# TESTIMONY

## Before the

## HOUSE INVESTMENTS AND FINANCIAL SERVICES COMMITTEE

## May 21, 2014

## BY LESLIE PETTIJOHN, OFFICE OF CONSUMER CREDIT COMMISSIONER

---

## HOME EQUITY LENDING

In 1997, the Texas Legislature passed a constitutional amendment allowing for home equity loans. The requirements are provided in Article XVI, Section 50 of the Texas Constitution. In 2003, the Finance Commission and Credit Union Commission were given interpretation authority over this section. The Commissions adopted interpretations in 2004. The OCCC worked with the Finance Commission, other Finance Commission agencies and with the Credit Union Commission and Department to develop administrative interpretations.

### ***Finance Commission of Texas v. Norwood***

In *Finance Commission of Texas v. Norwood*, 418 S.W.3d 566 (Tex. 2013), the Texas Supreme Court struck down several interpretations issued jointly by the Texas Finance Commission and the Texas Credit Union Commission, regarding the home equity provision in Article XVI, Section 50 of the Texas Constitution. The Supreme Court's decision dealt primarily with five issues:

- First, the court held that Texas courts have the authority to review the Commissions' home equity interpretations, and that the review is de novo (*i.e.*, the interpretations are not entitled to any deference).

- Second, the court held that the homeowners in the case had standing to challenge the interpretations, because they had demonstrated a possible injury.

- Third, regarding the constitution's 3% cap on fees other than interest, the court struck down interpretation 153.1(11), which defined "interest" as "interest as defined in the Texas Finance Code §301.002(4) and as interpreted by the courts." The court stated that interest means "the amount determined by multiplying the loan principal by the interest rate." In a supplemental opinion, the court explained that per diem interest and legitimate discount points are interest, and are therefore not included in the 3% cap.

- Fourth, regarding the constitution's requirement that a home equity loan be closed only at a lender's office, an attorney's office, or a title company, the court struck down interpretation 153.15(2), which allowed a lender to accept a properly executed power of attorney authorizing someone to close a loan on a homeowner's behalf. It also struck down interpretation 153.15(3), which allowed a lender to accept the homeowner's consent by mail. In its supplemental opinion, the court explained that "a power of attorney must be part of the closing to show the attorney-in-fact's authority to act." The supplemental opinion acknowledged that this requirement could impose a hardship on certain borrowers, such as overseas military personnel who do not have access to JAG lawyers. The court stated: "Whether the constitutional provision's intended protection is worth the hardship or could be more fairly or effectively provided by some other method is a matter that must be left to the framers and ratifiers of the Constitution."

- Fifth, regarding the constitution's requirement that a 12-day notice be sent to the homeowner, the court upheld interpretation 153.93, which provides that there is a rebuttable presumption that the homeowner receives the notice three days after it is mailed.

In order to comply with the court's decision, the Commissions intend to publish proposed amendments to the interpretations for public comment in June.

# Significant Policy Issues & Implementation of Legislation from the 83rd Legislature

## Credit Card Surcharge Prohibition

On March 5, 2014, a group of Beaumont merchants filed a complaint in federal court against Greg Abbott in his official capacity as Attorney General of the State of Texas and Leslie L. Pettijohn, in her official capacity as Commissioner of the Office of Consumer Credit Commissioner of the State of Texas, to enjoin enforcement of the credit card surcharge prohibition in Section 339.001 of the Texas Finance Code. The merchants argue that the prohibition is an unconstitutional violation of free speech and that it is void for vagueness, in violation of the First and Fourteenth Amendments to the U.S. Constitution. The case has been assigned to Judge Lee Yeakel in the Western District of Texas, Austin Division.

### HB 2548: Credit Card Surcharge Exclusive Jurisdiction

***Summary:***
Under previous law, the Finance Commission has exclusive jurisdiction to enforce Section 339.001 of the Finance Code, which prohibits credit card surcharges. This bill provides that the OCCC has exclusive jurisdiction to enforce the section. The bill also amends Chapter 14 of the Finance Code to provide that the OCCC has investigation authority, enforcement authority, and authority to order restitution to a person injured by a violation of Section 339.001.

