HOUSE COMMITTEE ON FINANCIAL INSTITUTIONS
TEXAS HOUSE OF REPRESENTATIVES
INTERIM REPORT 2002

A REPORT TO THE
HOUSE OF REPRESENTATIVES
78TH TEXAS LEGISLATURE

BURT SOLOMONS
VICE CHAIRMAN

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Committee On
Financial Institutions

January 24, 2003

Burt Solomons
Vice Chairman

P.O. Box 2910
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The Honorable James E. "Pete" Laney
Speaker, Texas House of Representatives
Members of the Texas House of Representatives
Texas State Capitol, Rm. 2W.13
Austin, Texas 78701

Dear Mr. Speaker and Fellow Members:

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

Respectfully submitted,

Burt Solomons, Vice Chairman

Mary Denny

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INTRODUCTION

At the beginning of the 77th Legislature, The Honorable James E. “Pete” Laney, Speaker of the Texas House of Representatives, appointed nine members to the House Committee on Financial Institutions (the Committee). The Committee membership included the following appointees: Kip Averitt, Chair, Burt Solomons, Vice-Chair, Mary Denny, Kent Grusendorf, Chuck Hopson, Kenny Marchant, José Menéndez, Jim Pitts and Miguel “Mike” Wise. Upon his election to the Texas Senate in April 2002, Chairman Averitt resigned his position in the Texas House, at which time Vice-Chairman Solomons assumed the responsibilities of Chair. Upon his election to the Texas House in April 2002, Holt Getterman was appointed to the Committee for the remainder of the Interim.

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

1. Review the mortgage lending industry in Texas to determine whether the expectations of the Mortgage Broker Licensing Act of 1999 and subsequent related legislation are being met.

2. Research trends and practices in the sub-prime lending market in Texas and identify any issues of public concern in those markets.

3. Review the practices of financial institutions to comply with consumer privacy provisions of the Gramm-Leach-Bliley Act, and assess the ease and convenience afforded customers in exercising their choices.

4. Evaluate the ability of the Texas agricultural community to gain access to capital markets throughout the state. Identify barriers to financing of viable agricultural and value-added enterprises. Review and evaluate the finance programs administered by the Texas Department of Agriculture. (Joint with House Committee on Agriculture and Livestock)

5. Study the methods currently used to report pawnshop transaction data between pawn shops and law enforcement agencies.

6. Actively monitor agencies and programs under the committee's oversight jurisdiction.

The Committee met in two public hearings, both held on June 4, 2002, at the State Capitol. The first was a Joint Hearing with the House Committee on Agriculture and Livestock, at which time public testimony was heard relating to Charge #4. Directly following this meeting, the House Committee on Financial Institutions met separately to hear public testimony on the remaining interim charges.

The Committee would like to express its appreciation to Commissioner Randall James and staff at the Texas Department of Banking, Executive Director Jim Buie and staff at the Texas Bond Review Board, Commissioner Leslie Pettijohn and staff at the Texas Office of Consumer Credit

Commissioner, Commissioner Harold Feeney and staff at the Texas Credit Union Department, Commissioner Jim Pledger and staff at the Texas Savings and Loan Department, and Executive Director Kimberly Edwards and staff at the Texas Public Finance Authority for their continued work to keep the Committee informed on important matters in their respective areas of authority.

The Committee would also like to express its appreciation to the following state government employees, industry representatives, consumer representatives and interested public citizens who testified before the Committee and contributed to the interim process: Robbye Adams (Austin Police Department), Clyde Atteberry (AARP), Mabry J. Brock (TDA), Edwina Carrington (TDHCA), Russ Chase (Texas Association of Mortgage Brokers), Ted F. Conover (Heritage Land Bank and Farm Credit Associations), Rudy Cran (San Antonio Police Department), Lee Deviney (Texas Dept. of Agriculture, Texas Agricultural Finance Authority), Lt. G. Ermis (Self), Ann Graham (Texas Bankers Association), Harry Griffin (San Antonio Police Department), John Henneberger (Texas Low Income Housing Information Service), Ken Hodges (Texas Farm Bureau), Mary Jackson (Cash America International), Robert Kennedy (Texas Department of Agriculture), James Kennon (Independent Bankers Association of Texas (Agriculture and Rural Affairs Committee)), Danny Klinefelter (Texas Cooperative Extension), Mike Mauldin (Texas Bankers Association), Mac McCommas (Texas Association of Pawnbrokers), Karen Neeley (IBAT), Sid Ordway (Self), Joe L. Outlaw (Texas Cooperative Extension), John Rabenold (Check 'N Go of Texas, Inc.; Community Financial Services Assn. of America), Rob Schneider (Consumers Union), Kenneth T. Scruggs (Household International), Steve Scurlock (Independent Bankers Association of Texas), Edward G. Smith (Texas Cooperative Extension), Bill Stinson (Texas Association of Realtors), Lawrence J. Temple (Texas Mortgage Bankers Association), Mark Waller (Texas Cooperative Extension), Bill White (Cash America), Det. Raymond Wilson (SAPD), Robert John "Jack" Wright (Self)

HOUSE COMMITTEE ON FINANCIAL INSTITUTIONS INTERIM STUDY CHARGES

CHARGE Review the mortgage lending industry in Texas to determine whether the expectations of the Mortgage Broker Licensing Act of 1999 and subsequent related legislation are being met.

CHARGE Research trends and practices in the sub-prime lending market in Texas and identify any issues of public concern in those markets.

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CHARGE Study the methods currently used to report pawnshop transaction data between pawn shops and law enforcement agencies.

CHARGE Actively monitor agencies and programs under the committee's oversight jurisdiction.

MORTGAGE BROKER LICENSING

BACKGROUND

Mortgage Broker Industry

Mortgage brokers originate approximately 70% of all mortgages nationwide, accounting for over $20 billion in mortgage loans in Texas in 2001. While not actual mortgage lenders, mortgage brokers assist borrowers in obtaining a mortgage loan. Due to the complex nature of mortgage loans, many borrowers feel it is in their best interest to obtain a mortgage loan through a broker. Brokers provide insight into the many complicated aspects of a mortgage loan, acting as an intermediary between the borrower and the lender.

Mortgage Broker Licensing Act of 1999

Prior to the 76th Legislative Session, the Texas Mortgage Broker Association (TMBA) organized an effort to become licensed by the State of Texas. Working with lawmakers, state regulators and interested parties, the TMBA crafted legislation for the licensing and regulation of mortgage brokers and loan officers operating within the state. Partly in response to growing consumer concerns over mortgage brokers, the TMBA took a concerted and responsible step towards assuring the confidence of Texas home buyers the mortgage broker industry.

The Mortgage Broker Licensing Act of 1999 (MBL Act) was passed by the 76th Texas Legislature and signed into law by Governor George W. Bush on June 19, 1999. This legislation represented the first time in Texas history that mortgage brokers and loan officers operating within the state would be required to be licensed and regulated. Prior to this, some mortgage brokers and loan officers had been able to arrange financing for Texas home buyers without adequate background in the industry or knowledge of the mortgage business[1]. Interested parties, including Banks, Credit Unions, Realtors, Mortgage Bankers, and other associated trade groups, worked with the TMBA to develop a regulatory framework that licensed the appropriate parties while avoiding burdensome duplicative licensing requirements.

Beginning in January 1, 2000, mortgage brokers and loan officers were required to hold a license with the Texas Savings and Loan Department (the "Department") in order to legally broker loans in the state. In the first year after the MBL Act became effective, 8,400 license applications were approved. Approximately one-third of those applications were mortgage broker applications and two-thirds were loan officer applications. Since that time, applications have continued to arrive at much higher than expected rates. Initial estimates by the State Comptroller anticipated a maximum of 5,500 licensees, of these 1,200 to1,500 were expected for mortgage brokers and 3,000 to 4,000 for loan officers. To date, the total number of active mortgage broker licensees is 15,990. Overall, the licensing and regulation have been seen as a major success due in large part to the herculean effort by Department to manage the program. As a result, consumers today benefit from the regulatory oversight provided by Texas to ensure the mortgage broker industry provide trustworthy and dependable service to Texas home buyers.

[1] Senate Bill 1074 Bill Analysis, Senate Research Center.

An integral part of the Act established the Mortgage Broker Advisory Committee (the Committee). The Committee by law is composed of four mortgage brokers and two real estate agents and meets twice a year. The Committee functions to advise the Savings and Loan Commissioner on issues pertinent to mortgage broker licensing, education, ethical conduct, continuing education and new and renewal applications. Much of the improvements to the licensing and regulatory system are due in part to the hard work and advise provided by the Committee.

Subsequent Legislation

The Mortgage Broker Licensing Act of 1999 was a first step in the mortgage broker licensing process. As the licensing process progressed, it became evident that additional improvements were needed. As a result, several legislative changes were made in 2001 to provide more comprehensive regulatory oversight to the appropriate licensees. Since the implementation of these changes, the Department and the Advisory Committee have continued to monitor the regulatory oversight process in hopes of further improving the service the industry provides to Texas consumers.

In the 77th Legislative Session, House Bill (HB) 1493 was passed to make several key changes to the mortgage broker regulatory process. In addition to the requirement of the Finance Commission to adopt standard forms relating to pre-approved or pre-qualified loan customers[2], the bill allowed the Department Commissioner to obtain the necessary criminal background checks from the FBI[3]. The bill also included clarifying language regarding appeals of administrative penalties[4]. The most significant change the bill made related to annual reporting by mortgage brokers, who are now required to file an annual report with the Department which included loan origination data for each broker or officer. Confidentiality provisions for the reports were also included in the legislation.

Further legislation in the 77th Legislative Session to impact mortgage broker licensing included HB 1636, the Texas Savings and Loan Department's "Sunset" Legislation. Contained within the legislation to continue the Department for another twelve years were provisions impacting mortgage brokers, both directly and indirectly. With its passage, the bill provided the agency with additional authority relating to consumer complaints, including the requirement to maintain a file on each individual complaint which contains, among other information "a summary of the results of the review or investigation of the complaint."[5] Other provisions relating to mortgage brokers included language to allow the Commissioner to issue a provisional license in certain

[2] TEX. FIN. CODE ANN. § 156.105 (2002).

[3] *Id.* § 156.206 (b) (2002).

[4] *Id.*§ 156.302 (e) (2002).

