages within all three categories.

Skilled Craft

The Department did not provide job opportunities in the Skilled Craft category.

Service Maintenance

The Department did not provide job opportunities in the Service Maintenance category.

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[1] Tex. Gov't. Code ch. 325, sec. 325.011(9)(A) (Vernon 1999).

[2] Tex. Labor Code ch. 21, sec. 21.501 (formally required by rider in the General Appropriations Act).

Appendix D

Savings and Loan Department

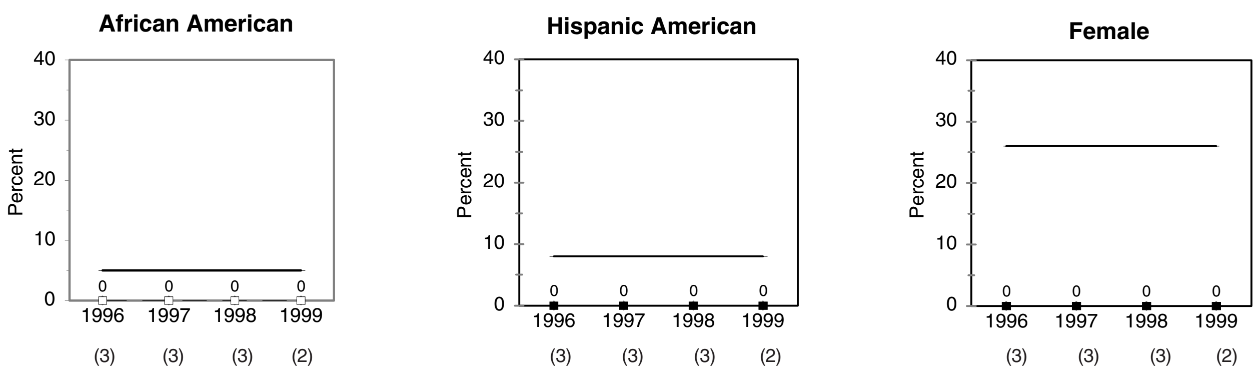
Equal Employment Opportunity Statistics

1996 to 1999

EEO Information

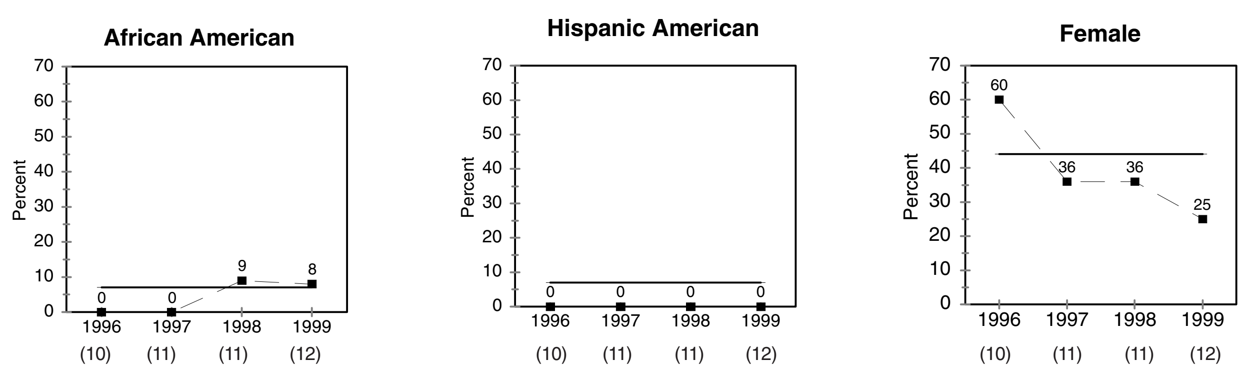
In accordance with the requirements of the Sunset Act,[1] the following material shows trend information for the agency's employment of minorities and females. The Department maintains and reports this information under guidelines established by the Texas Commission on Human Rights.[2] In the charts, the flat lines represent the percentages of the statewide civilian labor force that African Americans, Hispanic Americans and females comprise in each job category. These percentages provide a yardstick for measuring agencies' performance in employing persons in each of these groups. The dashed lines represent the agency's performance in employing persons in each job category from 1996 - 1999. Finally, the number in parentheses under each year shows the total number of positions in that year for each job category.