***Implementation Activities:***
The OCCC has been working through transition issues related to the changed enforcement policy associated with HB 2548. The Finance Commission adopted a rule to assist with enforcement procedure for complaints both before and after the effective date. Nineteen complaints are being processed under the older provisions. Nine of those have been closed and ten remain pending as they are being worked through to resolution. In FY14 to date, 40 complaints have been filed.

## Credit Access Businesses offering Payday (deferred presentment) and Auto Title Loans

***Background***:
The 82nd Legislature amended Chapter 393 of the Finance Code establishing new requirements for "credit access businesses," which are credit services organizations (CSOs) that provide payday loans or title loans. Credit access businesses (CABs) are required to provide a consumer disclosure prescribed by the Finance Commission. The disclosure must include interest, fees, and APR for the loan and a comparison of those charges to "alternative forms of consumer debt," and it must describe fees that the consumer will incur for renewing the loan. CABs are also required to obtain a license with the OCCC. The OCCC has examination and investigation authority over credit access businesses. Chapter 393 also requires the Finance Commission to create an endowment for financial education in Texas. The requirements became effective January 1, 2012.

Significant legislative activity and effort ensued in the 83rd Legislature for a short term lending reform bill. The 83rd session came to a close without a final legislative reform bill.

## *Regulatory Activities*

**Licensing**

The number of active CAB licenses reflects a growth of approximately 15% in FY13 and a 4% decline through the 2nd quarter of FY14 from the high mark of FY13.

| CAB Applications | FY12 | FY13 | FYTD-2Q14 |
|---|---|---|---|
| Number of CAB Licenses Issued and Active | 3,022 | 3,502 | 3,353 |

**Table 1: CAB applications received and processed as of August 2012, August 2013 and February 2014.**

**Consumer Protection & Examination**

The OCCC continues to focus resources on CAB compliance, performing 343 examinations during the first half of FY14. The average hours per CAB examination (8.06 hours) for the first two quarters of FY14 continues to be higher than initially anticipated. Challenges remain for smaller licensees and their understanding of the basic requirements of CAB disclosures and separation of the parties involved.

Compliance questions are consistently raised due to licensees' attempts to adapt their product offerings to fit around the framework of municipal ordinances. Based on our research, at least 15 municipalities have enacted regulations directly impacting CAB products.

| CAB Examinations | FY12 | FY13 | FYTD-2Q14 |
|---|---|---|---|
| Number of Examinations | 290 | 916 | 343 |
| Acceptable Level of Compliance | 90.9% | 91.1% | 92.42% |
| Investigations Completed | 0 | 13 | 4 |

The acceptable level of compliance has remained similar for the past three fiscal years. Presently, the OCCC has examined approximately 46% of the industry. Common violations and areas of non-compliance, in addition to that mentioned above, were identified as failure to provide consumer disclosures or providing incorrect consumer disclosures; failure to post fee schedules; and charging undisclosed fees such as certificate of title fees. Restitution to consumers as a result of examination of CABs is $38,448.98 for FYTD14.

| Consumer Complaints | | | | | |
|---|---|---|---|---|---|
| **Fiscal Year** | **Payday Loans** | **Title Loans** | **Total** | **% of all processed complaints** | **Consumer Refunds Issued** |
| FYTD-2Q14 | 131 | 72 | 203 | 24.25% | $7,527.63 |
| FY13 | 243 | 179 | 422 | 21.16% | $6,331.59 |
| FY12 | 179 | 103 | 282 | 14.49% | — |

The complaints predominately pertain to charges and fees, collection practices, posting/processing of payments, and repossessions.

## Credit Access Business Reporting

The presented statistics represent data reported to the Office of Consumer Credit Commissioner (OCCC) from credit access businesses (CABs) in the annual report for calendar year 2013 with comparison data from the 2012 annual report. A noticeable trend is the 9.82% decrease in the number of agreements (new loans and refinances) entered into during 2013. This overall decrease is attributable to a 39.49% increase in multiple installment payday loan agreements that provide for a longer repayment period and are characteristically refinanced less often.

