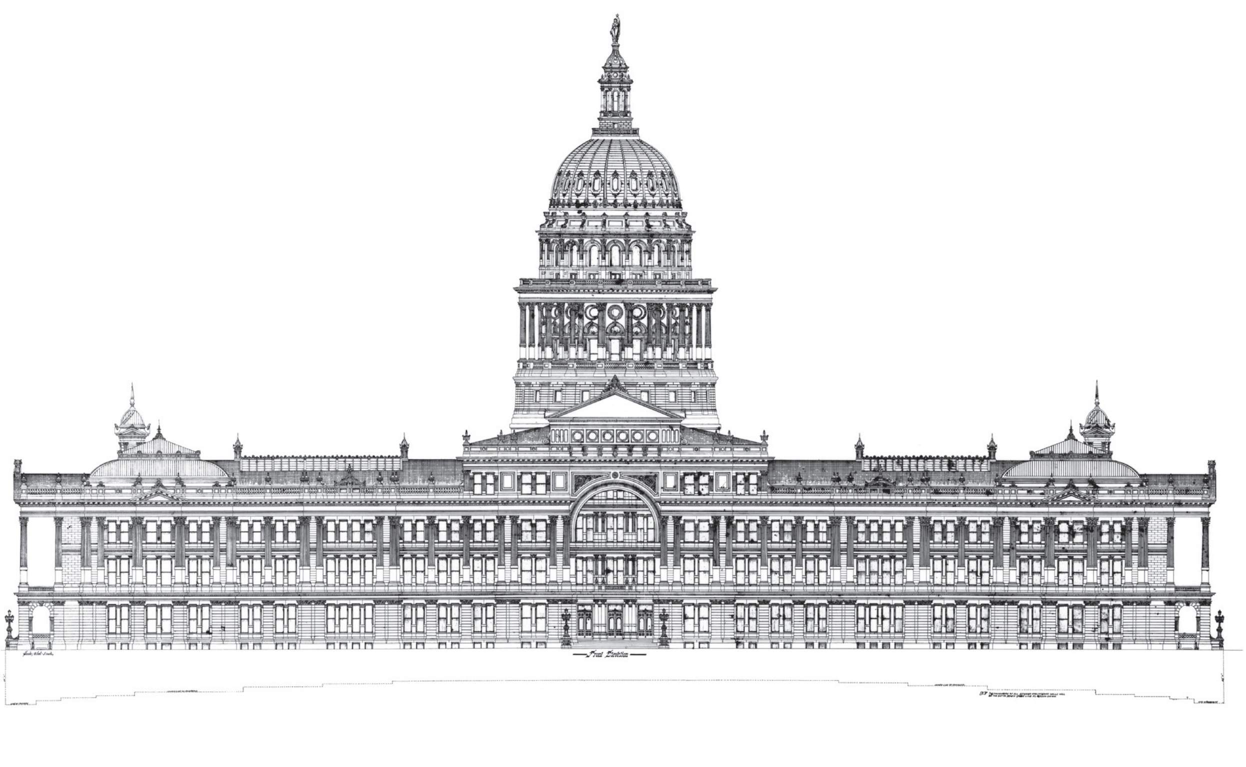
Interim Report
to the
82nd Texas Legislature

House Committee on

Pensions, Investments & Financial Services

January 2011



HOUSE COMMITTEE ON PENSIONS, INVESTMENTS AND FINANCIAL SERVICES
TEXAS HOUSE OF REPRESENTATIVES
INTERIM REPORT 2010

A REPORT TO THE
HOUSE OF REPRESENTATIVES
82ND TEXAS LEGISLATURE

VICKI TRUITT
CHAIRMAN

COMMITTEE CLERK
MERITA ZOGA

Committee On
Pensions, Investments, and Financial Services

January 10, 2011

Vicki Truitt
Chairman

P.O. Box 2910
Austin, Texas 78768-2910

The Honorable Joe Straus
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 House Committee on Pensions, Investments and Financial Services of the Eighty-First Legislature hereby submits its interim report including recommendations and drafted legislation for consideration by the Eighty-Second Legislature.

Respectfully submitted,

Vicki Truitt (Chair)

Rafael Anchia (Vice Chair)

Charles "Doc" Anderson

Dan Flynn

Ana Hernandez Luna

Chuck Hopson

Tan Parker

Marc Veasey

Beverly Woolley

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INTRODUCTION

At the beginning of the 81st Legislature, the Honorable Joe Straus, Speaker of the Texas House of Representatives, appointed nine members to the House Committee on Pensions, Investments, and Financial Services. The committee membership included the following: Vicki Truitt, Chair; Rafael Anchia, Vice Chair; Charles "Doc" Anderson; Dan Flynn; Ana E. Hernandez; Chuck Hopson; Tan Parker; Marc Veasey; and Beverly Woolley.

During the interim the committee was assigned five charges by the Speaker:

1. Study the impact of the debt relief industry, including debt management and debt settlement organizations, and the implications of regulating that industry.

2. Examine Texas school districts' administration of their employees' optional retirement investments.

3. Review and study the overall history, goals, and performances of the state's economic development program, Certified Capital Company. Identify and recommend changes as necessary.

4. Examine the performance and accountability of the Texas public pension funds and make recommendations as needed.

5. Monitor the agencies and programs under the committee's jurisdiction.

CHARGE #1: STUDY THE IMPACT OF THE DEBT RELIEF INDUSTRY, INCLUDING DEBT MANAGEMENT AND DEBT SETTLEMENT ORGANIZATIONS, AND THE IMPLICATIONS OF REGULATING THAT INDUSTRY.

In response to this charge, the Committee held a public hearing on July 8, 2010. The Committee heard both invited and public testimony.