State Agency Administration



The Department fell below the state goal from 1996 - 1999 for each of the three comparisons. It had one resignation and no hires in the category during the review period.

Professional



The Department fell below the civilian labor force for Hispanic American and Females every year with the exception of 1996, when it exceeded the percentage for females. The Department exceeded the civilian labor force for African Americans for 1998 and 1999.

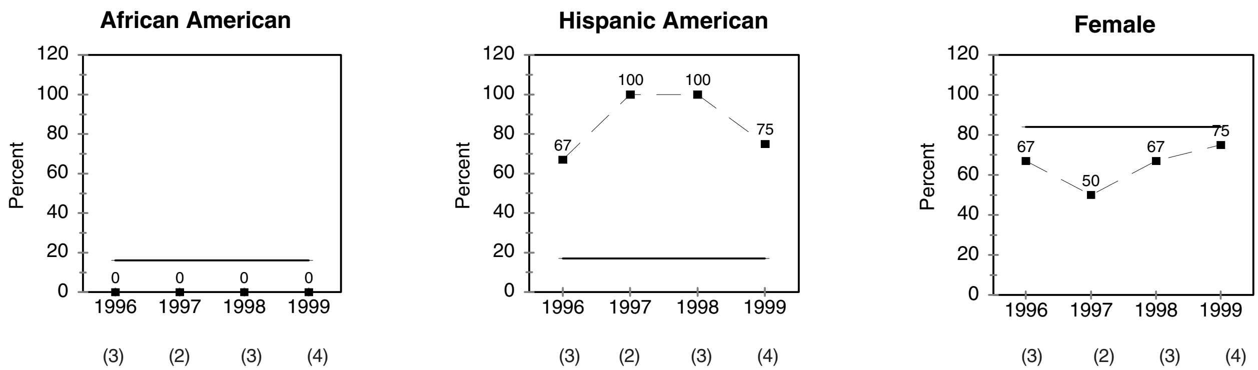
Technical

The Department does not provide job opportunities in the Technical category.

Paraprofessional

The Department does not provide job opportunities in the Paraprofessional category.

Administrative Support



The Department fell below the civilian labor force for African Americans and females every year. The Department has exceeded the state goal for Hispanic Americans since 1996.

Skilled Craft

The Department does not provide job opportunities in the Skilled Craft category.

Service/Maintenance

The Department does not provide job opportunities in the Service Maintenance category.

[1] Tex. Gov't. Code ch. 325, sec. 325.011(9)(B) (Vernon 1999).

[2] Tex. Labor Code ch. 21, sec. 21.501 (formerly required by rider in the General Appropriations Act).