[5] *Id.*§ 13.011 (2002).

circumstances,[6] and renew expired licenses and set fees accordingly.[7] The legislation also authorized the Commissioner to inspect and investigate mortgage brokers to ensure compliance with licensing laws and rules, including the authority to inform the appropriate law enforcement agency of any evidence of criminal activity.[8] Furthermore, the Finance Commission was instructed to adopt rules governing these inspections or investigations.[9]

Finally, Senate Bill (SB) 585 was passed to include a Farm Credit System institution along with other appropriate entities exempted from the mortgage broker licensing requirements. With the initial passage of the Mortgage Broker Act of 1999, there were expectations of future changes to the law to correct any oversights. Admittedly, the lending institutions of the Farm Credit System are adequately regulated by other agencies and thus should have been originally included in the exempted entities. SB 585 was passed to correct that oversight.

6 *Id.*§ 156.207 (2002).

7 *Id.*§ 156.2081 (2002).

8 *Id.*§ 156.301 (2002).

9 Rules 7 TAC § 80.13 and 7 TAC § 80.15.

ANALYSIS

Mortgage Broker Licensing in Texas

Nearly 16,000 mortgage brokers and loan officers are currently licensed by the Department, 79% higher than the number of licensees two years ago and 50% more than projected in the Department's Legislative Appropriations Request for FY 2002-2003. All mortgage broker licensing and related transactions addressed by the Department in FY 2002 have also exceeded expectations, as follows:

- 7,928 new individual licenses issued;
- 500-700 new license applications received monthly;
- 5,375 license renewals; and,
- 8,483 telephone inquiries.

In addition to the extraordinary level of license activity, the Department established the mortgage broker inspection program in FY 2002 authorized by the 77th Legislature, initiating 383 mortgage broker inspections for licensee compliance with the Mortgage Broker License Act ("MBL Act"), and other state and federal laws applicable to mortgage lending. In addition, the Department received 586 consumer complaints for investigation in FY 2002. Results from mortgage broker inspections and consumer complaint investigations resulted in the need for higher than expected enforcement activity.

Historically low interest rates, continued growth in the housing sector and above average financial opportunity in the mortgage industry are encouraging a variety of individuals from other industries, particularly from the real estate and insurance industries, to become involved in mortgage origination. State Farm Insurance has licensed its 1,500 insurance agents in Texas as mortgage brokers. We have been advised that other major insurance companies intend to adopt a similar licensing strategy. As the State Farm insurance agents expand their mortgage transaction business, we expect at least as many new loan officer applications will be received as these brokers license their staff to assist them in mortgage origination.

Inadequate Department Staffing

The Department is currently staffed to handle 10,000 licenses, yet active licenses now exceed 15,000. Inspections are identifying significant abuses that require aggressive enforcement action. To date, the Department is severely behind in issuing inspection reports, consumer protection investigations, and enforcement actions. Furthermore, due to increased media attention by TV stations in Houston and Dallas continuing investigative features on mortgage abuse, there are concerns about inquiries regarding inadequate staffing of consumer protection and enforcement.

Critical Staff Request

The mortgage broker inspection and enforcement programs are severely understaffed both in numbers and in the level of staff and quality of the staff's experience. Although the Department requested 13 full-time employees (FTEs) to implement the mortgage broker inspection program in its fiscal note for H.B. 1636, the adopted fiscal note authorized only 6 FTEs. Appropriations provided by the H.B. 1636 fiscal note did not provide adequate FTEs or salary levels to attract inspectors with the desired level of experience and business education in audit, finance, accounting and legal areas needed to make these programs effective. In FY 2002, the first year of the inspection program, turnover among inspectors has been 57 percent.

Industry Non-Compliance and Consumer Abuse

The mortgage broker inspection program evaluates the compliance of individual licensees and, when combined with an enforcement program, is the most effective way of changing the business practices of abusive licensees. Mortgage broker inspection reports issued to date have shown that abuses within the industry are serious. Forty percent of the mortgage brokers inspected thus far have exhibited notable violations and compliance problems, twenty percent of which have been categorized as serious abusers. However, limitations on the number of inspectors and consumer protection enforcement staff is resulting in significant and unacceptable delays in the issuance of inspection reports, consumer protection response, and enforcement actions against abusers.

Complaint Resolution and Enforcement

Consumer protection activities have increased each fiscal year with the growing number of active mortgage broker licensees. The complexity of complaints investigated by the Department and the time required to complete investigations has also increased. Currently, Department staffing for mortgage broker complaint investigation and enforcement actions consists of two investigators, and also requires most of the general counsel's time and a fraction of an administrative technician's time.

With two investigators, each investigator must manage a very challenging workload of 290 complaints. The Department's general counsel must deal with a caseload of 100-180 cases of possible enforcement actions resulting from complaints and inspections, while directing the investigators in their assignments and providing legal counsel on all other aspects of the agency's operations. As a result, complaint investigations are seriously behind schedule.

Enforcement actions are also seriously behind schedule. Enforcement actions are among the Department's most critical response to identified abuses. However, because of extremely limited staffing in these areas, the Department's ability to respond to identified problems and abuses is severely constrained.

Efficiency, eGovernment and TexasOnline

To address this extremely challenging volume of license activity, the Department has continuously sought ways to improve operating efficiency, revising operating procedures and employing technology at every opportunity to get more production from our limited staff. Efficient and extensive use of the Department's website has been a critical element in addressing the extraordinary challenges of the licensing volume. Perhaps most important has been the Department's adoption of the TexasOnline initiative. The Department was an early participant and enthusiastic supporter of this program and has enjoyed greater than 50% participation by renewing licensees.

Staffing Needs at Texas Savings and Loan Department

Due in large part to the unexpected volume of license applications and resulting high number of licenses issued in Texas, the Department has been challenged to meet the demands of licensing and regulating mortgage brokers with current staff levels. With legislative changes last legislative session to add inspection authority and consumer complaint documentation upon an already burdened staff, the Department has taken steps to add the appropriate number of FTEs to the agency to meet the workload. To date, these attempts have not been successful and the Department remains at staff levels determined at the time of the passage of the Act.

Since last session the number of mortgage broker and loan officer licensees has increased by more than 50 percent. Over the interim, the Department has been is so severely understaffed that it petitioned the Governor for an emergency appropriation to address mortgage broker inspections, consumer complaints and enforcement actions. While the Department acknowledges the upcoming session will face serious budget challenges, the current staffing level is not adequate to effectively enforce and administer the MBL Act. Mortgage abuse results in millions of dollars in unearned and inappropriate fees to Texas consumers annually. The Department is committed to addressing these abuses but appropriations levels need to match the magnitude of the problems identified. The Department has submitted a significant increase in appropriations for this activity and a contingency provision to ensure adequate staffing in the event of continued extraordinary growth or problems. All funds will be entirely raised from license fees and these authorizations will not require any funding from General Revenue.

Variance Request and Exceptional Appropriation

On July 30, 2002, to address immediate staffing concerns, the Department submitted a Variance Request to Governor's Office of Budget and Planning and the Legislative Budget Board asking for eight more FTEs and an additional $464,000 in appropriations for FY 2003 to address the extraordinary volume of licensing activity, enforce statutory compliance and remedy mortgage abuses. Indications are that the budget offices have been unable to find a satisfactory basis for approving the Department's request.

In connection with its Legislative Appropriations Request for FY 2004-2005, the Department requested an Exceptional Appropriation of $1.767 million for the biennium to provide fourteen additional FTEs, including seven inspectors, two investigators, and an administrative technician to substantially strengthen their inspection and enforcement activities. To support the growing volume of licensing activities required for mortgage broker regulation, three licensing technicians would also be added, along with a human resources specialist. This appropriation, which would supplement the Department's Base Appropriations and would have no impact on General Revenue, is essential to provide needed consumer protection and effective regulation of the mortgage broker industry.

Mortgage Broker License Fees

The volume of mortgage broker revenue in the FY 2002-2003 biennium will exceed authorized appropriations as well as all other operating costs and is expected to contribute approximately $1.2 million to General Revenue. Current licensing fees are $235 for a mortgage broker and $105 for a loan officer for a two year period. Acting with approval of the Finance Commission, the Department has statutory authority to raise these fees to $375 and $175, respectively, to cover its operating costs. The mortgage industry has specifically committed to an increase in these fees sufficient to collect additional revenue to cover all costs associated with this request.

Pre-License Testing Requirement

Too many new mortgage broker and loan officer licensees enter the business without an adequate understanding of the basic laws and regulations applicable to mortgage origination. Many professions require license candidates to pass a basic skills test prior to licensing. Pre-license testing for mortgage brokers could enhance existing license requirements and ensure that licensees will at least have a basic understanding of the laws and regulations applicable to their profession. Currently, a national test is being developed by the American Association of Residential Mortgage Regulators. The test program is patterned after the national testing program in the securities industry and would require applicants to separately pay for and pass the test prior to licensing. The national mortgage broker trade association has also adopted an initiative to require pre-license testing for all new mortgage broker licensees.

Texas Participation in a National Mortgage Originator Database

The mortgage industry is very mobile. It is extremely difficult to track mortgage originators with regulatory problems in one jurisdiction when they move from state to state. Legislation to authorize Texas to participate in a national initiative to establish a mortgage originator database would require registration of mortgage brokers in the database and permit the Department to share enforcement and licensing data with other states and participate in a national database initiative. The legislation would also authorize the Department to protect confidential data received from other jurisdictions.

Department Access to FBI Criminal History Records

H.B. 1493, as introduced in the 77th Legislature, among other things, sought to correct deficiencies in the MBL Act to authorize access to FBI criminal history records on all individuals applying for an MBL Act license. The FBI has very stringent restrictions on who can access such information and insists that enabling legislation permitting such access be worded in a very definitive manner. The language in H.B. 1493, as introduced, met the FBI requirements; however, in conforming that language to the Department's Sunset Legislation (H.B. 1636) the language enacted in the last session has been deemed unacceptable to the FBI. The Department has stated that access to FBI criminal history records on applicants is essential to protecting Texas consumers and enforcing compliance with the MBL Act.

Character, Responsibility and General Fitness Standard for Licensees

The MBL Act does not provide a character, responsibility and general fitness standard for obtaining a mortgage broker license. This requirement is common for most professional licenses issued by the State to individuals in positions to provide services where significant public trust is expected. Mortgage brokers assist help people obtain financing for the largest single purchase they will make in a lifetime. The Department seeks to add a character, responsibility and fitness standard to the licensing process.