BACKGROUND

The debt relief industry originated in the early twentieth century through debt pooling, the controlling and distributing of client funds to their creditors in a manner that did not require the discretion and action of the client. This first generation of debt relief providers communicated with a consumer's creditor to negotiate a partial payment to satisfy the consumer's debt. If an agreement was reached, the debt relief providers would profit in heavy fees and creditors would receive a smaller payment than expected. In the 1950s, more than half of state legislatures outlawed this industry.[1] Texas prohibited debt pooling in 1965, but amended the statute in 1967 to allow debt pooling by nonprofit organizations.

Fast-forward to the 21st century, the Texas Senate Committee on Business & Commerce conducted an interim study on the credit counseling and debt management industry in 2004. Prior to the 79th Legislative Session, statutes pertaining to debt relief remained untouched since 1967, but the business of debt relief was becoming one of the nation's fastest growing and unregulated industries. The Committee recommended that the Legislature modernize laws to enhance the regulatory structure and promulgate uniform standards of consumer protection in order to protect consumers from misleading, deceptive, and harmful practices. In 2005, the 79th Texas Legislature enacted SB 1112 to regulate part of the industry requiring credit counselors and debt management organizations to register with the Office of the Consumer Credit Commissioner and to maintain certain standards to renew registrations on an annual basis. However, the debt relief industry continued to evolve as citizens incurred increasing amounts of debt. Nationwide in 2010, the outstanding consumer credit reached $2.4 trillion.[2]

The debt relief industry has three different business models designed to assist consumers with debt. The first form of debt relief -- credit counseling -- offers services primarily by nonprofit

1 National Conference of Commissioners on Uniform State Laws. *Uniform Debt Management Services Act, Prefatory Note*. 2005.

2 Pettijohn, Leslie. Statement to the House Committee on Pensions, Investments, and Financial Services. Hearing, July 8, 2010. Available at: http://www.house.state.tx.us/committees/broadcasts.php?session=81&committeeCode=395

agencies (although some for-profit credit counseling entities operate in Texas) that aid consumers in repaying their debt through budgeting and financial advice. The second form of debt relief service is the debt management service provider (DMSP) which is an organization, nonprofit or for-profit, that establishes a plan for a consumer to pay one consolidated periodic payment to cover all debts in the program. The DMSP receives consolidated monthly payments from the consumer, holds the money in trust, and distributes monthly payments to the consumer's creditors. The DMSP often obtains reductions in finance charges from the creditors, but the consumer pays the full principal balance owed. The DMSP usually receives a monthly fee from the consumer and may receive a payment (known as "fair-share") from the creditors. The third model is a debt settlement company (DSC). DSCs are for-profit entities that offer their customers a plan to resolve unsecured debt for less than the amount owed. DSCs attempt to reach an agreement with the consumers' creditors for a lump sum payment in settlement of the consumers' debts. The plan requires that the consumer stop paying their creditors while the DSC negotiates with creditors to discharge consumer's debt for a percentage of the amount owed. This model of the industry is currently not regulated under Texas law.

Many credit counseling, debt management, and debt settlement companies offer legitimate services to consumers. Due to misleading practices by some debt settlement companies, SB 2233 was filed during the 81st Texas Legislative Session to require debt settlement services to register and to provide information to the Office of Consumer Credit Commissioner regarding consumer disclosures. SB 2233 was not enacted, and this Committee was tasked with studying the impact of the debt relief industry.

FINDINGS

As a result of state legislation passed in 2005 (SB 1112) debt management service providers are regulated under Texas Finance Code, Chapter 394. There are 58 DMSPs registered in Texas, 53 non-profit companies and five for-profit. Under statute, DMSPs are required to register with the Office of Consumer Credit Commissioner and work under rules adopted by the Finance Commission. The Finance Commission sets fee limitations, disclosure requirements, as well as consumer counseling and education requirements. The Office of Consumer Credit Commissioner is enabled with enforcement authority over DMSPs, including cease and desist orders, administrative penalties, restitution, suspension, or license revocation. SB 1112 also established that a provider must use a trust account for the management of all money paid by or on behalf of a consumer for disbursement to the consumer's creditor. This requirement allowed debt settlement companies to remain unregulated in Texas, as DSCs do not control consumer funds.

The Texas Attorney General's office has received over 450 complaints from debt relief clients, mainly debt settlement clients, over the last two years.[3] Allegations were categorized into three main concerns: high upfront fees, misrepresentation of services offered, and risks or implications not disclosed to the consumer. The debt settlement program requires a cessation of payments that technically put consumers in default of their contractual obligations with creditors, thus triggering aggressive debt collection efforts and even lawsuits by some creditors. As of July 2010, the Office of Attorney General filed six lawsuits under the Deceptive Trade Practices Act, with more investigations pending that could not be discussed at the time of the interim hearing. In these instances, debt settlement companies have been charged with the failure to negotiate settlements with creditors, charging customers for services that were not delivered, and misstating the effects of entering into a debt settlement program. Additionally, concerns have been raised that certain disreputable firms in the industry are not disclosing the increased risk of lawsuits, decreased consumers credit scores, debt forgiveness-related tax liabilities, increased collection efforts, interest, and late payment fees.

Nationwide, during the 2009 legislative session, 25 states introduced legislation regarding credit counseling, debt management and/or debt settlement. In the 2010 legislative period, 23 states introduced legislation and Illinois, Indiana, Kansas, Kentucky, Maryland, Minnesota, Mississippi and Virginia have enacted legislation this year.[4] Most legislation requires debt settlement companies to: a) register as a consumer debt management service provider in that state and provide detailed information concerning the services they offer; b) provide disclosures regarding

3 Dyer, Jay. Statement to the House Committee on Pensions, Investments, and Financial Services. Hearing, July 8, 2010. Available at: http://www.house.state.tx.us/committees/broadcasts.php?session=81&committeeCode=395

