HOUSE COMMITTEE ON FINANCIAL INSTITUTIONS

TEXAS HOUSE OF REPRESENTATIVES

INTERIM REPORT 2006

BURT SOLOMONS
CHAIRMAN

COMMITTEE CLERK
LESLEY FRENCH

COMMITTEE ON FINANCIAL INSTITUTIONS

TEXAS HOUSE OF REPRESENTATIVES
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BURT SOLOMONS
CHAIRMAN

BRIAN MCCALL
VICE CHAIRMAN

October 18, 2006

The Honorable Tom Craddick
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-Ninth Legislature hereby submits its interim report for consideration by the Eightieth Legislature.

Respectfully submitted,

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Burt Solomons, Chair

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Rep. Brian McCall, Vice-Chair

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Rep. Norma Chavez

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Rep. Dan Flynn

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Rep. Ryan Guillen

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Rep. Rob Orr

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Rep. Debbie Riddle

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INTRODUCTION

At the beginning of the 79th Legislature, the Honorable Thomas "Tom" Craddick, Speaker of the Texas House of Representatives, appointed seven members to the House Committee on Financial Institutions (the Committee). The Committee membership included the following appointees: Burt Solomons, Chair, Brian McCall, Vice-Chair, Norma Chavez, Dan Flynn, Ryan Guillen, Rob Orr and Debbie Riddle.

During the interim, Speaker Craddick assigned the Committee on Financial Institutions the following three charges:

1. Examine the feasibility and impact of consolidating the state financial regulatory agencies which include the Office of Consumer Credit Commissioner, Texas Department of Banking, Department of Savings and Mortgage Lending (formerly Texas Savings and Loan Department) and the Texas Credit Union Department.

2. Evaluate predatory lending practices involved with subprime mortgage lending within the state, primarily in the border counties including:
   - Study the patterns of mortgage fraud and develop statutory changes to reduce incidences of mortgage fraud and punish violators.
   - Study the relationship between mortgage brokers and residential borrowers including:
     whether or not the mortgage broker is the agent of the residential borrower; the types of disclosures which should be required; and, the sources and nature of compensation.

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

The Committee met in two public hearings, held on May 1, 2006 and June 20, 2006, at the State Capitol. During the first hearing, the Committee heard testimony on issues regarding financial services. The Committee heard testimony on all interim charges during the second hearing.

The Committee would like to express its appreciation to Commissioner Randall James and staff at the Texas Department of Banking, Executive Director Robert Kline and staff at the Texas Bond Review Board, Commissioner Leslie Pettijohn and staff at the Texas Office of the Consumer Credit Commissioner, Commissioner Harold Feeney and staff at the Texas Credit Union Department, Commissioner Danny Payne and staff at the Texas Department of Savings & Mortgage Lending, 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:

John Fleming (Texas Department of Savings & Mortgage Lending), Paul Carmona (Office of the Texas Attorney General), Sally Hanners (Office of the Texas Attorney General), James Rader (Unauthorized Practice of Law Committee of the Texas Supreme Court), Stephen Schottman (Texas Department of Housing and Community Affairs), Karen Neeley (Independent Bankers Association of Texas), Steve Scurlock (Independent Bankers Association of Texas), Dan Donohoe (JP Morgan Chase), Mindy Carr (Texas Land Title Association), Randy Erben (Texas Association of Mortgage Attorneys), Jim Robertson (Texas Association of Mortgage Attorneys), Ron Walker (Texas Association of Realtors), Daniel Gonzalez (Texas Association of Realtors), Ben Streusand (Texas Mortgage Bankers Association), Jim Rudd (Texas Association of Mortgage Brokers), Everett Ives (Texas Association of Mortgage Brokers), Everett Anschultz (Texas Association of Mortgage Brokers), Robert Doggett (Texas Low Income Housing Information Service).

Finally, the Committee staff would like to thank the Chairman's staff members that assisted in the preparation of this report - Bonnie Bruce and Kari Torres.

HOUSE COMMITTEE ON FINANCIAL INSTITUTIONS

INTERIM STUDY CHARGES

CHARGE Examine the feasibility and impact of consolidating the state financial regulatory agencies which include the Office of Consumer Credit Commissioner, Texas Department of Banking, Department of Savings & Mortgage Lending (formerly Texas Savings and Loan Department) and the Texas Credit Union Department.