Broader License Revocation Authority

Clarification on license revocation authority would ensure that licenses can be revoked for patterns of mortgage abuses, non-compliance with the statute or order of the commissioner, failure to pay duly assessed fines or fees, failure to provide access to mortgage or accounting records, or failure to comply with statutory information requests.

Exempt Entities from Mortgage Broker Licensing Requirements

The Act specifically exempted certain entities from its requirements at the time of passage in 1999. These exemptions were based on the belief that these entities are already regulated and supervised by other state or federal regulators, these regulators were providing sufficient regulatory oversight, and additional regulatory requirements would be both duplicative and burdensome. At the time of passage, the list included the following entities: a bank, savings bank, savings and loan association (including subsidiaries and affiliates), a state or federal credit union, a state licensed insurance company, a mortgage banker, and a non-profit 501©)(3) corporation. Farm Credit System institutions were added to the list of exempted entities in the 2001 session[10].

During the 77th Legislative Session, the issue of exempted entities arose during consideration of HB 1493. While at no point in the legislative process did this bill directly address exemptions to the licensing requirement, the bill was seen as an opportunity to change the list of exempted entities. In particular, the issue of whether or not mortgage bankers (mortgage companies) should be exempt. The question arose whether or not mortgage bankers are actually regulated, and if not, should they be regulated by the State of Texas in the form of a mortgage broker license. The same issue was discussed at the June 4, 2002 interim hearing, and was later addressed in a letter dated September 25, 2002 to Vice Chairman Burt Solomons. In the letter, Larry Temple, on behalf of the Texas Mortgage Bankers Association (TMBA), outlines the current requirements placed on mortgage bankers by either the United States Department of Housing and Urban Development (HUD), the Federal National Mortgage Association (Fannie Mae), the Federal Home Loan mortgage Association (Freddie Mac) or the Governmental National Mortgage Association (Ginnie Mae). The letter concludes that "the financial and regulatory review and oversight requirements for a mortgage broker are dramatically greater than the requirements for a Texas mortgage broker," and therefore, the mortgage banker exemption should not be removed.

The letter identified a study by the Texas Finance Commission as directed in 1985 by Senate Concurrent Resolution (SCR) 4 by Parker (69th Texas Legislature) to "conduct a study relating to

[10] TEX. FIN. CODE ANN. § 156.202 (2002).

the feasibility and practicality of mortgage company regulation by the State of Texas," and issue a complete report of its findings and recommendations. The Bill Analysis of SCR 4 states that mortgage companies, being unregulated by the State of Texas, "are not required to provide depositor or investor insurance," further stating that the Attorney General's office had received "an increasing number of complaints on the practices of mortgage companies," naming the First Mortgage Investment Association specifically as a mortgage company that had recently filed for bankruptcy protection under Chapter 11. In a public hearing on November 18, 1986, Larry E. Temple, representing the TMBA, testified before the Finance Commission that he was told by Senator Parker "was mainly concerned 'about looking at the need for regulation of those entities who receive deposits rather that those companies who make mortgage loans to the public.'" On December 5, 1986, the Finance Commission named a Subcommittee to address specific concerns relating to a possible deposit-taking prohibition. After the findings of the Subcommittee were reported, the Finance Commission concluded in their January 30, 1987 minutes that "no additional regulation of the mortgage banking industry was necessary."[11]

[11] Texas Dept. of Banking, *Rpt. to Subcomt. Reviewing SCR 4 Relating to Mortgage Banking*, 1987. (Report available at the Texas Legislative Reference Library, P.O. Box 12488 - Capitol Station, Austin, Texas 78711, (512) 463-1252).

RECOMMENDATIONS

1. The Committee recommends the Finance Commission approve increases in mortgage broker licensing and renewal fees to ensure the Department has adequate resources for its regulatory and oversight obligation.

2. The Committee recommends that the mortgage broker license application include a requirement to pass a pre-license test of the basic understanding of the laws and regulations applicable to the profession.

3. The Committee recommends legislation to authorize Texas to participate in the establishment of a national mortgage originator database and require all Texas licensees to be registered in the database once it is completed.

4. The Committee recommends amending the MBL Act to correspond exactly with FBI requirements to allow the Department access to FBI criminal history records on all applicants as is required currently by the Act.

5. The Committee recommends a character, responsibility and fitness standard be added to the licensing process as found in other state licensing requirements.

SUB-PRIME LENDING MARKET IN TEXAS

BACKGROUND

Lending Markets in Texas

Prime lenders, generally banks and credit unions, typically offer loan products to borrowers with the best credit ratings. Prime loans typically have a lower rate than higher-cost subprime loans. Offered by subprime lenders, borrowers who cannot qualify for prime loans are often faced with paying higher rates for subprime loans. Most subprime lenders are currently regulated in Texas by the Office of Consumer Credit Commissioner (the "OCCC"). OCCC licensees include 4,313 regulated loan licensees and 1,536 pawnshops. Of all OCCC licensees, 46% are secured customer installment lenders, 26% are pawnshops, 14% are home equity lenders, 12% are signature lenders and 2% are second mortgage lenders.

There are various types of mortgage activities conducted by OCCC licensed lenders in Texas, including home equity loans and second lien mortgage loans (also known as 342.G loans). Home equity loans are generally either a second mortgage home equity loan or a first mortgage home equity loan. Second mortgage home equity loans are typically made at a higher rate of interest than first mortgage loans. They are made based on the equity a borrower has in their home and do not affect the interest rate of the first mortgage. In a first mortgage home equity loan, the borrower refinances an existing mortgage and gets cash back (commonly known as a "cash out refinance," or "cash out refi"). A 342.G, or second lien mortgage loan, is a home improvement or purchase money loan and is not subject to the home equity provisions in the Texas Constitution.[12]

Texas Constitutional Home Equity Provisions

The current home equity provisions contained in Article 16, Section 50 of the Texas Constitution provide considerable protection against abusive lending practices. Key consumer protection requirements of all home equity loans made in Texas include:

- Eighty percent loan-to-value ratio ("80% LTV"): Limits the amount that may be loaned to eighty percent of the value of the home minus the amount still owed on the original mortgage.

- Non-recourse loan: Restricts the lenders from accessing the borrower's personal finances to repay the loan. In the event of default, the lenders must foreclose on the property.

- Judicial foreclosure: Requires the lenders to go through judicial foreclosure proceedings before foreclosing on the property.

- Three percent fee cap: Limits all fees charged in a home equity loan to three percent of the loan total. Common fees charged include appraisal fees, attorney

[12] *Subprime Lending: Hearing Before the House Comm. on Fin. Inst.,* 77th Tex. Legis., Interim (June 4, 2002) (testimony of Leslie L. Pettijohn, Consumer Credit Commissioner of Texas).

fees, and certain types of insurance. Initially there was a question as to whether homeowners insurance was included in the 3% fee cap, but Texas regulatory agencies opined that it is not included.[13]

- <u>No lines of credit:</u> Restricts home equity loans made in Texas from being open ended "lines of credit" loans, which allow the borrower to access their equity in installments. The result of this restriction forces Texas consumers to take the entire amount of the loan at once.

- <u>No prepayment penalty:</u> Restricts a lender from charging a penalty fee in the event the loan is paid back ahead of time.

- <u>No additional collateral:</u> Restricts a lender from accepting any real or personal collateral other than the security interest in the homestead. The parties may agree, however, for the lender to acquire an interest in items incidental to the collateral.

- <u>Acceleration prohibited:</u> Restricts a lender from accelerating an equity loan because of a decrease in the market value of a home or because a borrower defaults on another indebtedness except a debt secured by a prior valid encumbrance against the homestead.

- <u>Only debt secured on house (except provided in Art. 50 Sec. 16 (a)1-5):</u> There cannot be an additional lien on the homestead except as provided in the Constitution for allowable encumbrances against a homestead.

Legislation from the 77th Texas Legislature

In response to growing concern over the cost of certain home loans, Senator Royce West passed SB 1581 in the 2001 Legislature. The legislation established certain provisions for refinancing low-rate home loans, including restrictions against replacing or consolidating these loans within the first seven years. For home loans with an interest rate over twelve percent, requirements were established for disclosure notices on the value of mortgage counseling, HUD counseling information, additional mortgage counseling information and additional notices as required by the Finance Commission of Texas, including an official notice regarding high cost home loans.

The bill also established a notice required to be given to any applicant who is being offered any individual or group credit life, disability or unemployment insurance along with their mortgage. As established in the bill, the notice reads as follows:

[13] Office of Consumer Credit Commissioner of Texas, Texas Department of Banking, Texas Savings and Loan Department, Texas Credit Union Department, Regulatory Commentary on Equity Lending Procedures (October 7, 1998).

INSURANCE NOTICE TO APPLICANT

You may elect to purchase credit life, disability, or involuntary unemployment insurance in conjunction with this mortgage loan. If you elect to purchase this insurance coverage, you may pay for it either on a monthly premium basis or with a single premium payment at the time the lender closes this loan. If you choose the single premium payment, the cost of the premium will be financed at the interest rate provided for in the mortgage loan.

This insurance is NOT required as a condition of closing the mortgage loan and will be included with the loan only at your request.

You have the right to cancel this credit insurance once purchased. If you cancel it within 30 days of the date of your loan, you will receive either a full refund or a credit against your loan account. If you cancel this insurance at any other time, you will receive either a refund or credit against your loan account of any unearned premium. YOU MUST CANCEL WITHIN 30 DAYS OF THE DATE OF THE LOAN TO RECEIVE A FULL REFUND OR CREDIT.

To assist you in making an informed choice, the following estimates of premiums are being provided along with an example of the cost of financing. The examples assume that the term of the insurance product is ____ years and that the interest rate is ______ percent (a rate that has recently been available for the type of loan you are seeking). PLEASE NOTE THAT THE ACTUAL LOAN TERMS YOU QUALIFY FOR MAY VARY FROM THIS EXAMPLE. "Total amount paid" is the amount that would be paid if you financed only the total insurance premium for a ___ year period and is equal to the amount you would have paid if you made all scheduled payments. This is NOT the total of payments on your loan.