4 Morton, Heather. "Credit Counseling, Debt Management and Debt Settlement 2009 Legislation". National Conference of State Legislatures. September 8, 2010. <<http://www.ncsl.org/IssuesResearch/BankingInsuranceFinancialServices/CreditCounselingDebtManagementandSettlement/tabid/18564/Default.aspx?tabid=18564 >

fees; and c) explain the risks and benefits of contracting with a debt relief service provider. Some states have regulated the industry further with fee caps, security bonds, and strict accounting requirements. A number of studies confirmed the need for regulation including the United States Government Accountability Office (GAO). The GAO conducted an investigation in 2010 and found that 17 out of 20 debt settlement companies investigated engaged in fraudulent, abusive, and deceptive practices to consumers.[5]

Forty states and one U.S. territory signed onto the National Association of Attorneys General letter to the Federal Trade Commission (FTC) regarding Proposed Rulemaking to amend the FTC's Telemarketing Sales Rule, 16 C.F.R. Part 310 to address the sale of debt relief services. At least 21 states brought forth 128 enforcement actions against debt relief companies. Nationwide, charges brought against unscrupulous DSCs included:

- unsubstantiated claims of consumer savings;
- deceptive representations about the length of time necessary to complete a debt relief program;
- failing to adequately inform consumers they will be subject to continued collection efforts, including lawsuits and increases to account balances due to extended nonpayment;
- deceptive disparagement of consumer credit counseling;
- deceptive disparagement of bankruptcy as an alternative for debtors;
- collection of substantial upfront fees so that a debt relief company gains even if it fails to perform;
- lack of transparency and information for consumers as to payment of fees, status of accounts, and communications with creditors;
- significant delays in active negotiation or engagement with creditors;

- savings claims and settlement fees based, not on the original balance, but on the inflated amount due, including late fees and default rates of interest at the time of settlement.[6]

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5 U.S. Government Accountability Office. *Debt Settlement. Fraudulent, Abusive, and Deceptive Practices Pose Risk to Consumers.* (GAO-10-593T). April 2010. Available at: http://www.gao.gov/new.items/d10593t.pdf

6 National Association of Attorneys General. Letter to Federal Trade Commission. *Re: Telemarketing Sales Rule -*

Subsequent to the interim hearing held on July 8, 2010, the FTC issued their Final Rule to which debt relief services (including debt settlement companies) are subjected. These rules went into effect on October 27, 2010. It defines "debt relief service" to include "any service or program represented, directly or by implication, to renegotiate, settle, or in any way alter the terms of payment or other terms of the debt between a person and one or more unsecured creditors or debt collectors, including but not limited to, a reduction in the balance, interest rate, or fees owned by a person to an unsecured creditor or debt collector."[7] Specifically, the Rule provides:

1. **Scope**: The Final Rule applies to for-profit companies that sell debt relief services over the telephone, including credit counseling, debt settlement, and debt negotiation services that aim to reduce credit card or other unsecured debt. The Rule applies to inbound and outbound telemarketing calls.
2. **Advance fee ban**: Debt relief companies may no longer charge a fee before they settle or reduce a customer's debt. To collect a fee, the company must first have reached a successful result for the consumer, must have an agreement between the customer and creditor, and the customer must have made one payment to the creditor. If the customer ahs multiple debts, the company can collect a pro-rate share of its total fee once it completes each of these steps for each debt.
3. **Disclosures**: Debt relief companies will be required to make four specific disclosures to consumers, including:
    a. how long it will take for consumers to see results,
    b. how much it will cost,
    c. the negative consequences that could result from using debt relief services, and
    d. key information about dedicated accounts if they choose to require them.
4. **Misrepresentations**: Debt relief companies will be prohibited from making misrepresentations, including specific misrepresentations commonly made in this area.
5. **Dedicated Bank Account for Fees and Savings**: As part of the advance fee ban, the Rule specifies that debt relief companies may require that consumers set aside their fees

Debt Relief Amendments Matter No. R41100123. Oct. 2009. Available at: http://www.naag.org/assets/files/pdf/signons/20091023.FTC_Debt_Relief_Final.pdf

7 16 C.F.R. § 310.2(m) (definition of "debt relief service")

and savings for payment to creditors in a "dedicated account" if the following five conditions are met:

   a. the dedicated account is maintained at an insured financial institution,
   b. the consumer owns the funds (including any interest accrued),
   c. the consumer can withdraw the funds at any time without penalty,
   d. the provider does not own or control or have any affiliation with the company administering the account, and
   e. the provider does not exchange any referral fees with the company administering the account.

6. **Enforcement**: State Attorneys General have authority to enforce the Rule upon notice to the FTC. This is in addition to States' general deceptive trade practice laws.[8]

As a result, the Final Rule applies to for-profit debt relief services, including credit counseling, debt settlement, and debt negotiation services. The Final Rule does not cover nonprofit firms, unless companies falsely claim nonprofit status. All debt relief companies are subject to the new FTC rules and State Attorneys General have authority to enforce the Rule in addition to States' general deceptive trade practice laws.

The U.S. Congress also took action with the passage of H.R. 4173, the "Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010". The Act creates a new, independent bureau within the Federal Reserve System, the Bureau of Consumer Financial Protection (CFPB). The CFPB is vested with rulemaking, supervisory and enforcement authority over a wide range of consumer financial products and services, including financial advisory services such as credit counseling, debt management, and debt settlement. Effective July 21, 2011, the Consumer Financial Protection Bureau will take over enforcement of federal consumer protection laws and have full authority to prescribe rules or issue orders pursuant to any federal consumer financial law. To the extent that a state law affords greater protections to consumers, such state law will not be deemed inconsistent and is therefore not preempted.

8 "Debt Relief and Debt Settlement- An Executive Summary". Texas Office of the Attorney General. December 2010.

RECOMMENDATIONS

- Debt relief plans are options for consumers who cannot otherwise afford or manage unsecured debt but cannot or do not wish to file for bankruptcy. The Texas Legislature must determine a balance between consumer protection and industry regulation in order to create an environment where legitimate debt relief companies could compete to provide services desired by consumers. The Committee recommends that Texas establish a method by which debt settlement companies may register with the Office of Consumer Credit Commissioner and allow free market forces to facilitate the better companies' serving the public need.