Appendix E

Office of Consumer Credit Commissioner

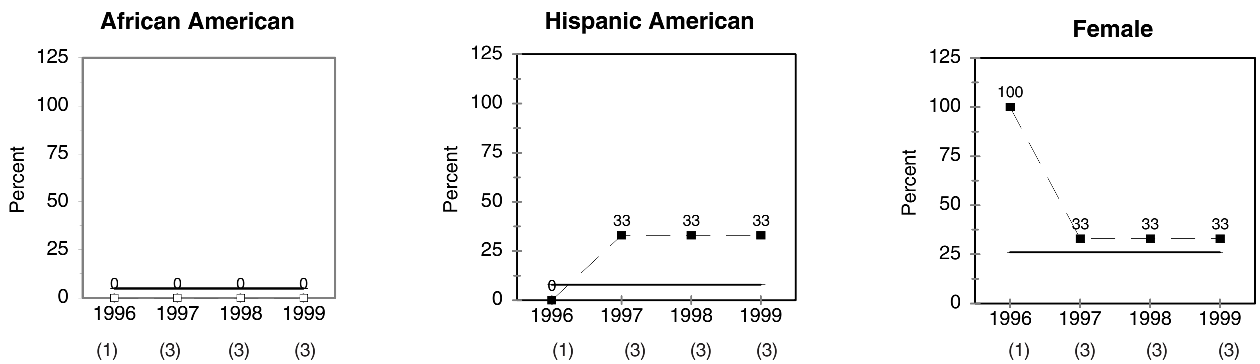
Equal Employment Opportunity Statistics

1996 to 1999

EEO Information

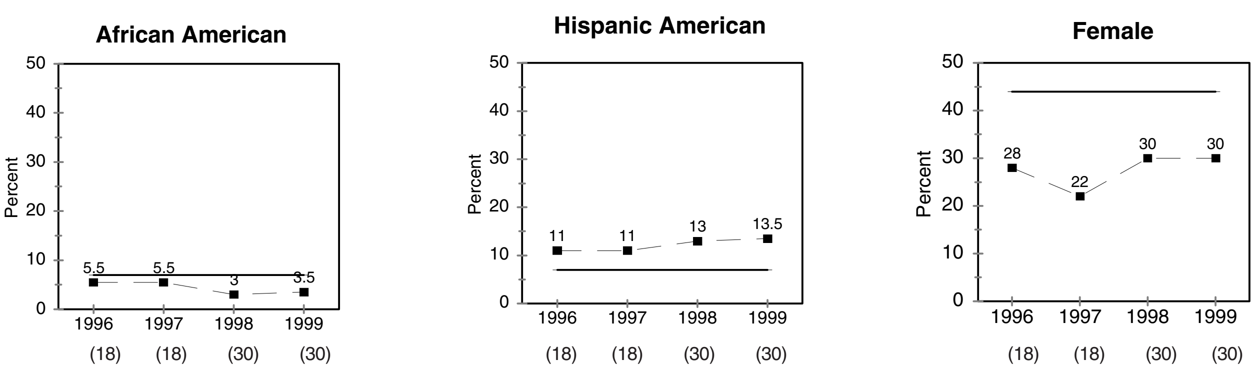
The following material shows trend information for the agency's employment of minorities and females in accordance with the requirements of the Sunset Act.[1] The agency maintains and reports this information under guidelines established by the Texas Commission on Human Rights.[2] In the charts, the flat lines represent the percentages of the statewide civilian labor force that African Americans, Hispanic Americans, and females comprise in each category. These percentages provide a yardstick for measuring agencies' performance in employing persons in each of these groups. The dashed lines represent the agency's actual employment percentages in each job category from 1996 to 1999. Finally, the number in parentheses under each year shows the total number of positions in that year for each job category.

State Agency Administration



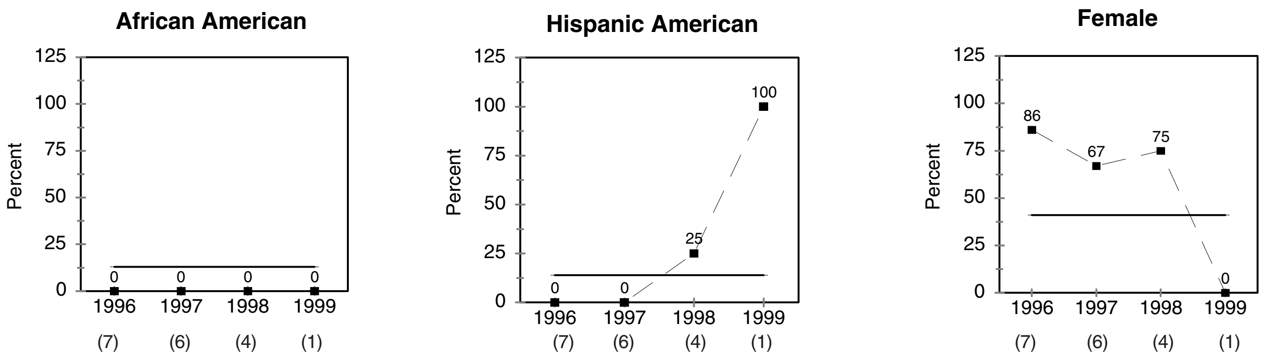
The agency exceeds expectations in this category for Hispanic Americans and females, but falls short in employment by African Americans.