CREDIT LIFE INSURANCE: Estimated premium of $_______
DISABILITY INSURANCE: Estimated premium of $_______
INVOLUNTARY UNEMPLOYMENT INSURANCE: Estimated premium of $________
TOTAL INSURANCE PREMIUMS: $_______
TOTAL AMOUNT PAID: $_______

SB 1581 also established provisions relating to high-cost home loans, restricting balloon payments within the first five years, negative amortization and prepayment penalties. The bill also requires lenders of high-cost home loans to analyze the borrowers ability to repay, including their income, debt, employment and other resources as part of the underwriting process.

Finance Commission Mortgage Lending Study

The Office of Consumer Credit Commissioner underwent Sunset Commission review in the 76th Interim, resulting in the passage of SB 317 by Senator David Sibley during the 77th Legislature. Included in SB 317 was a legislative mandate instructing the Finance Commission of Texas to conduct a study on the mortgage lending industry in Texas. The mandate reads as follows:

"The Finance Commission of Texas and the consumer credit commissioner shall conduct a study of mortgage lending practices with emphasis on identifying possible predatory and discriminatory lending patterns or practices. In conducting the study, the agencies shall collect data from entities making mortgage loans about mortgage loans using the data formats of the Home Mortgage Disclosure Act of 1975 (12 U.S.C. Section 2801 et seq.) and other data fields necessary to identify possible predatory practices. In conducting the study, the agencies shall also study and consider parameters that could be used to consistently classify credit risk among mortgage loans for the purpose of assessing possible predatory or discriminatory lending practices. The agencies shall prepare a report detailing the findings and recommendations resulting from the study and deliver the report to the lieutenant governor, the speaker of the house of representatives, and legislative committees dealing with lending entities before December 1, 2002."

To date, progress on the Finance Commission Study has been hampered by the reluctance of many recipients to participate in the survey. At the August 16, 2002, meeting of the Finance Commission, concerns over the ramifications of participating in the survey were raised by various interested parties. Concerns focused on whether or not federal privacy law is in violation regarding individual customer information and whether or not this information could be subject to state open records laws. To address these concerns, steps have been taken to obtain from the FDIC a letter stating whether or not conveyance of the requested information is in violation of federal law. A request was sent to the Texas Office of Attorney General for an opinion on whether or not the state's open records laws apply to such information. Also, survey responses are being returned to the respondents' appropriate regulator rather than to the Texas Legislative Council to give the information additional protection under state law.

ANALYSIS

Subprime Lending Market

According to Home Mortgage Disclosure Act (HMDA) data, the subprime lending market has grown at a tremendous rate over the past decade. From 1993 to 1999, reported subprime loans increased almost tenfold from 104,000 subprime refinance loans in 1993 to 1 million in 1999. In 1994, subprime refinance loans totaled $35 billion, representing less than 5 percent of all mortgage originations. By 1999, subprime lending had increased to $160 billion, nearly 13 percent of the mortgage origination market.[14]

While some may have concerns in the growth in the subprime market in Texas, it is important to remember that the subprime market serves an important role in providing the necessary access to credit for certain potential home buyers. Credit-impaired buyers, who often have blemishes on their credit report, an insufficient credit history, or nontraditional credit sources, may otherwise not have access to the necessary credit to buy a home were it not for subprime lenders[15].

This is not to say, however, that there aren't certain valid concerns in some areas, specifically high foreclosure rates, high cost interest and loan features that prove to be unfavorable to consumers. It is helpful to recognize that subprime borrowers behave differently than prime borrowers, and that to fairly assess these borrower's ability to repay their loans, a lender may have different criteria for rating their creditworthiness. Often these borrowers have less available cash, which may result in lenders putting in a different rate schedule to account for customers' occasional inability to make regular payments.

Studies have indicated that subprime lending is disproportionately concentrated in low-income and minority neighborhoods. Due in part to the absence of mainstream lenders in certain neighborhoods and differences in credit behavior of the borrowers, disparities have been shown in subprime lending across certain neighborhoods[16].

Predatory Loan Practices

Subprime lending practices are often inaccurately confused with predatory lending. While there seems to be no definitive definition for predatory lending, the U. S. Department of Housing and Urban Development describes that, "predatory lending - whether undertaken by creditors, brokers, or even home improvement contractors - involves engaging in deception or fraud, manipulating the borrower through aggressive sales tactics, or taking unfair advantage of a borrower's lack of understanding about loan terms. These practices are often combined with loan terms that, alone or in combination, are abusive or make the borrower more vulnerable to abusive practices."

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[14] U.S. Dept. of Housing and Urban Development and U. S. Treasury, *Curbing Predatory Home Mortgage Lending* (June 2000).

[15] Allen Fishbein and Harold Bunce, *Subprime Market Growth and Predatory Lending,* available online at http://www.huduser.org/publications/pdf/brd/13Fishbein.pdf

[16] *Ibid.*

When considering potential predatory lending practices in Texas, it is important to consider the current home equity provisions established in the Texas Constitution. Compared to most other states, Texas already has some of the strongest anti-predatory laws in the nation. The home equity provisions restrict by law the abusive lending practices commonly complained about elsewhere. The following chart summarizes common abusive lending practices and the current restrictions in Texas law to prevent them:

Practices Commonly Pointed Out as Predatory		
Practice	**Description**	**Texas Response**
Equity Stripping	A predatory lender targets an individual with a great deal of equity in their home. The lender then loans a borrower more than the borrower can financially handle, knowing the borrower is likely to default. The lender can then foreclose on the home, *stripping* the homeowner of all equity earned.	Home Equity Constitutional Protections: • Restricts the amount of equity that can secure the loan to 80% providing some equity remains with the homeowner • Restricts a borrower to one home equity loan per year limiting refinance fees and protecting the borrower's equity TEXAS FINANCE CODE Protections for Second Mortgages: • Ensures lenders evaluate a borrower's ability to repay before a loan is made ensuring that a lender's lending decision is not based solely upon a borrower's equity
Flipping	A predatory lender refinances a borrower's loans repeatedly within a short period of time. Each time the loan is refinanced, or *flipped*, the borrower is charged high fees, sometimes including prepayment penalties.	Home Equity Constitutional Protections: • Restricts a borrower to one home equity loan per year limiting refinance fees and protecting the borrower's equity TEXAS FINANCE CODE Protections: • Restricts lenders from contracting for prepayment penalties on loans with interest rates of 12% or greater to refinance a loan
Packing	The lender *packs* excessive fees, including unnecessary insurance coverage, other up-front charges, and additional junk fees (escrow waiver fees, fax fees, copy charges, etc.) into the loan agreement without the borrower's understanding. Often the fees far exceed what would be expected or justified based upon economic grounds.	Home Equity Constitutional Protections: • Restricts a lender to 3% in fees limiting the ability of lenders to charge for certain reimbursable costs TEXAS FINANCE CODE Protections for Second Mortgages: • Limits lenders from collecting fees that are not reasonable or authorized
Insurance Packing	A predatory lender may add unwanted extras to the loan without the borrower's full knowledge. The most common product added to loans is credit life or disability insurance. In mortgage loans, the cost of credit insurance can be high. On a $28,000 loan, the cost of credit insurance can exceed $4,000. The $4,000 premium is added to the loan and financed over the life of the loan. The lender earns more interest on the loan and also earns a commission for selling the insurance.	TEXAS FINANCE CODE Protections for Home Loans: • Limits lenders from contracting for insurance where the premium is prepaid in a single installment, without providing a monthly premium alternative where the amount of the insurance is not included in the loan

Practices Commonly Pointed Out as Predatory (continued)		
Practice	**Description**	**Texas Response**
Balloon Payments	A predatory lender reduces the monthly payment on a home loan by having the borrower pay off only the accrued interest each month. This kind of financing will result in a huge balloon payment at the end of the repayment term, usually ranging from 10 to 15 years. The borrower often believes they are paying down the loan and is completely unaware of the balloon payment due at the end of the term. The borrower may owe as much at the end of the term as they originally borrowed. Elderly borrowers are often unable to refinance the loan, making foreclosure inevitable.	Home Equity Constitutional Protections: • Prohibits lenders from contracting for balloon payments TEXAS FINANCE CODE Protections for Second Mortgages: • Prohibits lenders from contracting for balloon payments
Aggressive Marketing	Predatory lenders will offer bill consolidation equity loans encouraging consumers to pay off credit card, retail, and motor vehicle debt by consolidating them all into one home loan, promising lower monthly payments. While lower monthly payments do result from this transaction, the consumer trades short-term debt for long-term. Instead of paying off their bills in three to four years, it will now take them 15 to 30 years to pay. The consumer will also pay much more in interest over the life of the loan.	Home Equity Constitutional Protections: • Requires lenders to provide certain disclosures to borrowers warning that failure to repay the loan could result in losing the home TEXAS FINANCE CODE Protections: • Requires lenders to provide a disclosure to a borrower warning that the loan could be considered a "high cost home loan" and direct the borrower on where to obtain counseling
Fraud and Abuse	In many cases, lenders utilized fraud and abuse to prey on certain groups—the elderly, minorities, and individuals with lower incomes and less education—with deceptive or high-pressure sales tactics.	Home Equity Constitutional Protections: • Requires lenders to provide certain disclosures to borrowers warning that failure to repay the loan could result in losing the home TEXAS FINANCE CODE Protections for Home Loans with Interest Rates of 12% or Greater: • Requires lenders to provide a disclosure to a borrower warning that the loan could be considered a "high cost home loan" and direct the borrower on where to obtain counseling Deceptive Trade Practices Act Protections: • Restricts lender advertising and sales to ensure that the borrower is not mislead by misrepresentations and false claims

1 Predatory Mortgage Lending, North Carolina Department of Justice, 1999, 2000, State of North Carolina, p1.

High Cost Home Loan Counseling

In the 77th Legislative Session, S.B. 401 was filed by Senator Royce West which, if it had passed, would have required counseling in connection with a "high cost home loan." As introduced, the bill defined a "high cost home loan" basically as any home loan under $240,000. The bill also set penalties of up to $10,000 in punitive damages, plus actual damages and court costs, for violating the provisions of the bill. Most importantly, though, the legislation would have required all affected borrowers to receive credit counseling from a HUD approved counselor before closing the loan. Certain interested parties felt the requirements of the bill would have affected too broad a base of borrowers, while others argued the importance of credit counseling in association with certain home loans. Despite the fact that the legislation failed to pass into law, its introduction demonstrates the importance of credit counseling availability, especially in relation to certain loans.