CHARGE #2: EXAMINE TEXAS SCHOOL DISTRICTS' ADMINISTRATION OF THEIR EMPLOYEES' OPTIONAL RETIREMENT INVESTMENTS.

In response to this charge, the Committee held a public hearing on June 22, 2010. The Committee heard both invited and public testimony.

BACKGROUND

The 77th Legislature passed SB 273 in 2001 to set guidelines for certification by companies who offer voluntary 403(b) investment options through salary reduction agreements between public school employees and their local employer. It required the Teacher Retirement System to compile a list of companies from which school employees can choose when they wish to use a salary reduction agreement to make their investments. SB 273 set out rules on how 403(b) products could be marketed to end anti-competitive marketing practices of some of these 403(b) vendors.

In November 2004, the United States Department of the Treasury and the Internal Revenue Service proposed regulations that would increase the responsibility of public school districts and other employers for retirement plans offered under the Internal Revenue Code. During the 80th Legislative session, House Bill 2341 was passed into law to enable school districts to comply with changes in the Internal Revenue Code without violating Texas Statutes. However, some industry participants expressed fears that some 403(b) vendors would take advantage of the change in federal regulations and deploy anti-competitive marketing practices again in Texas school districts. With this change in IRS regulations, the practice of using free or reduced-priced third party administration services (TPAs) to limit competition for 403(b) products among teachers began to take place in some parts of the state.

Some school districts were giving preferential treatment to various 403(b) vendors in exchange for benefits from TPA's, the TPA's 403(b) affiliates, or their agents. In these instances a company would approach a school district with significant concerns about the district's compliance with the new 403(b) rules. The company would offer to administer 403(b) TPA reporting or compliance for “free or at a reduced price.” The district need only to agree to let the company handle compliance for all of the various 403(b) vendors, and in many cases, make them the sole 457(b) provider. Through this relationship, some TPAs de-listed many of their competitors off the payroll and attempted to push their own 403(b) product, at the expense of existing ones, despite clear prohibitions in the law that a school may not accept any benefit from a company offering a qualified investment product, such as a 403(b) plan. This deceptive practice hurt teachers who may have paid fees and bought retirement plans unnecessarily, as well as other third-party agents who could not compete with large agencies offering their services as “loss-leaders.”

Business models that allow companies that are contracted with school districts to be their third party administrator as well as a vendor, or affiliated vendor, result in an inherent conflict of interest. This does not provide sufficient protections to ensure that the information given to or the products offered to school teachers are objective and in their best interest. As a result HB 3480 was passed during the 81st Legislative session to stop the emerging practice of using free or reduced-priced third party administration services as vehicles to limit competition for 403(b) products.

FINDINGS

HB 3480 (81R) provided safeguards to protect teachers' investments by requiring firms to register with, be licensed by, or regulated by the Texas Department of Insurance (TDI), the State Securities Board (SSB), and the Texas Department of Banking (TDB), respectively, and to require that their products are approved by the Teacher Retirement System of Texas (TRS). This ensures that all service providers and their products are appropriately vetted before a company enters into a contract with a school district. The bill also allows TDI, SSB, and TDB to investigate any complaint received from TRS regarding this issue.

TRS has no direct authority over 403(b) program, but HB 3480 required school districts that enter into salary reduction agreements for 403(b) products to only contract with companies that are certified by TRS. Under the program TRS, by rule, sets fee limits and maintains a website with registered products and fee details so all members can access over 9,000 different listings. Currently there are 86 certified companies and 266 products with 9,605 investment options registered.

TDI and the SSB now register TPAs, resolve complaints, and have enforcement capabilities they didn't have prior to the legislation.

> "From the perspective of the SSB, it appears that HB 3480 and changes that have been made in IRS regulations have addressed the two areas we had problems with previously in enforcement… We haven't had any complaints since the past legislation or implementation."[9]

The State of Texas is on the forefront of protecting our teachers. Prior to SB 273 in 2001, there were 5 class-action lawsuits brought by Texas teachers for abuses addressed in SB 273. Teachers settled for over $40 million. HB 3480 continues those protections and specifies that a company can either sell a 403(b) product, or administer the 403(b) plan in a district, not both within the same school district.

RECOMMENDATIONS

- The Legislature, agencies, and school districts need to continue to monitor any future changes in IRS regulations and behavior of the market. No additional legislation indicated at this time.

9 Morgan, John. Statement to the House Committee on Pensions, Investments, and Financial Services. Hearing, June 22, 2010. Available at: http://www.house.state.tx.us/committees/broadcasts.php?session=81&committeeCode=395

CHARGE #3: REVIEW AND STUDY THE OVERALL HISTORY, GOALS, AND PERFORMANCES OF THE STATE'S ECONOMIC DEVELOPMENT PROGRAM, CERTIFIED CAPITAL COMPANY. IDENTIFY AND RECOMMEND CHANGES AS NECESSARY.

In response to this charge, the Committee held a public hearing on June 22, 2010. The Committee heard both invited and public testimony.

BACKGROUND

The Certified Capital Company (CAPCO) is a government-sponsored, private venture capital company formed to provide growth capital to small businesses in states to stimulate job growth and economic development in the state. Approximately 20% of states across the country have implemented CAPCO programs to encourage the growth of businesses in their jurisdictions.[10] The program in Texas was created in 2001 under SB 601 but not authorized until 2005 under Program One. In 2007 the Legislature approved HB 1741 which authorized CAPCO Program Two in order to allow an additional $200 million in investment credits. It also added low-income community business as an investment option for CAPCOs in Program One and Program Two.

The goal of CAPCO programs is to strengthen local economies by stimulating flow of capital to early-stage businesses that are unable to access traditional financing, in order to create job opportunities and increase tax revenue. Early-stage businesses are defined under statute as those entities that meet at least one of three criteria: revenues must be under $2 million during the previous fiscal year; the business must not be more than two years old; or the business must be involved in the development of a new product or service.