Professional



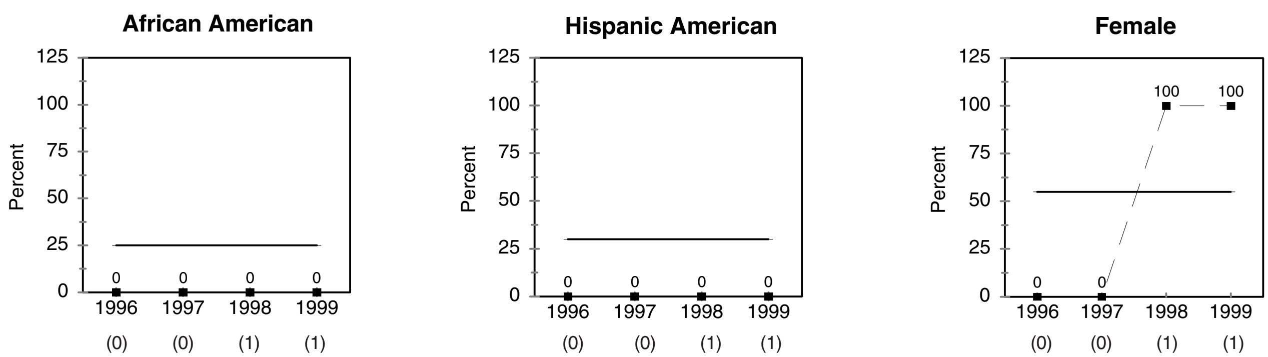
Except for Hispanic Americans, OCCC falls below the benchmarks for professional employment.

Technical



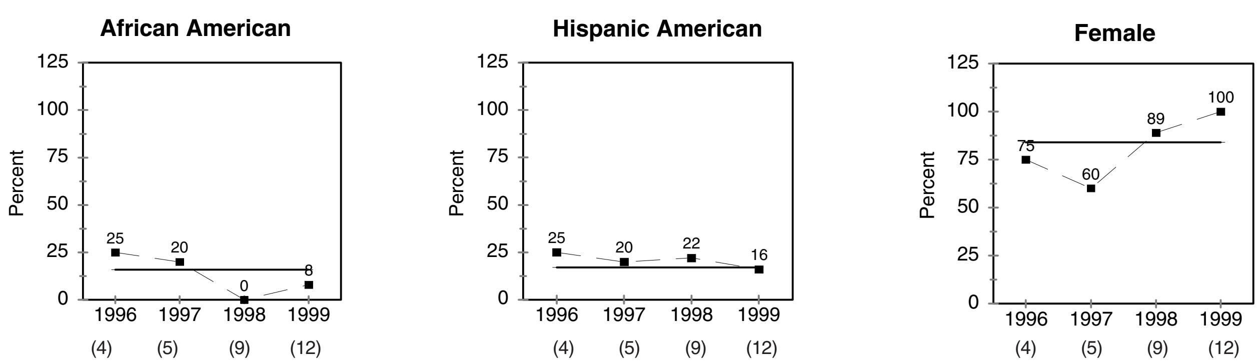
In 1999, the agency significantly exceeded the state goal for employment by Hispanic Americans, but dropped in employment of females.

Paraprofessional



While employment in this category rose significantly for females in 1998 and 1999, the agency fell short of the state benchmark for African Americans and Hispanic Americans.

Administrative Support



OCCC's percentage of employment by African Americans and Hispanic Americans has declined in recent years, but has increased for females.

Skilled Craft

The agency does not provide job opportunities in the Skilled Craft category.

Service Maintenance

The agency does not provide job opportunities in the Service Maintenance category.

[1] Tex. Gov't. Code ch. 325, sec. 325.011(9)(A) (Vernon 1999).

[2] Tex. Labor Code ch. 21, sec. 21.501 (formally required by rider in the General Appropriations Act).