RECOMMENDATIONS

1. The Committee considers borrower education to be a vital aspect of any subprime lending. Since these customers are often less financially sophisticated than a prime lender, the Committee recommends that education on such things as how to apply for credit, how to use credit responsibly, how to repair credit and how to shop for credit be included in the loan application process for all subprime loans.

CONSUMER PRIVACY

BACKGROUND

Gramm-Leach-Bliley Financial Modernization Act

On November 12, 1999, the Gramm-Leach-Bliley Financial Services Modernization Act (GLBA) was signed in to law, making several fundamental changes to the federal laws that govern the financial system. With the passage of GLBA, the restrictions on affiliations between certain types of institutions were eased, essentially allowing banks, insurance companies and securities firms to operate under one roof for the first time in over 50 years. GLBA contained provisions requiring an institution to provide clear and conspicuous notice of its privacy policy and practices to its customers and to allow customers the right to prevent their information from being shared with a non-affiliated entity.

On February 22, 2000, the federal banking agencies proposed regulations on consumer financial privacy. By November 13, 2000, these consumer privacy regulations became effective, but were optional until July 1, 2001, to allow affected financial institutions sufficient time to ensure compliance. By this date, all financial institutions as defined by GLBA were required to have developed and delivered copies of the institution's privacy notice to their current customers. The notice was required to include information on opting-out of information sharing when such information was to be shared with an unaffiliated third party. Institutions are required to provide these same notices to new customers and are required to send them to all customers on an ongoing basis of at least once per year.

The GLBA also preserves the right of each states to strengthen the privacy provisions as they are established in federal law. Thus, GLBA sets a minimum privacy standard that all institutions must adhere to, but allows each individual state to decide for itself if these minimums are adequate. At the time GLBA was passed, the general sentiment of the Texas Legislature, specifically this Committee, was to "wait and see." By allowing time to pass to determine if the provisions of GLBA were adequate, it was reasoned that rash decisions could be avoided. As a result, legislative changes were made during the 77th Texas Legislature to conform state law to GLBA, but no additional privacy requirements were adopted.

ANALYSIS

Federal Study of Information Sharing Practices

Currently, the U. S. Department of the Treasury, the Federal Trade Commission and other federal functional regulatory agencies are conducting a study of information sharing practices among financial institutions and their affiliates. The public comment period ended as of May 1, 2002, with approximately 50 comments having been received. Comments were generally divided between pro-consumer (mainly from individual citizens and consumer advocacy groups) and pro-industry (mainly from financial institution representative and industry trade groups).

Common consumer responses reflect confusion and frustration over privacy notice and the opt-out process. Consumer respondents complained of hard-to-read forms, confusion over why certain institutions did not provide an opportunity to opt-out, and difficult opt-out procedures. One particular respondent explained that upon calling their institution to opt-out, they were given a explanation of the result of opting out and asked numerous survey questions about why they decided to opt-out. Frustration was expressed that most people who receive privacy notices along with their financial statements confuse them with junk mail and immediately throw them away. Many of these types of consumer respondents expressed their preference of an opt-in system, which they felt would place the burden on the financial institution rather than the customer.

Industry responses focused on the additional services that are provided as a result of GLBA, since consumers now have access to insurance and investment services at their bank. Additionally, the ability to offer these expanded financial services has required considerable capital investment by these institutions. Industry respondents claimed that to deny the bank from sharing information necessary to provide these services would be contrary to the purpose of GLBA. Further limitations, according to industry responses, would restrict the services now provided to consumers under GLBA.

Consumer Response to Privacy Notices

Since consumers have had the right to opt-out of information sharing, less than five percent have actually done so. Consumer complaints have been low as well. From September 2000 to June 2002, the Texas Department of Banking has received only one privacy related complaint, two reports of identity theft not associated with a bank, and eleven inquiries of individuals wanting to opt-out. During this same period, the FDIC's Dallas Region (includes Texas, New Mexico, Oklahoma and Colorado) have received a total of seven complaints relating to privacy. This low response to both financial institutions and regulatory agencies indicates that the general public is either unaware or content with the current privacy regulations. From a legislative standpoint, any additional legal requirements should focus on ensuring that consumers have the best possible opportunity to be both aware and content.

Industry Compliance with GLBA Privacy Regulations

According to testimony by Texas' two largest financial industry trade groups, the cost of compliance with GLBA privacy requirements amounts to millions of dollars nationwide. This cost includes the development and delivery of over 4.2 billion privacy statements. According to an informal survey of its members, the Independent Bankers Association of Texas reports that the cost per notice for its member banks range from $0.71 to $2.18 per notice, with the average being about one dollar. The method of choice for most financial institutions has been a simple "statement stuffer" which is included with a customers monthly statement explaining their privacy rights. As is often the case, additional promotional material is included with the privacy notices, potentially resulting in customers mistaking privacy notices for marketing information and not carefully reading and understanding the privacy policies of their financial institution.

Standardized Notice Format

In a letter dated February 15, 2002 to the Secretary of the Federal Trade Commission, the National Association of Attorneys General addressed the issue of uniform, standard privacy notices. The letter urges the federal regulatory agencies to require all financial institutions to issue uniform notices based on scientific expertise to ensure consumers receive a readable notice and can therefore make informed choices in exercising their privacy rights. Citing a study by the Harris Interactive for the Privacy Leadership Initiative, the letter identifies that the most important information to consumers in order to make an informed decision as: "1) how does this financial institution share my personal information with third parties?; and 2) what do I have to do to remove my personal information from the shared database?" The letter stresses the importance of scientific expertise in developing a useful notice, using the FDA food label as a good example of an effective plain language example.

Identity Theft

While not directly addressed by the privacy requirements of GLBA, testimony provided to the Committee also identified a growing concern within the financial services industry over consumer identity theft. With today's modern financial system providing consumers various methods to conduct financial transactions comes added vulnerability to criminal identity theft. Personal information that has become susceptible to being stolen includes more than a customers name, address and telephone number. Rather, consumers today must guard against the loss of banking and credit card account numbers, social security numbers, personal identification numbers (PINs) and other passwords, and income information. Regardless of the choice they make regarding information sharing, consumers should nonetheless take steps to protect themselves from identity theft.

RECOMMENDATIONS

1. The Committee recommends that measures be taken to protect against identity theft for Texas consumers.

2. The Committee recommends that alternative formats and delivery methods of privacy policies be developed to ensure Texas consumers understand their privacy rights and decide whether or not to exercise their opt-out rights based on this understanding.

3. The Committee recommends a standard be developed to ensure that privacy notices are clear and conspicuous so that consumers will easily comprehend the information contained therein.

AGRICULTURAL ACCESS TO CAPITAL MARKETS

BACKGROUND

Current Agricultural Lending Market in Texas

The agricultural community in Texas has one of the highest agricultural operator debt levels in the nation, according to a 1997 Census of Agriculture study by the U. S. Department of Agriculture. At the time of the study, Texas agricultural operator debt totaled over $8 billion, with over half of this amount being provided by commercial and savings banks. Other major providers of agricultural operator debt include farm credit system institutions, traditional lenders, implement dealers and finance corporations, farm service agencies and state and county government lending agencies.

Providers of Agricultural Operator Debt - Texas (1997)

Providers	Amount	% of Total Debt
Commercial and Savings Banks	$ 4,250,000,000	52.0%
Farm Credit System	$ 1,235,407,000	15.1%
Other Lenders	$ 745,615,000	9.1%
Mortgage Debt from Seller	$ 577,946,000	7.1%
Implement Dealers and Financing Corp.	$ 442,309,000	5.4%
Farm Service Agency	$ 307,512,000	3.8%
State/County Govt. Lending Agencies	$ 196,241,000	2.4%
Land Purchase Companies	$ 155,797,000	1.9%
Other Debt (Unpaid Bills)	$ 106,598,000	1.3%
Life Insurance Companies	$ 63,133,000	0.8%
Co-Ops, Merchants and other Input Suppliers	$ 46,752,000	0.6%
Small Business Administration	$ 38,701,000	0.5%
Contractors	$ 7,179,000	0.1%
TOTAL	$ 8,173,239,000	

Accor
ding to bank published financial reports available in the Federal Deposit Insurance Corporation (FDIC) website, farm loans by Texas banks, both state and national institutions, have increased over the past decade. From 1992 to 2001, total farms loans in the state increased over $1 billion, from almost $3.6 billion to almost $4.7 billion. Of this amount, farmland loans increased from over $900 million to over $1.6 billion, while production loans went from over $2.6 billion to over $3 billion. Interestingly, while the total loan dollars increased over this span, the number of Texas banks making agricultural loans decreased from 1,089 institutions in 1992 to 686 in 2001. Coinciding with the decrease in lenders was a gradual increase in the percentage of total farms loans compared to total assets from 2.02% to 3.23%.

Agricultural lending markets involve several unique factors not experienced in other capital markets. Some key items to consider in relation to agricultural lending are:

- Government assistance programs and subsidies are necessary to partially offset lending risks and keep independent farmers in business;

- Normal production expenses, particularly irrigation costs, are continuing to rise;

- Environmental issues associated with pesticides and herbicides may also increase production costs;

- The availability of water for crop irrigation may be a serious problem in the immediate future; and

- The ability of young farmers to effectively compete and enter the industry is being seriously jeopardized because of high capital entry requirements.

To assist in understanding the history and complexities of the agricultural lending market, the Texas Finance Commission is currently preparing a Agricultural Business Lending Study. This comprehensive research project of Texas agricultural business will include a 20-year history of statistical and demographic agricultural lending information, a historical review of government sponsored agricultural price, conservation, guaranty, and direct lending support programs, and a current survey of lending experiences by agricultural producers or “first handlers” in Texas. The process will include in-depth interviews with industry experts to obtain relevant information, a survey of about 400 producers meeting the study’s population definition, and a comprehensive report with narrative analysis and statistical support. The report is expected to be issued by November 30, 2002.

Texas Department of Agriculture Programs

The Texas Department of Agriculture (TDA) has several current programs available to the Texas agricultural industry. These programs are designed to assist and promote the use of Texas agricultural products and to create and retain jobs through business development using value-added production, processing and marketing of agricultural products.