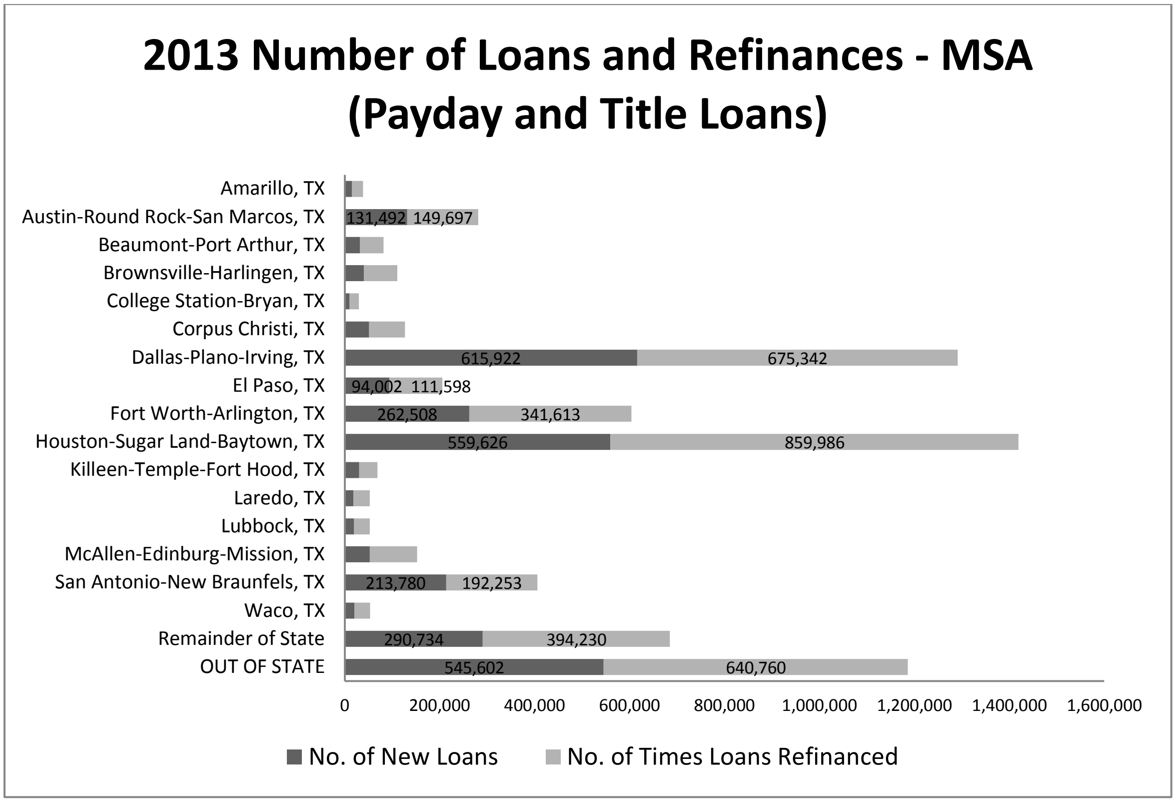
| Data Highlights (All Loan Types) | 2013 | 2012 |
|---|---|---|
| Number of payday (deferred presentment) loans obtained | 2,538,458 | 2,660,270 |
| Number of auto title loans obtained | 472,929 | 475,681 |
| Number of payday (deferred presentment) refinances | 3,065,164 | 3,794,565 |
| Number of auto title refinances | 795,670 | 689,774 |
| Number of vehicles surrendered or repossessed under all auto title loans | 37,649 | 37,062 |
| Total number of locations reporting | 3,590 | 3,458 |