The Comptroller's office and the Texas Treasury Safekeeping Trust Company are responsible for administering the program. The CAPCO program is funded by "Insurance Premium Tax Credits" rather than state general revenue. Insurance companies subject to premium taxes invest money into CAPCO's. These insurance companies receive a note and in turn, are repaid via the tax credits earned by the CAPCOs for the amount of that investment. The insurance company will receive its principal back in the form of tax credits in a dollar for dollar reduction in premium taxes the insurance company would have owed the state.

10 "What Are CAPCO Programs?" Retrieved from: http://www.capcofacts.com/what-is-capco.html.

In Texas, only insurers who are required to pay a premium tax on insurance policies issued in Texas are eligible to invest in CAPCO-issued debt instruments. Each CAPCO must have two principals or employees with investment management experience in the venture capital industry. CAPCOs compete for available funds from a limited pool of insurance company investors. Unlike typical venture capital funds, the rules governing the types of businesses and the structures of CAPCO investments are targeted and restrictive. The CAPCO legislation was designed to support strategically located and early-stage businesses, businesses that have at least 80 percent of their employees (either head count or payroll amount) located in Texas, and entrepreneurs who are developing new products or services and are in need of expansion capital. Under statute, the CAPCO must invest 30 percent of its certified capital within three years of funding and 50 percent by the end of the fifth year. It must invest 50 percent of its capital in operations defined as early-stage businesses and 30 percent into businesses with principal business operations in strategic investment areas (SIA). The State Comptroller makes an annual determination of what constitutes an SIA, based on unemployment and per-capita income and also including locations identified as federal urban empowerment zones. The SIA designation is a state economic development tool that permits companies located in these areas to take credits against state franchise taxes for research activities, job creation, and investment in machinery and equipment.

A CAPCO company must invest in businesses:

- already headquartered in Texas, or businesses that intend to do so within 90 days of a CAPCO investment;
- with no more than 100 employees and paying 80% of payroll to employees in Texas;
- primarily engaged in manufacturing, processing, or assembling products, conducting research and development, or providing services;
- that are not primarily (> 20% of revenue) engaged in retail sales, real estate development, financial services including insurance, banking, or lending; professional services provided by accountants, attorneys, or physicians.[11]

11 Ballard, Paul. Statement to the House Committee on Pensions, Investments, and Financial Services. Hearing, June 22, 2010. Available at: http://www.house.state.tx.us/committees/broadcasts.php?session=81&committeeCode=395

FINDINGS

To date, $400 million in premium tax credits have been issued; $200 million issued in 2005 to CAPCO's under Program 1 and $200 million in 2008 under Program II. In order to remain certified, all CAPCOs file a prescribed annual report with the Comptroller by January 31 of each year with specific information and details about the dollar amount of investments in their portfolio companies. The data include their portfolio businesses' employee head counts, average wages, and the number of jobs created or retained as a result of the investment. There are several restrictions and limitations on CAPCO expenditures, and violations can result in assessment of penalties or decertification. A number of safeguards exist and CAPCOs may request the Comptroller to determine a business as prequalified before investments are placed. The CAPCO must also file a financial report audited by a Texas licensed certified public accountant. Once the CAPCO has complied with its annual reporting requirements, the Comptroller's office conducts a thorough review of the information to verify its accuracy and confirm whether the CAPCO is in compliance with the statute and regulations. The annual review may include site visits to portfolio companies, an examination of accounting records, and state and federal employment reports filed by the CAPCO's portfolio companies. In turn, the Comptroller reports all CAPCO investment and employment information to the Governor, Lt. Governor, and the Speaker of the House of Representatives by December 15 of each even-numbered year.

According to the 2008 state comptroller's report to the Legislature, ten CAPCO's invested into 48 portfolio companies. During 2006-2008 a total of 958 jobs were retained with an average salary of $66,309. A total of 690 jobs were created with an average salary of $52,998.[12] In addition, follow-on private capital totaling $108,267,035 has been invested in these companies.[13] In the 2006 comptroller's report, 121 jobs were retained with an average salary of $63,908; 23 jobs were created with an average salary of $46, 383.[14]

12 Texas Comptroller of Public Accounts. 2008 Biennial Certified Capital Companies Report. 15 Dec. 2008.

13 Crist, Scott. State's CAPCO program generates follow-on funds. *The Houston Chronicle*. 21 May 2009. Retrieved from: http://www.chron.com/disp/story.mpl/editorial/outlook/6436200.html

14 Texas Comptroller of Public Accounts. 2006 Biennial Certified Capital Companies Report. 15 Dec. 2006.

The CAPCO program is designed to focus investment capital to meet both its economic development objective and to create incentives for the private sector to participate and put money to work in the program. This public-private collaboration could continue to provide Texas the foundation for sustained economic development.

RECOMMENDATIONS

- The Legislature should consider reauthorizing the program and continue to make capital available.

CHARGE #4: EXAMINE THE PERFORMANCE AND ACCOUNTABILITY OF THE TEXAS PUBLIC PENSION FUNDS AND MAKE RECOMMENDATIONS AS NEEDED.

In response to this charge, the Committee held a public hearing on August 8, 2010. The Committee heard both invited and public testimony.

BACKGROUND

The majority of public pension systems in Texas are controlled locally, although state law provides administrative guidelines for all systems as well as direct statutory control of the largest plans, the Employees Retirement System (ERS) and Teacher Retirement System (TRS). The state provides benefits for teachers, higher education personnel at state colleges and universities, legislators, state employees, state judges, district attorneys, and state-elected officials. The Legislature only has authority over benefit changes for the statewide Texas Municipal Retirement System (TMRS) and the statewide Texas County & District Retirement System (TCDRS). Local systems in Austin, Dallas, El Paso, Fort Worth, Galveston, Houston, and San Antonio are covered by specific state laws. Paid and volunteer fire fighters throughout Texas belong to local plans operating under the Texas Local Fire Fighter Retirement Act.