The Rural Economic Development Division (the Division) assists rural communities and agribusiness throughout the state. Among the many services provided are assisting start-up agricultural businesses with identifying resources for business plans, contacts, feasibility studies and grant searches. The Division also administers the Texas Capital Fund to provide financial assistance to eligible cities and counties, conducts regional economic development workshops and identifies opportunities for diversifying traditional agriculture-based economies. Furthermore, the Division promotes awareness among the agricultural community of state, federal and private economic development and finance programs.

One state level finance program available since its creation in 1987 is the Texas Agricultural

Finance Authority, a public authority within TDA providing financial assistance through eligible lending institutions to credit-worthy individuals, business and to rural communities. The finance programs administered by TAFA may provide guarantees to a lending institution in support of a borrower's loan request, reduce the interest on certain types of loans, purchase an interest in a loan, and provide financing for infrastructure and other purposes that will enhance or maintain economic development in a rural community. TAFA programs assist rural communities and businesses, producers, processors, marketers and entrepreneurs to diversify agricultural production and to create value-added agricultural businesses that will capture a greater share of state, national and international markets.

Texas Risk Management Education Program

The Texas Risk Management Education Program (the "TRME Program") is administered through the Texas Cooperative Extension, part of The Texas A&M University System. The TRME Program is funded by the Texas Legislature and is intended to provide a comprehensive basis for risk management education covering such aspects as sources of risk, strategies for reducing risk and economic and financial analysis of alternative strategies for reducing risk. The TRME Program has two main components: risk management education and financial and risk management ("FARM") assistance. The risk management education component includes both educational materials and the Master Marketer Program. The FARM Assistance involves a strategic decision support system and assistance from risk management specialists.

The Master Marketer Program was started in 1996, combining three successful educational concepts (intensive education, master volunteers and marketing clubs) into a program to help farmers and ranchers understand how to use various risk management strategies. Participants attend a 64-hour intensive marketing education training session to increase their marketing/risk management awareness, knowledge and skills. Once trained, the participants then serve as volunteers to start and lead marketing clubs in their home counties. To date, over 70 marketing clubs statewide have been established.

Overall, more than thirteen workshops have been conducted with over 600 graduates. Reported individual increase averaged $23,900 per producer. Furthermore, the program has been expanded to include a national Marketing Club Teleconference Network and a quarterly Master Marketer newsletter. Since 1998, various curriculum tools have been developed for the public, including a *Risk Management Education Curriculum Guide* and a *Marketing Club Cookbook.* Furthermore, the importance and impact of the program was recognized in the 2002 Farm Bill, encouraging the U. S. Secretary of Agriculture to "expand such programs to provide quality risk management training for farmers across the country."

FARM Assistance is a strategic planning tool designed to provide farmers and ranchers the flexibility to pro forma analyze their operation under risk for the purpose of choosing among risk management tools and business strategies. Basically, it allows producers to do "what ifs." Key advantages of the FARM Assistance program include working one-to-one with clientele, analyzing and reporting on base operation, a database of alternatives and producer data, and the long term benefit to expanded numbers of producers.

FARM Assistance provides valuable services to the program's participants. It allows producers to analyze where their business currently stands, including organizing their financial records. The program then projects where the producers business will be without changes, then compares this to how certain business alternatives will impact their production. This tool allows producers to approach potential lenders with a solid business plan in place. Furthermore, the program allows producers to compare their production to other producers in the area within a certain biogeographic area. Participants in the program represent a diverse base of production areas, including crops, cattle, dairy, poultry, sheep/goats, aqua-culture (catfish and crawfish), pine trees, and miscellaneous products like emus, eco-tourism and hunting.

Once a participant has analyzed their operation, business alternatives are then considered. Various investment decisions are considered, taking a conservative approach to decision making. Options that are considered include purchasing or leasing additional land, renting versus buying additional equipment, analyzing alternative crops or increasing herd size, and projecting the impact of future government payments. Financially, the participants analyze the impact of paying off existing debt, off-farm investments, and refinancing existing debt.

The impact of the FARM Assistance program extends beyond its participants. For those farmers and ranchers who do participate, the program has resulted in benefits of $114 million, or $306,000 per producer. In the near future, the program will utilize its extensive producer information database to monitor the health of Texas production. FARM Assistance can then effectively assess the impact of proposed policy changes for the Legislature as well as help target future educational programs.

The impact of the FARM Assistance program extends beyond its participants. For those farmers and ranchers who do participate the value of strategic decisions made have resulted in a benefit of $114 million, or $306,000 per producer. This number per producer encompasses all benefits, both positive economic decisions made and negative economic decisions avoided over a 10 year projection. In the near future, the program will utilize its extensive producer information database to monitor the health of Texas production. FARM Assistance can then effectively assess the impact of proposed policy changes for the Legislature as well as help target future educational programs

2002 Farm Bill

The Farm Security and Rural Investment Act of 2002 (the "2002 Farm Bill") was signed into law on May 13, 2002. Key provisions support the production of a reliable, safe and affordable food supply, promote stewardship of land and water, facilitate access to American farm products, encourage continued infrastructure development, and ensures continued agricultural research. The bill includes provisions to alter the farm payment program to include counter-cyclical farm income support, expand conservation land retirement programs and emphasize on-farm environmental practices, and restructure rules to create more eligible borrowers for Federal farm credit assistance, among others.

Title V of the 2002 Farm Bill represents the changes made to Federal credit policies. While relatively minor changes were made, significant impact could be seen in beginning farmer and rancher programs. Farm Service Agency ("FSA") lending resources were changed to modify program benefits, target more resources toward beginning farmers and ranchers and increase the opportunity to buy land held by the FSA. Annual funding for FSA loan programs was set at $3.8 billion. Additionally, FSA farm loan eligibility rules were relaxed to make more borrowers eligible for Farm credit assistance, including increases in the percentage that may be lent for down payment loans and extensions in the duration of these loans.

ANALYSIS

Credit Availability for Agricultural Borrowers

Credit availability to agricultural borrowers was outlined in testimony before the committees, highlighted by results from a survey conducted by the Independent Bankers Association of Texas ("IBAT") to its Agriculture and Rural Affairs Committee. According to respondents, issues that have caused concern or reduced credit availability for agricultural loan applicants were ranked as follows:

1. Lack of equity
2. Bad credit/over leveraged
3. Concern regarding federal farm program
4. Adverse weather conditions
5. Poor marketing plan
6. Poor experience with the applicant
7. Applicant's lack of experience

General concerns presented to the committees included those of weather and water, and the impact that various factors may have on crop prices. IBAT recommended to the committees that assurance regarding stability of prices and inputs were needed to provide reasonable credit to stable agricultural producers..

Home Equity Lending Restriction on Agricultural Property

The current Constitutional restriction on home equity lending for agricultural property was discussed in testimony before the two committees as a barrier to credit for Texas farmers and ranchers. As a result, agricultural lenders are currently unable to offer home equity loans to the agricultural sector, regardless of the fact that there are potential borrowers in this market that do have a basis for credit and are able to service their loans. Proponents of allowing agricultural borrowers access to their equity suggest this restriction on the assets of the agricultural citizen puts them on unequal footing compared to their urban counterparts.

In 1997, Texas passed legislation to allow its citizen to access the equity in their homestead for the purposes of a home equity loan. Considerable consumer protections were built into the provisions. One of the limitations included in the bill that passed both the Legislature and a public referendum was a restriction against using agricultural property. This provision was intended to ensure that an individual, in this case a farmer or rancher, would not lose their ability to make a living as a result of foreclosure. According to testimony, many of today's agricultural borrowers are not full-time farmers as they cannot make a living on the 200 acres allowed for an agricultural homestead. Instead, they must rely on off-farm income to service their debt. Thus, according to testimony, the restriction intended to help farmers might actually be hurting their ability to do what is in their best interest.

Additional Considerations

Additional testimony provided on behalf of the Texas Bankers Association focused on several other factors to consider in the agricultural lending market. These included:

1. Consideration of “Aggie bonds”- Tax-free bonds that have been successful in other states, could possibly provide access to capital for the agricultural industry in Texas.

2. Possible establishment of special category of TAFA loans that could be approved by staff for funding - Due to TAFA Board meeting only once a month, some agricultural borrowers experience a 60 to 90 day delay from the time eligible loan application was made at their bank. This delay can potentially lead to loss of business or missed business opportunity, especially to small producers.

3. TDA to promote new products - Urging TDA to seek out data on what Texans consume and how to foster production of these products. The “Go Texan” program was cited as a good example of promoting the purchase of Texas products.

4. Creation of TDA ombudsman - To help lenders and borrowers negotiate and navigate available federal lending programs.

5. Revisions to Uniform Commercial Code in Texas - Potential problem arises when borrowers can release a UCC-1 inappropriately without signature.

RECOMMENDATIONS

1. The Legislature should provide local individuals interested in agricultural value-added processing with assistance in feasibility analysis of potential value-added enterprises via Texas Cooperative Extension resources. A program very similar to the FARM Assistance program could advise value-added entrepreneurs in regard to business and marketing plans for a potential project.

2. The Legislature should consider removing the home equity restriction against agricultural property. By allowing for access to their own assets, agricultural producers may find that the ability to access the equity in their agricultural property to be a helpful part of an overall financing strategy.

PAWNSHOP TRANSACTION DATA METHODS

BACKGROUND

Pawn Transaction Data

According to data collected by the Office of Consumer Credit Commissioner, 8.8 million pawn transactions were conducted in Texas during 2000, with two-thirds of these transactions being from the state's fifteen largest counties. If purchase transactions are also considered, the total increases to around 10 million transactions at all pawnshops statewide. Texas pawnshops serve approximately 4 million customers with the average loan size being about $70. Eight out of ten pawn customers redeem their pledged property.

Under current state law, every pawn transaction conducted in the state must include a pawn ticket. This pawn ticket is given to the pledgor of the goods (the customer) at the time of the transaction and must include the following information:

- name and address of the pawnshop;
- name, address, physical description and driver's license number (or other official license number) of the customer;
- the transaction date;
- an identification and description of the item being pawned (including serial number if available);
- amount of cash or credit given to customer for the item;
- amount of any service fee the customer is being charged;
- the total amount the customer must pay back to reclaim the item;
- the annual percentage rate (APR) of the transaction;
- the maturity date of the transaction, or when the customer must repay the amount to reclaim the item according to the terms agreed to on the pawn ticket; and,
- a statement declaring the customer is not obligated to reclaim the item and the item may be forfeited to the pawn broker 61 days after the maturity date.