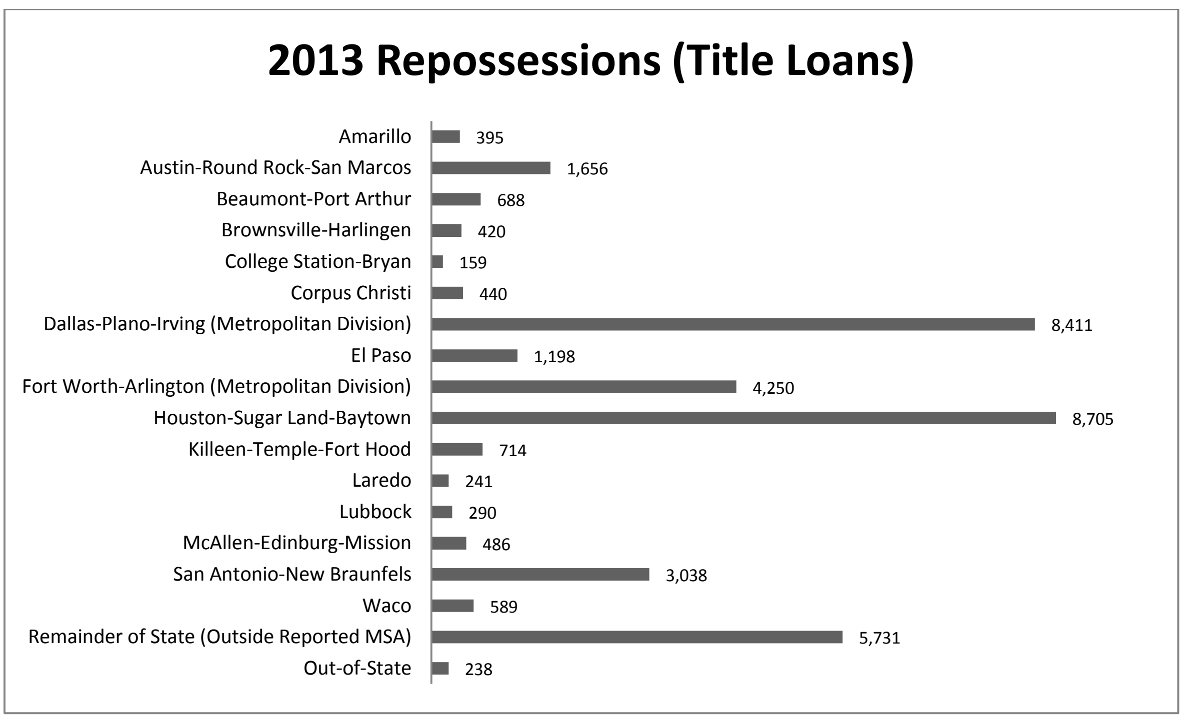
| | Single Installment | | Multiple Installment | |
|---|---|---|---|---|
| Payday Loans | 2013 | 2012 | 2013 | 2012 |
| Number of consumers for whom the CAB obtained an extension of credit | 1,034,188 | 1,080,644 | 485,855 | 290,139 |
| Number of extensions of credit obtained by CAB | 1,865,045 | 2,238,938 | 673,413 | 421,332 |
| Number of refinances | 2,911,469 | 3,622,957 | 153,695 | 171,608 |
| Average Loan Amount [1] | $463 | $468 | $514 | $575 |
| Average Fee per $100 borrowed [1] | $23.07 | $22.85 | $133.40 | $137.89 |
| Average original term (in days) [1] | 19 | 19 | 142 | 98 |
| Average number of loans and refinances per consumer | 4.62 | 5.42 | 1.70 | 2.04 |

| | Single Installment | | Multiple Installment | |
|---|---|---|---|---|
| Title Loans | 2013 | 2012 | 2013 | 2012 |
| Number of consumers for whom the CAB obtained an extension of credit | 321,832 | 297,948 | 57,812 | 67,691 |
| Number of extensions of credit obtained by CAB | 403,902 | 395,199 | 69,027 | 80,482 |
| Number of refinances | 758,003 | 649,620 | 37,667 | 40,154 |
| Average Loan Amount [1] | $1,240 | $1,003 | $1,137 | $1,188 |
| Average Fee per $100 borrowed [1] | $21.81 | $22.57 | $70.01 | $91.79 |
| Average original term (in days) [1] | 30 | 29 | 172 | 146 |
| Average number of loans and refinances per consumer | 3.61 | 3.51 | 1.85 | 1.78 |

[1] Average statistics for individual products are averaged from the four separate quarterly reports, for each calendar year.

Geographic information for loan volume and motor vehicle repossessions are presented in the following two charts. The first chart represents the number of new loans made and the number of times those loans were refinanced in CY 2013 by Metropolitan Statistical Area (MSA). The second chart focuses on the number of motor vehicle repossessions that resulted from title loans in 2013.