Each year, Texas taxpayers spend millions of dollars to fund public pensions. State government employees also contribute a portion of their salary to help fund their future retirement benefits. Nationwide, many public pension plans are facing significant financial challenges due to many factors, including: escalation in health care costs; large losses after 2008 market downturn; and employees retiring earlier and living longer. The market downturn left plans with lower than expected asset values while tax revenue declined leaving some public pension funds owing their pensioners more than the funds can afford to pay out in retirement benefits. The funding of retirement programs represents a significant expense for all levels of Texas government; however, the benefit is providing retirement income to retirees who have spent their careers serving in these levels of government.

FINDINGS

Investment earnings contribute up to 70% of public pension trusts and movement in stock markets has had a substantial impact on the funding status of retirement systems. The performance of Texas public pension funds was greatly impacted by the 2008 market downturn.

The peak of the total net value of assets was at an estimated $210 billion in 2007. As of August 2010, the total net assets are an estimated $175 billion, up from the $150 billion value at the bottom of the market downturn in spring of 2009.[15] However, most Texas public retirement system plans did not achieve their expected rate of return over the last decade, posing challenges to achieve actuarial soundness. The Texas State Pension Review Board (PRB), an independent state agency that oversees and reviews state and local government retirement systems in Texas, has adopted guidelines which state that the funding period for a public retirement system should never exceed 40 years. According to actuarial valuations filed with the PRB, approximately 18 Texas plans have amortization periods exceeding 40 years.

The Employees Retirement System (ERS) administers five retirement plans for 291,000 members. The ERS plan for state employees, statewide office holders, legislators is at a funded ratio of 87.4% for the 2009 Fiscal Year Actuarial Valuation, down from 92.6% in 2008. The Law Enforcement and Custodial Officer Supplemental Retirement Fund status is 86.1% funded, down from 92%, and the Judicial Retirement System II Trust Fund is sufficiently funded and considered actuarially sound under Texas law.[16] Investment losses were the major factor in ERS' funded ratio decline. However, contributions and benefit design also impact the trust fund's financial status. The Texas Constitution requires that an employee contribution must be at least 6% of his salary and the state contribution must be between 6-10% of the aggregate payroll. Any proposal for benefit increases may not be adopted if the unfunded actuarial liabilities of the retirement system exceed 30 years.[17] ERS continues to follow best practices to adhere to actuarial standards. Over the last 20 years Texas has contributed $5.2 billion tax dollars towards employees' retirement but through long-term investment strategies, ERS paid out $15.2 billion in

15 Hanson, Christopher. Statement to the House Committee on Pensions, Investments, and Financial Services. Hearing, August 8, 2010. Available at: http://www.house.state.tx.us/committees/broadcasts.php?session=81&committeeCode=395

16 Buck Consultants. *Employees Retirement System. Actuarial Evaluation. August 31, 2009.* 17 Nov. 2009. Available at: http://www.ers.state.tx.us/news/reports/documents/av_2009_ers.pdf

17 Tex Gv. Code Ann. § 811.006.

retirement income over the same period.[18] During the 2009 Legislative session, HB 2559 passed to reduce long-term liabilities and improve the plan's sustainability. State employee contributions were increased, return to work provisions modified to establish a 90-day waiting period, and a 2nd tier of eligibility was created for new employees.

The Teacher Retirement System (TRS) administers a pension trust fund for 1.27 million active members and retirees. As of the August 31, 2009 actuarial evaluation, the fund value was valued at $88.7 billion, down from the fund's peak of $104.9 billion in 2008.[19] The Legislature establishes all benefits for TRS retirees and the state's contribution makes up approximately 20% of the funds source. Both the state and public employees have a significant financial interest in trust funds that are solvent and wisely managed. Approximately 60% of the TRS fund is income from investments while 40% is derived from employee and employer contributions. Unlike other states around the nation, the Texas Legislature adjusts contribution rates on a biennial basis to allow for actuarial balance.

RECOMMENDATIONS

There is significant interest in reforming Texas public pension plans, particularly in light of current market conditions. The Legislature has direct authority over the ERS and TRS plans which are under a defined benefit plan design. Defined benefit plans typically forecast investment earnings and smooth investment results to be consistent with long-term, cost-effective investment goals. The Legislature and local governments must carefully manage a public pension fund's projected investment assets to ensure they keep pace with the fund's estimated benefit obligations. Current economic conditions continue to remain volatile and retirement funds are greatly dependent upon the financial market activity. The Legislature should study the positive and negative implications of creating tiers for new employees to be rolled into a defined contribution or hybrid plan and make recommendations to the 83rd

18 Fuelberg, Ann. Statement to the House Committee on Pensions, Investments, and Financial Services. Hearing, August 8, 2010. Available at: http://www.house.state.tx.us/committees/broadcasts.php?session=81&committeeCode=395

19 Gabriel, Roeder, Smith and Company. *Teacher Retirement System. Actuarial Valuation as of August 31, 2009.* 2009. Available at: http://www.trs.state.tx.us/about/documents/actuarial_valuation_presentation.pdf

Legislature. Plans under TMRS, TCDRS, and local systems that need to improve their funded status will need to look at increasing contribution rates of both employees and employers, as well as amending plan structures such as automatic cost-of-living increases, pension spiking, or early retirement incentives in order to reduce future liabilities. Legislation should be considered to require the PRB to report to the Legislature on the investment performance of public pension funds. In the event public pension funds are not meeting their investment return assumptions, the fund must submit to either the PRB or the Legislature contingency plans to develop alternative funding policies. The Legislature should also consider reviewing the Securities and Exchange Commission's recent rule adoption addressing "pay to play" practices by investment advisers and recommend necessary changes to Texas public pension plans investment policies.[20]

20 Securities and Exchange Commission. 17 CFR Part 275. Political Contributions by Certain Investment Advisers. Available at:
http://www.sec.gov/rules/final/2010/ia-3043.pdf

CHARGE #5: MONITOR THE AGENCIES AND PROGRAMS UNDER THE COMMITTEE'S JURISDICTION.