This information is then provided to law enforcement agencies as required by Texas Finance Commission administrative rule. The pawnshops may supply this information either electronically or as a paper copy of the pawn ticket. For information received electronically, pawn shops often format the data so that it corresponds with police computer systems. This is done voluntarily at the expense of the pawnshop in coordination with local law enforcement agencies. Data that is provided as a copy of the pawn ticket must be manually input into police computer systems, either by volunteers or law enforcement agent personnel. There are also privately owned companies that collect pawn data and offer law enforcement departments access for a fee. Police departments are thus able to search a database of pawn transaction data that may include more than data from their jurisdiction.

Past Legislative Initiatives

Over the past several legislative sessions, several legislative attempts have been made to require pawnshops to report their transaction data to law enforcement electronically. In the 75th legislative session, H.B. 2338 and companion S.B. 1274 were filed to require pawnshops with the necessary computer equipment to file pawn data electronically. Again in the 76th legislative session, H.B. 2676 and companion S.B. 963 were filed to require electronic data transfer (EDT) and establish a standardization of the EDT process. None of these bills were passed into law.

OCCC Pawn Data Report

Due in part to the unsuccessful attempts to resolve this issue in the previous two session, the 77th Legislature included in H.B. 1763 a provision mandating the Texas Finance Commission and the Department of Information Resources to form a committee including members of the pawnshop, law enforcement and computer industries to study possible standard formats for EDT. The committee was also to consider privacy issues related to EDT to ensure the protection of financial information of the pawn customers. The committee adopted three objectives for the project:

- Define a standard format for electronic data transfer from pawnshops to law enforcement agencies;
- Explore the issues, including privacy, relating to statewide use of the format specified; and,
- Evaluate potential information system solutions to put the standard format into practice.

The project involved a series of public hearings across the state and a survey of representatives from law enforcement agencies, the pawn industry and information system providers. The resulting legislative report entitled "Pawnshop Electronic Data Transfer Report on Recommended Standards and Privacy Issues" was published on June 30, 2002.

ANALYSIS

Electronic Data Transfer

According to testimony, electronic data transfer would improve law enforcement's ability to receive and search pawnshop transaction data. EDT would decrease costs or resources needed for law enforcement to input data into their system. Furthermore, EDT would enable law enforcement to match data on a more comprehensive level with National Crime Information Center (NCIC) and Texas Crime Information Center (TCIC) databases. Benefits to pawnshops include reduced costs and increased revenue associated with being able to move inventory to storeroom floors more quickly. Eventually, if a standard method of data exchange were developed, costs associated with submitting and receiving data on both ends would be reduced.

Public Concerns

Public concerns over EDT primarily regard the privacy of customer information. With financial institutions now being required to notify all customers of their privacy policies and identify how information is being shared, customers are more aware than ever of their privacy rights. Exceptions included in the Gramm-Leach-Bliley Act allow the current sharing of information to law enforcement agencies by pawnshops without requiring privacy notices to be sent. However, concerns remain over how this information is used once it has been delivered.

With increased access to data and the ability to search data more thoroughly, concerns also involve the potential profiling of pawn customers. Pawn industry representatives have expressed concern over the negative impact this could have on their businesses. With the modern day negative connotations associated with the idea of profiling, pawn operators are afraid this would potentially scare off their customers. Since second hand stores and flea markets are unregulated, customers will potentially prefer these businesses over pawnshops due to the ease with which transactions can be made and the lack of concern over data collection. While law enforcement agents acknowledge that there are concerns over the idea of profiling, they insist that the collection and analysis of data is necessary to do their job effectively. The police departments explained that their primary objective is the return of stolen property to its rightful owners.

Statewide Pawn Database

The idea of a statewide database to be used by pawnshops and law enforcement alike was also considered by the Committee. Rather than the current requirement of having pawnshops deliver data to local law enforcement agencies, a centralized database could be established for all Texas pawnshops. Each shop in Texas would report data directly to the database. Law enforcement agencies could then potentially search all pawn data statewide for stolen property.

Currently, several third party providers of electronic data transfer offer large databases of pawn data to law enforcement agents. Typically, the company collects data from pawnshops, inputs it into a searchable database, and charges law enforcement a fee for access. Three such companies currently in business are LeadsOnline, or L.E.A.D.S. (Law Enforcement Automated Database Search), TrackItFindIt (TIFI) and Automated Pawn System.

RECOMMENDATIONS

1. The Committee recommends that those pawnshops that currently store pawnshop data electronically and that possess the necessary technological capacity to transfer transaction data electronically be required to do so to local law enforcement agencies.

2. The Committee recommends that further study be done on the feasibility of regulating businesses such as second hand shops and flea markets that are currently unregulated to ensure that every means possible to reclaim stolen property would be available to law enforcement agents in Texas.

AGENCY OVERSIGHT

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

Over the course of the interim, committee staff regularly attended agency meetings and maintained regular communication with agency heads and staff to remain aware of any important developments during the interim. The following is a summary of pertinent agency matters and possible legislative issues for the 78th Texas Legislature.

Texas Department of Banking

The following is an agency update for the Texas Department of Banking during the 77th legislative interim:

Bank Supervisory Responsibilities

The Texas Banking System appears relatively stable overall given the economic downturn that has persisted since March 2001. However, one bank failed this calendar year, and there are an increasing number of institutions exhibiting signs of increased risk exposure. Some institutions exhibit shrinking net interest margins, increases in loan and lease losses, and downgrades in asset quality. In addition, there has been a marked increase in the numbers of fraudulent activities against financial institutions. Other significant concerns include external accounting and auditing practices, further movement into new financial products and services such as insurance and subprime lending, and changing information technologies (IT) that are recreating delivery and storage systems. Early identification of increased risk exposure is a complex process that involves combining continuous off-site monitoring and analysis with on-site examinations for in-depth reviews of targeted areas. Examiner training needs to be expanded to include more specialization in areas such as capital markets, bank owed life insurance products, subprime lending characteristics, and IT technologies to name a few. In addition, more staff is needed because the size and complexity of our state banks is expanding.

Supervisory Responsibilities under Interstate Branching

The Texas Banking System is predominately a "Host" state banking environment, meaning that a large portion of our citizens are being served by a system of branches of institutions chartered in other states. The Commissioner, however, has some statutory supervisory authority over these institutions that are state-chartered in other states, and is working with "Home" state banking departments to provide for the thorough and efficient regulation of these entities that would include Texas involvement. As the size of the state's population and economy grows, so do the assets and deposits of the financial institutions conducting business within our borders. Working with other state banking departments is a logical and effective means for staying abreast of and having supervisory input into affairs of these institutions that affect the condition of our economy. There is an additional benefit derived by using the Department's supervisory staff. Many of these out-of-state institutions tend to be bigger in size, more complex in structure, and diverse in their activities. Our staff's exposure to these types of operations requires more staff time, but increases our presence and impact on out-of-state banks with branches in Texas.

Compliance with the USA Patriot Act

The USA Patriot Act gives law enforcement authorities an array of new powers to use in the nation's campaign against terrorism. Specifically, Title III is the International Money Laundering Abatement and Anti-Terrorist Financing Act of 2001 and includes numerous provisions for fighting international money laundering and blocking terrorist access to the U.S. financial system. The Department supervises banks, foreign bank agencies, trust companies, and money service businesses that must comply with these laws. Active and aggressive monitoring of illegal money laundering activities is not merely an option; it is a necessity to help protect the quality of life for all of our citizens. The Department is committed to doing its part through the supervision of these activities in our state-chartered and licensed entities. In some instances, the Department is also working with other state and federal law enforcement and regulatory agencies in this area. These duties are an addition to existing law compliance duties of examiners and take extra time.

Internet Bill Paying Services

The proliferation of bill paying services through the Internet includes numerous electronic methods for citizens and businesses to conduct financial transactions. Bill paying services such as "CheckFree," "PayTrust," and "Yahoo! Bill Pay," along with payment services such as "PayPal," are non-bank entities that for the most part are unregulated. These companies hold citizens' funds and are not FDIC insured depositories. Our citizens and businesses need protection from unscrupulous or mismanaged vendors that handle their financial transactions. Such licensing, bonding, and supervision will involve cooperation with other state and federal agencies. In addition, our examination staff needs training in these activities.

Additional Legislative Items

Regarding possible Legislative changes, the Department may propose changes to Chapter 153 of the Texas Finance Code dealing with currency exchange licensing requirements. In addition, proposed changes to private child support enforcement agency laws, Chapter 396 of the Texas Finance Code, could include: contract disclosure requirements; greater enforcement authority for the Department; and clearer definition of a covered party for filing a complaint.

Office of Consumer Credit Commissioner

The following is an agency update for the Office of Consumer Credit Commissioner during the 77th legislative interim:

Mortgage Lending Study

Signaling increased attention to the practice of predatory lending in Texas, the Legislature directed the agency to conduct a study of mortgage lending with an emphasis on identifying possible predatory or discriminatory lending patterns or practices. The finance commission agencies have been working with the Texas Legislative Council to complete the study.

High-Cost Home Loan Notice

The Legislature mandated that lenders provide a written notice to a borrower who applies for a home loan with an interest rate of 12% or greater. The written notice, produced in both English and Spanish, warns the borrower that the loan may be a high-cost loan. The notice requirement is a big step for Texas in addressing potential predatory lending practices. It encourages consumers to be more knowledgeable about the lending process, to contact their local housing counselor, and to shop lenders for the lowest rate. A special toll-free consumer number, (866) 303-INFO (4636), establishes a new point of access to the regulatory oversight bodies. The OCCC's complaint resolution section handles calls to this number and maintains complaint and inquiry volume data for all three Finance Commission of Texas agencies.