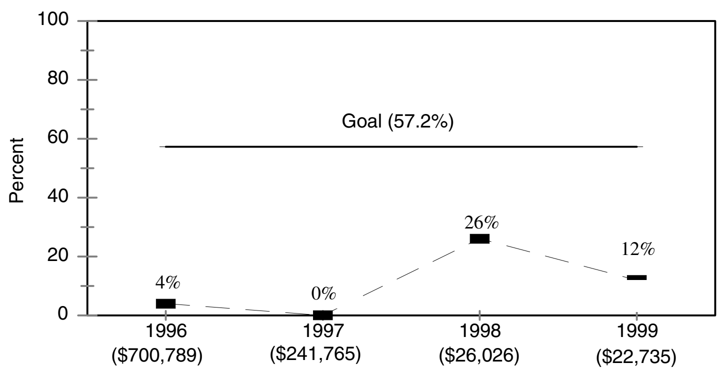
Appendix F

Department of Banking

Historically Underutilized Businesses Statistics
1996 to 1999

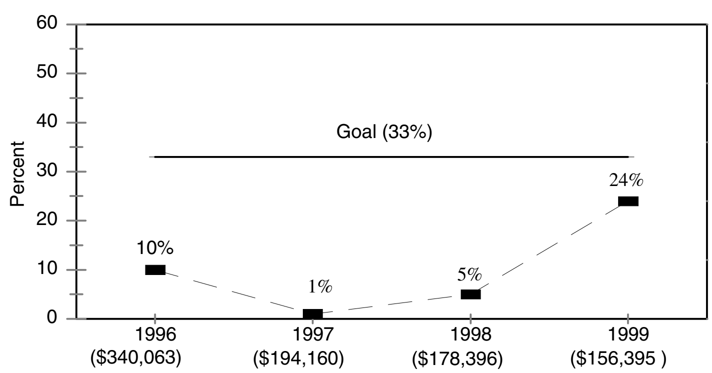
The Legislature has encouraged state agencies to use Historically Underutilized Businesses (HUBs) to promote full and equal opportunities for all businesses in state procurement. In accordance with the requirements of the Sunset Act,[1] the following material shows trend information for the agency's use of HUBs in purchasing goods and services. The agency maintains and reports this information under guidelines in the General Services Commission's enabling statute.[2] In the charts, the flat lines represent the goal for each purchasing category, as established by the General Services Commission. The dashed lines represent the agency actual spending percentages in each purchasing category from 1996 to 1999. Finally, the number in parentheses under each year shows the total amount the agency spent in each purchasing category.

Special Trade

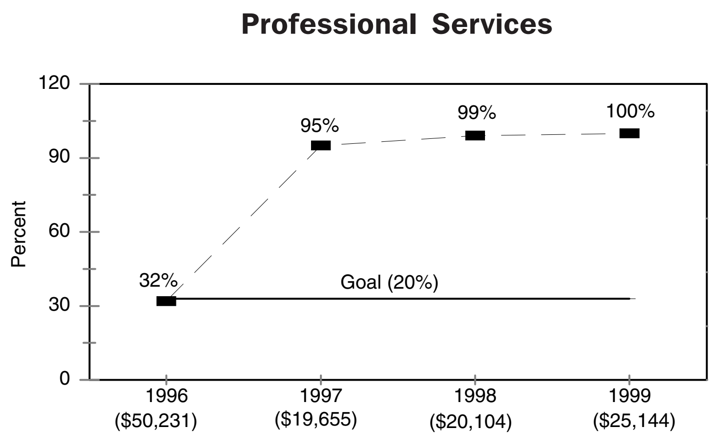


The Department fell below the state goal each year. Since 1997 special trade has not been a significant source of expenditures for the agency.