BACKGROUND

The House Committee on Pensions, Investments, and Financial Services has jurisdiction over the following state agencies:

- Office of Consumer Credit Commissioner
- Texas Department of Banking
- Department of Savings and Mortgage Lending
- Texas Treasury Safekeeping Trust Company
- Texas Public Finance Authority
- Bond Review Board
- Employees Retirement System of Texas
- Teacher Retirement System of Texas
- Office of Fire Fighters' Pension Commissioner
- Texas County and District Retirement System
- Texas Municipal Retirement System
- State Pension Review Board
- State Securities Board

In response to this charge, the Committee held a public hearing on August 8, 2010. The Committee heard both invited and public testimony and asked the agencies for status updates on the implementation of legislation from the 2009 Legislative session.

FINDINGS

Office of Consumer Credit Commissioner

The Office of Consumer Credit Commissioner (OCCC) licenses regulated lenders, property tax lien lenders, residential mortgage loan originators, motor vehicle sales finance companies, pawnshops, and pawnshop employees. The OCCC also registers debt management service providers, refund anticipation loan facilitators, and creditors who finance the sales of their goods and services. In fiscal year 2009, the agency processed 421 regulated loan applications, 90 property tax lien lenders, 83 pawnshop applications, 2,742 employee applications, and 838 motor vehicle sales finance applications. As a result of HB 2774, which established the OCCC as a Self-Directed Semi-Independent agency, the agency now has more flexibility to react in a timely manner to changes in the economy or regulated industries. SB 1966 authorized a retail seller to offer to the retail buyer a debt cancellation agreement. The Finance Commission has approved administrative rules and established procedures and maximum reasonable rates for the debt cancellation agreement. HB 3621 removed a $50 cap as the maximum amount an automobile dealer can charge as a documentary fee. The documentary fee is for preparing and processing the documents associated with the sale of a motor vehicle, including remittance of the sales and motor vehicle tax to the state. The Finance Commission approved administrative rules and established a safe harbor maximum amount and standards for reasonableness for the documentary fee. HB 2438 prohibits a retail seller from accepting a trade-in motor vehicle for a motor vehicle sold under a retail installment contract unless the retail seller provides to the retail buyer a completed disclosure of trade-in equity form. The agency established a standard disclosure form and the Commission approved administrative rules.

Texas Department of Banking

The Texas Department of Banking (TDB) regulates and supervises state-charted banks, trust companies, offices of foreign bank agencies, money service businesses, prepaid funeral contract sellers, and perpetual care cemeteries. The TDB conducts examinations of these entities to ensure they are operating under compliance with state and federal law. Private child support enforcement entities and check verification entities have to register with the TDB. As a result of the implementation of HB 2774 (establishing Self-Directed Semi-Independent status) the TDB has sustained and retained tenured financial examiners in order to preserve its credibility with federal counterparts. HB 3762 amended provisions relating to the regulation of prepaid funeral benefits. The bill clarified that the Texas Department of Banking has authority to require annual reports from a permit holder and establish a financial capacity component for permit holder renewals. In accordance with provisions of the bill, the TDB published a prepaid funeral brochure, developed an informational website, and modified contract disclosures.

Department of Savings and Mortgage Lending

The Texas Department of Savings and Mortgage Lending (DSML) regulates and supervises state chartered savings banks and the licensing/registration and regulation of the state's mortgage industry. On July 20, 2008, President Bush signed the Housing and Economic Recovery Act into law, creating the Secure and Fair Enforcement (S.A.F.E.) Mortgage Licensing Act of 2008. The Texas Legislature complied with the S.A.F.E. Act with the passage of HB 10. The purpose of the Act was to create a Nationwide Mortgage Licensing System & Registry (NMLSR), increase uniformity, reduce regulatory burden, enhance consumer protection, and reduce fraud. As of April 2010, the DSML has registered over 26,000 filings with the NMLSR. HB 2774 also established the Self-Directed Semi-Independent status allowing DMSL to be responsive in new hires and retention efforts.

Texas Treasury Safekeeping Trust Company

The Texas Treasury Safekeeping Trust Company is a special purpose entity created to more efficiently and economically manage, invest, and safeguard funds for the state and various subdivisions. The Company manages over $50 billion in state assets and invests funds in consultation with the Comptroller's Investment Advisory Board. The company administers Local Government Investment Pools and 12 separate endowment funds. Legislation affecting the Company was not introduced last session.

Texas Public Finance Authority

The Texas Public Finance Authority (TPFA) is the State's primary issuer of debt repaid from General Revenue. The TPFA issues bonds on behalf for the General Services Commission to provide financing for the construction or acquisition of facilities for State agencies or other programs authorized by the Legislature. Legislation affecting the TPFA was not introduced last session.

Bond Review Board

The Bond Review Board (BRB) is responsible for approval of all state debt issues and lease purchases, as well as the collection and analysis of all state debt to ensure that debt financing is used prudently to meet Texas' infrastructure needs and other public purposes. The BRB also administers the Private Activity Bond Allocation Program (PAB). Private activity bonds are bonds that meet any of the following tests:

1) Private Business Use Test - more than 10% of the proceeds are to be used for any private business use;

2) Private Security or Payment Test - payment on principal or interest of more than 10% of the proceeds is to be directly or indirectly secured by, or payments are to be derived from a private business use; and

3) Private Loan Financing Test - proceeds are to be used to make or finance loans to persons other than governmental units.

SB 2064 enacted a number of changes to enable the PAB program to operate more efficiently and allow for the administration of federally-created bonding authority.