Plain Language Contracts

In its review of the OCCC, the Sunset Advisory Commission noted that loan contract language was often confusing and difficult for consumers to understand. The report concluded that the lack of standardized, easy-to-read contracts puts consumers at risk of making poor financial decisions and recommended that the OCCC require its licensees to use consumer loan contracts written in plain language. As a result, the OCCC is drafting plain language model contracts for all the creditors it regulates, working with a committee of attorneys. The agency will prepare Spanish versions of all the model contracts as well. Whenever a regulated loan transaction is conducted primarily in Spanish, a lender already is required to present the borrower with a Spanish-language disclosure; however, the new documents will increase substantially the information available to Spanish-speaking borrowers in the borrower's own language. By making the lending process more understandable, these documents will empower Spanish-speaking Texans with knowledge, allowing them greater access to credit. The model contracts, whether in English or Spanish, will make the terminology consistent across product offerings, simplifying the credit process for everyone. These new steps will make it easier for all Texans to understand credit contracts.

Motor Vehicle Sales Finance

The OCCC's Sunset bill increased the agency's authority over motor vehicle sales financing activities in Texas. The new authority extends the OCCC's regulatory activities to include licensing and regular examination of these creditors. The provisions extend to any seller of a motor vehicle on a retail installment contract, regardless of whether the seller holds the note or assigns the paper. Any finance company that is assigned a motor vehicle retail installment contract is also subject to licensing. The agency is focused on the issues surrounding this significant and historic development in the agency's regulatory activities. Increasing the agency's authority beyond registration to include licensing and examination will provide sufficient regulatory tools to better address complaints. With this expanded authority, the OCCC can better protect consumers and ensure motor vehicle sales finance companies comply with credit laws. The OCCC believes the regulation will help strengthen the industry and boost consumer confidence.

Electronic Data Transfer Project

The Legislature required the Finance Commission of Texas-the OCCC serves as the Finance Commission designee- and the Department of Information Resources (DIR) to prepare a report devising one or more standard formats for pawnbrokers to electronically provide data to law enforcement agencies. The report was issued on June 30, 2002, and can be found online at www.occc.state.tx.us/pages/Credit_Industry/Pawn/edt.html.

Texas Credit Union Department

The following is an agency update for the Texas Credit Union Department during the 77th legislative interim:

Currently, the department is charged with the regulation and supervision of 247 credit unions with combined total assets exceeding $15 billion. In simply terms that means that during the last six years, when the Department averaged a turnover ratio of 32% in its examination staff, total assets in credit unions increased 105 percent.

While we are making progress toward appropriate staffing levels, it still takes time for an examiner to gain the skills required to become fully productive. Today we have 16 examiners on staff. Of that total, 4 have less than 12 months of experience and another 8 examiners have anywhere from 13 to 40 months of experience. Therefore, 75% of our staff has less experience than we believe necessary to deal with the complexities and sophistication of many of our credit unions. Despite this obstacle, however, we are managing to stay reasonably current with our required examination schedule.

In addition, as provided by Section 15.405, Finance Code, the Credit Union Commission spent considerable time this summer reviewing the Texas Credit Union Act to determine if it would authorize the Department to make any legislative recommendations to the Legislature. Although the Commission identified a number of potential amendments, we have been advised that the Industry has developed a legislative agenda that includes very similar recommendations. Accordingly, at this time, it is not anticipated that the Department will make any formal legislative recommendations for consideration during the next session.

Texas Public Finance Authority

The following is an agency update for the Texas Public Finance Authority during the 77th legislative interim:

Financing

- Currently preparing to issue approximately $75,000,000 of General Obligation Bonds to finance projects authorized by HB3064/HJR97 (Proposition 8) at an interest rate of approximately 4.25%, and will monitor interest rates to attempt to issue approximately $75,000,000 General Obligation Refunding Bonds and $50,000,000 Building Revenue Refunding Bonds to lower the interest rate on outstanding debt.

- Refinanced variable rate General Obligation Commercial Paper ("CP") to fixed rate bonds in February 2002. Converted all outstanding GO CP, totaling $387,700,000, to a 4.4% fixed interest rate. This refunding reduced TPFA's GO debt service budget by $29,556,000 in FY02-03, and $23,385,000 in FY 03-04.

- Established two commercial paper programs to fund projects authorized by HB3064/HJR97 (Proposition 8) and SB 1296/SJR37 (Proposition 2). Updating the commercial paper program used to finance the Master Lease Purchase Program. Commercial paper rates have averaged below 2% for the past 12 months.

- Received 19 requests for financings to date. Completed 9 transactions, including 2 master lease financings. Currently working on 4 transactions and anticipate 3 more requests for financings in FY 03.

- Provided financing to 25 agencies through the Master Lease Program. Financed 103 leases with a value of $38.5 million. Effective financing rate was below 2%.

- Conducted meetings with representatives from various charter schools, Texas Education Agency, bond attorneys, investment banks, and other states to develop a financing mechanism for charter schools as authorized by HB 6.

- Met with representatives from Texas Department of Insurance and the Joint Underwriting Association to discuss implementation of a financing mechanism for Nursing Home Liability Insurance as authorized by SB 1839.

Agency Operations

- Implemented HB 2153 to increase TPFA Board to 7 members and make other technical amendments to TPFA's organic law.

- Completed FY 02 under budget (UB); carried forward approximately $38,800, part of which will fund an accounting system interface.

- Obtained approval to acquire and implement an accounting system to provide direct interface with USAS and automate budget tracking.

- Hired a budget analyst and a financial analyst to support workload created by authorization of additional debt.

- Continue to enhance agency's website and use of electronic and on-line technology in daily operations.

Texas Bond Review Board

The following is an agency update for the Texas Bond Review Board during the 77th legislative interim:

- BRB staff developed a new website which now features several searchable databases for interested parties.
- BRB staff, in conjunction with the Higher Education Coordinating Board, developed and created a new online Capital Expenditures Plan application process. The online process is tied directly to the BRB's database and is now on the web in a researchable format.

- Legislatively, the BRB staff spent a significant amount of time working with various Interim House and Senate committees including the following:

- Interim Committee on Bond Use and Debt Financing

- Interim Committee on State Bond Revenues

- Interim Committee on the Private Activity Bond Allocation Program

- Senate Committee on Veterans Affairs and Military Installations

- Developed new debt issuer guidelines and made recommendations for debt consolidation per the requirements HB 2190.

- BRB staff will propose statutory fee increases to the Private Activity Bond Allocation Program. Fees associated with this program have not increased since the inception of the program.

- BRB staff will also be working on legislative changes designed to clarify statutory language regarding the Private Activity Bond Allocation Program.

Texas Savings and Loan Department

The following is an agency update for the Texas Savings and Loan Department during the 77th legislative interim and for the upcoming 78 legislative session:

Thrift Industry

The state thrift system is currently comprised of 24 state chartered savings institutions with $14.0 billion in total assets. This is an increase of $2.3 billion in regulated assets over the past twelve months with one less institution. Additionally, one *de novo* charter has been approved pending full subscription of its capital requirement and is expected to open by year end.

All state chartered thrifts are "well capitalized" and have equity capital greater than 7.0%. All except one institution in the state thrift system was profitable in calendar 2001 and 88% continued profitability in the first half of 2002. While some deterioration in asset quality has occurred over the last year, the majority of the state thrift system is being operated in a safe and sound manner with 92% of the institutions with 99% of the total assets in the state system rated in the two highest regulatory categories for depository financial institutions.

Economic Considerations

The current economic downturn remains a challenge, supporting a continued need for expanded examination, supervision and enforcement activity in the state-chartered thrift industry.

Federal Banking Regulatory Agencies Downsizing

Federal budget constraints have recently resulted in the consolidation of a number of regional offices by the FDIC and the OTS, and the announcement of up to 20% reduction in staffing by both federal agencies. While the Department has been informed by both agencies that these changes will not effect our joint regulation of the state chartered thrift industry and related financial institution holding companies, the ultimate impact is not certain.

Federal Thrift Initiatives

The merger of the FDIC's separate bank and thrift industry deposit insurance funds has again garnered a great deal of attention in Washington. A recent conversion of a major mid-west thrift institution to a national bank charter and rumors of other possible conversions away from the federal thrift charter have also raised questions about whether Congress should consider merging the Office of Thrift Supervision, which regulates federal thrifts, with the Office of the Comptroller of the Currency, which regulates national banks.

The reasons for maintaining separate insurance funds have largely disappeared and an OTS / OCC merger would likely be linked to a merger of the insurance funds. If an OTS / OCC merger were enacted, many of the 24 remaining federal savings institutions in Texas (with combined assets of more than $40 billion) would likely convert to the state thrift system. It is unlikely that all federal savings institutions would migrate to the state system, but the potential for conversion of up to twenty federal thrifts to the state system under this scenario is reasonably high.

Out-of-State Travel Limitation

Maintaining an ongoing program of training for thrift examiners is essential to a safe and sound industry and the training needs for mortgage broker inspectors is critically important to effective regulation of the mortgage industry. To meet these training needs, the Department and its counterparts in other states rely heavily on training conducted cooperatively among the states and/or federal agencies. Out-of-state travel limitations in the General Appropriations Act are based on the Department's actual out-of-state travel expenses for FY 2000 of $6,736, severely limiting our ability to participate in these important programs. In February 2002, we submitted a request to the Legislative Budget Board to increase the amount of this limitation for FY 2002 and 2003 to more closely match current training needs, specifically considering the training needs resulting from the addition of six inspectors to the new mortgage broker inspection program.

Texas Savings and Loan Department Legislative Issues for the Session

The following are issues that may be presented to the 78th Legislature for its consideration by the Department, industry representatives and/or others.

Revisions to Mortgage Broker Licensing Act

For an overview of the Mortgage Broker Licensing Act and pertinent recommendations, please see Charge #1 of this report beginning on page four.

Limited Revisions to State Savings Bank Act

The Department would like to conform the Savings Bank parity provisions and merger/conversion provisions to those applicable to other types of state depository institutions. This would include specific authority for conversions to and from credit union charters similar to the authority in the Banking Code.

Usury Issues Related to Commercial Loans

The primary owner of Beal Bank, SSB, a state chartered savings bank, has been aggressively waging a letter writing campaign to members of the Legislature and others, to obtain modification or repeal usury provisions in the Texas Constitution as they relate to loans over $3 million to a commercial enterprise. He argues that an out-of-state lender can make loans to Texas companies at negotiated interest rates, or with profit participation, beneficial to both the borrower and lender, while Texas lenders making a loan of the same amount, terms and conditions would be subject to substantial limitation and risk significant penalty if it is was determined usurious. Advocates allege this situation places Texas lenders at an unfair advantage in the market and limits competitive credit alternatives available to these more sophisticated commercial borrowers.