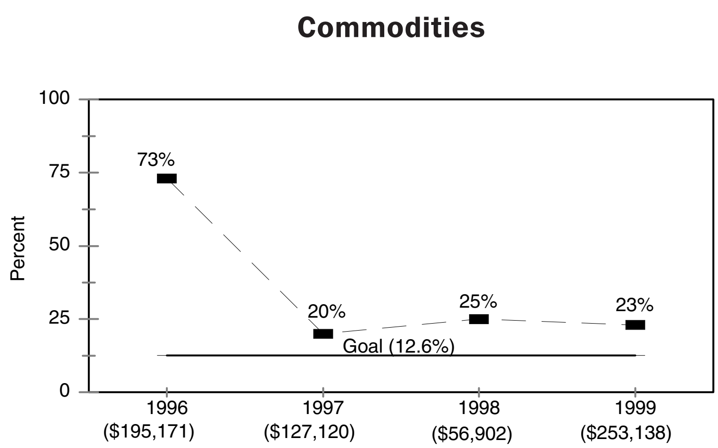
Other Services



The Department fell below the state goal each year, with some improvement in 1999.



The Department exceeded the state goal during all years. HUB spending was particularly high in 1997 through 1999.



The Department exceeded the state goal during all years.

[1] Tex. Gov't. Code ch. 325, sec. 325.011(9)(B) (Vernon 1999).

[2] Tex. Gov't. Code ch. 2161, (Vernon 1999). Some provisions were formerly required by rider in the General Appropriations Act.

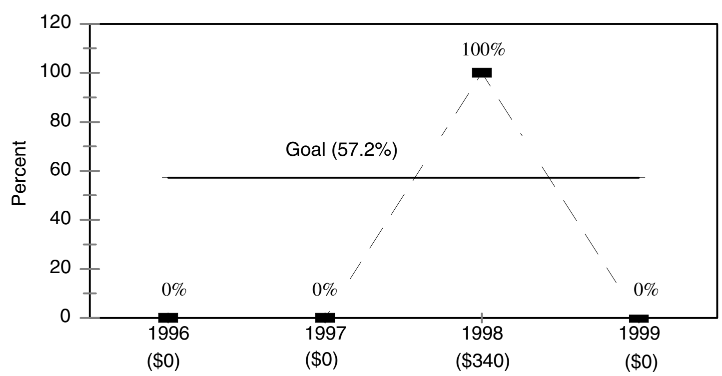
Appendix G

Savings and Loan Department

Historically Underutilized Businesses Statistics 1996 to 1999

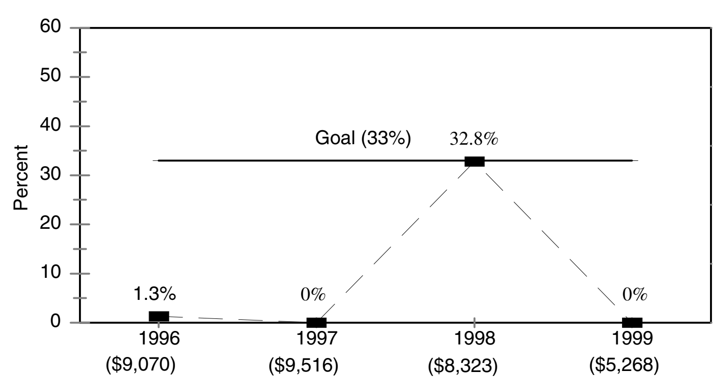
The Legislature has encouraged state agencies to use Historically Underutilized Businesses (HUBs) to promote full and equal opportunities for all businesses in state procurement. In accordance with the requirements of the Sunset Act,[1] the following material shows trend information for the agency's use of HUBs in purchasing goods and services. The agency maintains and reports this information under guidelines in the General Services Commission's enabling statute.[2] In the charts, the flat lines represent the goal for each purchasing category, as established by the General Services Commission. The dashed lines represent the agency actual spending percentages in each purchasing category from 1996 to 1999. Finally, the number in parentheses under each year shows the total amount the agency spent in each purchasing category.