**Advisory Bulletins**

The OCCC issued five advisory bulletins to CABs during FY 2013 and FY 2014:

- In a February 2014 bulletin, the OCCC explained that the agency will no longer extend a grace period for submitting delinquent quarterly and annual reports. All delinquent reports will immediately be subject to administrative penalties without additional notice.
- In an October 2013 bulletin, the OCCC explained that CABs may not file criminal charges against consumers without specific evidence of criminal conduct. For example, a dishonored postdated check is not sufficient evidence to show that a consumer committed criminal conduct.
- In a February 2013 bulletin, the OCCC described inconsistencies in CAB quarterly and annual reports, and explained how CABs can review their reports to ensure accuracy.
- In a December 2012 bulletin, the OCCC expressed concern regarding certain CABs' practice of referring consumers to locations outside city limits, in order to avoid the application of city ordinances.
- In another December 2012 bulletin, the OCCC expressed concern regarding certain CABs' business practices that attempt to avoid regulatory requirements that generally apply to CABs. Typically these practices involve attempts to alter payday loans or auto title products in a subtle way that might circumvent the statutory requirements.

**Texas Financial Education Endowment**

As part of the licensing process each CAB location pays an annual assessment fee to OCCC to support opportunities for asset building, improved consumer credit, and financial education (§393.628, Texas Finance Code). The assessments are collected by the OCCC during the licensing process and are invested with the Texas Treasury Safekeeping Trust Company.

The Finance Commission of Texas oversees the Endowment and its grant program. The endowment supports innovative consumer credit building activities and programs for youth and adults throughout the state. In December 2013 the Finance Commission selected eight organizations to receive grant awards in an aggregate amount of $250,000 in the first grant award cycle. The program activities of the awarded grants fall into three categories: K-12 Financial Education and Capability, Financial Coaching and Adult Financial Education and Capability. The next grant cycle is planned for 2015.

## SB 1251: Regulated Loan Fees

***Summary:***

Under previous law, Chapter 342 of the Finance Code provided a $25 maximum administrative fee under Subchapter E, and a $10 maximum acquisition charge under Subchapter F. This bill allows the Finance Commission to adopt rules setting a higher Subchapter E administrative fee and a higher Subchapter F acquisition charge. The bill provides that the administrative fee and the acquisition charge are not interest.

The bill also allows authorized lenders to use the true daily earnings method or scheduled installment earnings method for a Subchapter F loan. The bill includes interest-calculation requirements and payment-allocation requirements for a Subchapter F loan in which a lender uses these earnings methods.

***Implementation Activities:***

At its August 2013 meeting, the Finance Commission adopted a rule setting the maximum administrative fee at $100 and the maximum acquisition charge at the lesser of $100 or 10% of the cash advance. The rule also prohibits a Subchapter F lender from charging an acquisition charge more than once per month. Later in August, the OCCC distributed an advisory bulletin summarizing the rule's requirements. At its October 2013 meeting, the Finance Commission adopted a rule describing the calculation requirements for Subchapter F loans using the true daily earnings method or scheduled installment earnings method.

Data is being gathered during examinations to evaluate the effectiveness of the rules and identify any patterns or practices of abuse. The OCCC is also collecting additional information in annual reports that regulated lenders are required to provide. In March 2014, the agency issued a bulletin describing new information that the agency is requiring in the annual report, including information about administrative fees and acquisition charges, as well as breakdowns of interest and fee income.

## TRANSPARENCY AND EFFICIENCY

The Office of Consumer Credit Commissioner continuously seeks to operate in a transparent and efficient manner. Streamlining regulatory procedures, including licensing and registration, through the use of information technology is a strong priority for the OCCC. The agency has embarked upon a multi-phase project to modernize legacy systems. Specifically, the OCCC has implemented an online, cloud-based licensing and registration system to provide for effective application processing, self-service transactions, annual reporting, renewals, and online payment of fees. The project will provide enhanced data management and substantially improve service delivery times and quality outcomes.

Efforts to be more responsive and transparent to Texas taxpayers and citizens include ensuring that public information will be more accessible in the new system. The OCCC is spending a considerable amount of time and resources responding to Public Information requests. Where possible, data is being made more publicly available, either through the agency's website or through the new licensing platform. Given the nature of some requests which seek nonpublic information, rulings from the Attorney General are often required. Responses to these types of requests are typically more voluminous and consume substantial resources. Some of this is to be expected, however, the agency is very cognizant of maintaining the proper balance in providing public information and maintaining confidential and proprietary information.

The OCCC works to streamline its programs and services at every opportunity if efficiencies can be obtained without sacrificing the quality of service or objectives needed to fulfill the mission of the agency and its statutory responsibilities. The OCCC values its relationships with the Legislature and its many diverse stakeholders, welcoming and encouraging constructive feedback to improve regulations and programs.