Employees Retirement System of Texas

The legislature passed HB 4586 authorizing ERS to establish a pilot program regarding alternative payment methods for healthcare. HealthSelect members in North Texas may participate in a medical home pilot to test alternatives to traditional fee-for-service payments. SB 872 permitted eligible survivors of law enforcement officers, fire fighters and other public servants to receive a state contribution for health insurance to allow for continued health insurance coverage and financial assistance. SB 2577 requires ERS to develop a cost-neutral or cost-positive plan under the group benefits program for providing bariatric surgery coverage for eligible employees. ERS is working on the proposed patient selection criteria generally followed by the BlueCross and BlueShield of Texas Medical Policy Guideline. HB 2283 authorized ERS to add a Roth 401(k) option as a part of the TexaSaver program. ERS is conducting a survey during the Fall of 2010 to measure participant interest and collect date on potential administrative costs. HB 2559 increased employee contributions, created a second tier of retirement eligibility for new hires, which increased the minimum retirement age from 60 with five years of service to 65 with ten years of service. The second tier also modifies the methods used to meet the rule-of-80, and retirement benefits will be calculated using the highest 48 months of salary rather than the highest 36 months. HB 2559 revised return-to-work provisions so that a state employee may not retire and return to state employment until 90 days after the date of his retirement. The bill also states that ERS shall make a good faith effort to award contracts to qualified emerging managers. ERS has established an emerging manager program that has been incorporated into the ERS Investment Policy. ERS is in the process of developing relationships with emerging managers with plans to further develop and expand the pool of emerging managers.

Teacher Retirement System of Texas

The Legislature passed HB 3480, which provided safeguards to protect teachers' investments by requiring that firms' products are certified, registered, and approved by TRS. New requirements were adopted by the board in October 2009, including platform company qualifications. HB 3347 updated statute governing the TRS retirement plan to maintain compliance with federal tax code requirements. HB 1191 authorized a retiree, eligible for coverage under the Texas Public School Employees Group Insurance Program of the TRS, to select any insurance benefit coverage for which the person was eligible on the date that the person retired and during any open enrollment periods for retirees set by the system by rule. TRS implemented the new initial enrollment period and permits a retiree to select coverage during the first 90 days after retirement. SB 704 enabled TRS-Care and TRS-ActiveCare participants to obtain a multi-month supply of any drug at participating retail pharmacies under the same terms as mail order.

Office of Fire Fighters' Pension Commissioner

The Office of Fire Fighters' Pension Commissioner (FFPC) administers the Texas Emergency Services Retirement System for local volunteer fire and EMS personnel. As the administrator of the fund, the FFPC collects contributions of participating department members, invests the proceeds, calculates benefits, and issues payments to retirees and their beneficiaries. The FFPC also provides oversight, administrative support, and training for local board trustees of 38 paid, 3 part-paid, and 80 volunteer fire departments. Legislation affecting the FFPC was not introduced last session.

Texas County and District Retirement System

The Texas County and District Retirement System (TCDRS) provides retirement, disability and survivor benefits for over 215,000 county and district employees in Texas. The TCDRS does not receive state funding but is governed by the Texas Legislature. HB 407 was enacted to target changes to outdated plan design provisions, processes, and funding arrangements, along with administrative and technical changes and clarifications.

Texas Municipal Retirement System

The Texas Municipal Retirement System (TMRS) provides retirement benefits to 837 participating cities. TMRS does not receive state funds but is governed by the statute. The Legislature enacted HB 360 to provide the framework necessary to allow TMRS to credit or charge net investment income or losses to participating municipalities. The bill allowed for further diversification of the fund's investment portfolio to alleviate municipality contribution rates through higher investment returns.

State Pension Review Board

The State Pension Review Board (PRB) is an oversight agency for Texas public retirement systems. The PRB conducts continuing reviews of public retirement systems and provides information and technical assistance on pension planning. The agency also prepares actuarial impact statements and recommends policies, practices, and legislation to appropriate governmental entities. Although legislation did not pass affecting the PRB, legislation was considered. Bills relating to the tracking of public retirement system investments in emerging managers and historically underutilized businesses were considered in both chambers. In addition, consideration was given to expand the oversight of the PRB to include statewide investment funds such as The University of Texas Investment Management Company and the Texas Treasury Safekeeping fund.

State Securities Board

The State Securities Board (SSB) is responsible for regulating the securities industry in Texas by registering securities offered or sold in Texas and oversee the firms and individuals selling securities or providing investment advice. The SSB investigates violations and pursues administrative enforcement actions or refers matters for criminal prosecution. The agency registers dealers, agents, investment advisers and their representatives to ensure only qualified firms are authorized to offer securities. HB 3480 created greater safeguards for teacher retirement accounts. Previously, teacher retirement funds were invested in unregistered investments sold by unregistered persons. Following the passage of the bill, the SSB has not seen additional problems.

MINORITY REPORT

STATE OF TEXAS
HOUSE OF REPRESENTATIVES
DISTRICT 103

RAFAEL ANCHIA
MEMBER

February 7, 2011

The Honorable Vicki Truitt
Chair, Committee on Pensions, Investments and
Financial Services
P.O. Box 2910
Austin, Texas 78768

Dear Chairwoman Truitt:

As a member of the Texas House Pensions, Investments and Financial Services Committee and as a signatory of the committee's interim report for the 81st Session, I would like to offer my dissenting opinion to the report's first charge:

> Study the impact of the debt settlement relief industry, including debt management and debt settlement organizations and the implications of regulating that industry.

The committee report's recommendation for charge #1 was not sufficiently explicit in proposing legislative recourse for addressing this growing problem in Texas' financial services sector. The report recommends that all debt relief services may register with the Office of Consumer Credit Commissioner and allow free market forces to facilitate the better companies' serving the public need.

The report does not go far enough to recommend that the legislature must create a regulatory framework for debt settlement companies under the Office of Consumer Credit Commissioner in order to create a predictable and transparent marketplace for both market participants and consumers.

Despite this shortcoming in the report's first recommendation, I am placing my signature on the report in full support of its content, but would like to have this letter included as a minority opinion on charge #one. In addition, I want to work with you and the members of the committee this session to more fully address the issue of debt settlement.

Sincerely,

Rafael Anchia | Ana Hernandez-Luna | Marc Veasey

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