Special Trade



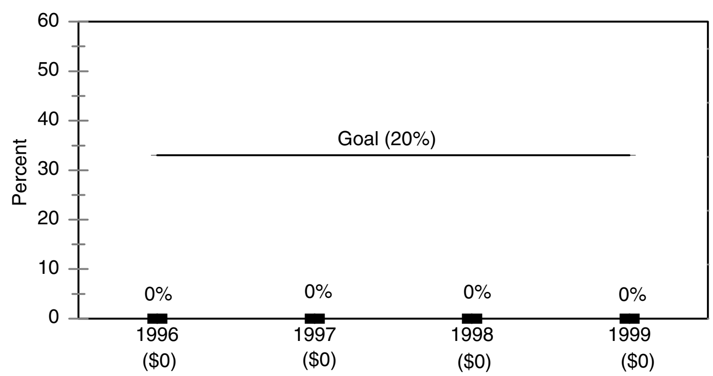
Except for 1998, the Department had no expenditures in this area.

Other Services



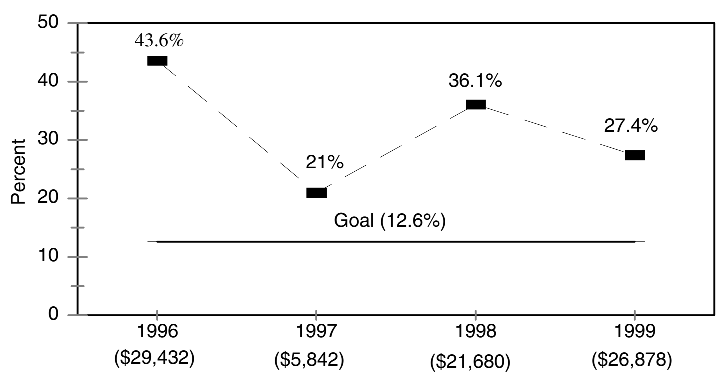
The Department has fallen below the statewide HUB goal for every year shown.

Professional Services



The Department had no expenditures in this area.

Commodities



The Department exceeded the state goal each year.

[1] Tex. Gov't. Code ch. 325, sec. 325.011(9)(B) (Vernon 1999).

[2] Tex. Gov't. Code ch. 2161, (Vernon 1999). Some provisions were formerly required by rider in the General Appropriations Act.

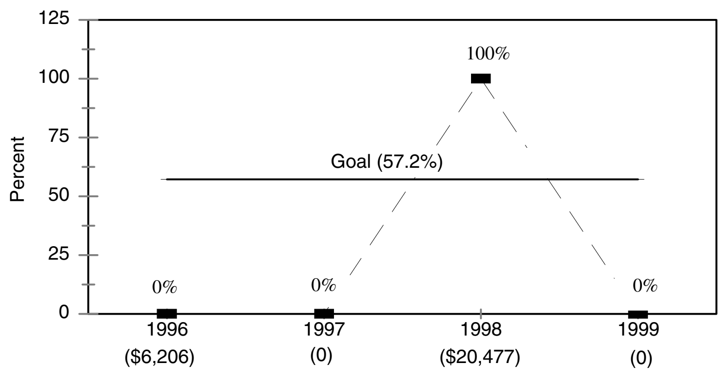
Appendix H

Office of Consumer Credit Commissioner

Historically Underutilized Businesses Statistics
1996 to 1999

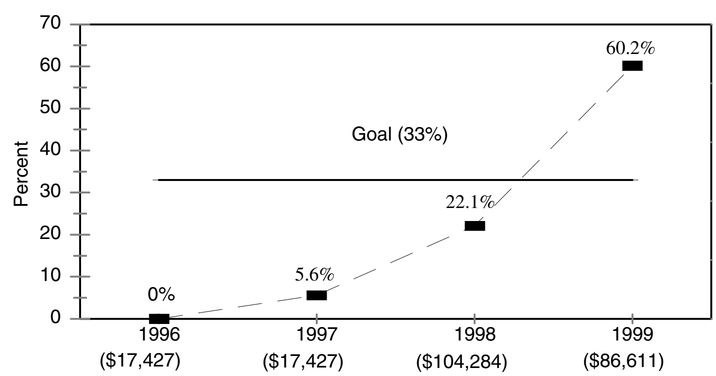
The Legislature has encouraged state agencies to use Historically Underutilized Businesses (HUBs) to promote full and equal opportunities for all businesses in state procurement. In accordance with the requirements of the Sunset Act,[1] the following material shows trend information for the agency's use of HUBs in purchasing goods and services. The agency maintains and reports this information under guidelines in the General Services Commission's enabling statute.[2] In the charts, the flat lines represent the goal for each purchasing category, as established by the General Services Commission. The dashed lines represent the agency's actual spending percentages in each purchasing category from 1996 to 1999. Finally, the number in parentheses under each year shows the total amount the agency spent in each purchasing category.

Special Trade



The agency exceeded the state goal in 1998, but had no expenditures in this category in 1999.

Other Services

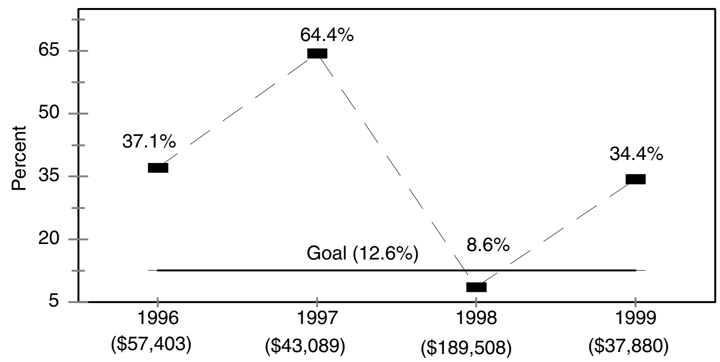


OCCC has significantly increased it expenditures in this category in recent years, and finally met the state goal in 1999.

Professional Services

The agency had no expenditures in professional services in 1996 to 1999.

Commodities



While the agency has fluctuated over the past four years, it has generally met or exceeded the state goal for commodities.

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[1] Tex. Gov't. Code ch. 325, sec. 325.011(9)(B) (Vernon 1999).

[2] Tex. Gov't. Code ch. 2161, (Vernon 1999). Some provisions were formerly required by rider in the General Appropriations Act.

Appendix I

Staff Review Activities

The Sunset Staff engaged in the following activities during the review of the Finance Commission, Department of Banking, Savings and Loan Department, and Office of Consumer Credit Commissioner:

- Worked extensively with executive management and staff from the agencies' major programs.
- Attended public meetings and visited with members of the Finance Commission and Mortgage Broker Advisory Committee about their ideas and opinions about the State's regulation of financial institutions.
- Attended bank, thrift, and pawnshop examinations.
- Met with bankers, non-profit interest groups, associations, local police departments, justices of the peace, and industry and consumer attorneys in Austin, Dallas, Arlington, Houston, Johnson City, and Georgetown to discuss their interaction with the Finance Commission agencies.
- Worked with the Governor's Office, Lieutenant Governor's Office, Speaker's Office, Legislative Budget Board, legislative committees, and legislators' staff.
- Met with officials from the U.S. Office of the Comptroller of the Currency, Federal Deposit Insurance Corporation, Federal Reserve Bank of Dallas, and Federal Trade Commission regarding federal laws, and interaction with state regulators.
- Interviewed state officials from the Texas Department of Transportation, Texas Funeral Service Commission, Texas Department of Insurance, Office of Attorney General, and Texas Department of Housing and Community Affairs.
- Conducted interviews and solicited written comments from national, state and local interest groups regarding their ideas and opinions about the State's role in regulating financial institutions.
- Attended the annual conference of the Texas Consumer Finance Association to visit with members about the State's role in consumer credit and the regulation and programs provided by OCCC.
- Reviewed reports by the State Comptroller, State Auditor's Office, National Association of Consumer Credit Administrators, Consumers' Union, Federal Reserve Board, Jumpstart, and Community Financial Services Association.
- Researched the structure of agencies in other states with similar functions.
- Reviewed agency documents and reports, state and federal statutes, legislative reports, previous legislation, literature on financial issues, other states' information, and information available on the Internet.

Sunset Review of the Finance Commission Agencies

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