CHARGE Evaluate predatory lending practices involved with subprime mortgage lending within the state, primarily in the border counties including:

- Study the patterns of mortgage fraud and develop statutory changes to reduce incidences of mortgage fraud and punish violators.
- Study the relationship between mortgage brokers and residential borrowers including:
  whether or not the mortgage broker is the agent of the residential borrower; the types of disclosures which should be required; and, the sources and nature of compensation.

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

CONSOLIDATION OF FINANCIAL INSTITUTIONS

BACKGROUND

The financial institutions industry is an integral part of the Texas economy. Many small- and medium-sized businesses seek credit from these institutions to begin their operations and/or support and expand their business once they are established. This exchange stimulates the economy through job creation and consumer spending.

Maintaining our strong economy is a top priority for the Texas Legislature. As a result, the Legislature attempts to streamline governmental agencies in order to effectively utilize tax dollars; one method is to consolidate state agencies that regulate similar industries. Most states have one or two agencies that oversee and regulate financial institutions.[1] Texas is unique in that it has four distinct agencies: Texas Department of Banking, the Texas Department of Savings & Mortgage Lending, Texas Credit Union Department, and the Office of Consumer Credit Commissioner.[2]

The United States has a dual banking system. Dual banking refers to the system of state and federal chartering and regulation of banks. Historically, Congress has preserved the integrity of the dual banking system. National banks are chartered and regulated by the Office of the Comptroller of the Currency and Texas state banks are chartered and regulated by Department of Banking.[3] National thrifts are regulated by the Office of Thrift Supervision while Texas state savings banks are regulated by the Department of Savings & Mortgage Lending. The Federal Deposit Insurance Corporation oversees national banks and savings banks.

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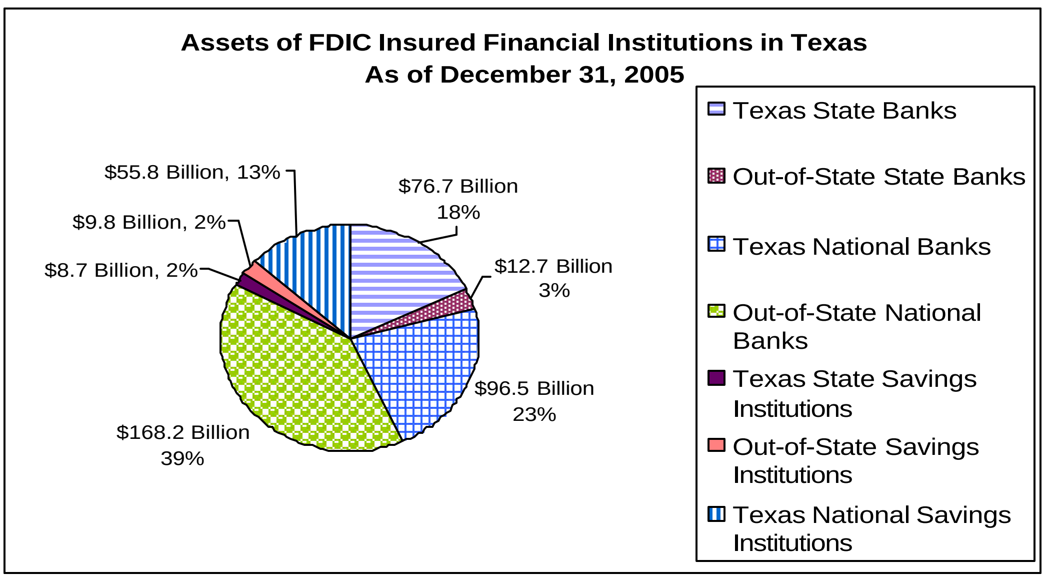
[1] The following states have consolidated agencies or agencies that are a division of one financial department: Alaska (Department of Commerce, Community and Economic Development, Division of Banking and Securities), Arizona (Arizona Department of Financial Institutions), California (Department of Financial Institutions), Colorado (Department of Regulatory Agencies), Connecticut (Department of Banking), Florida (Office of Financial Regulation), Georgia (Department of Banking and Finance), Hawaii (Department of Commerce & Consumer Affairs), Idaho (Department of Finance), Illinois (Department of Financial & Professional Regulation), Indiana (Department of Financial Institutions), Kentucky (Office of Financial Institutions), Maine (Department of Professional & Financial Regulation), Maryland (Department of Labor, Licensing and Regulation), Massachusetts (The Office of Consumer Affairs and Business Regulation), Michigan (Department of Labor and Economic Growth), Minnesota (Department of Commerce, Financial Examinations Division), Mississippi (Banking Division), Missouri (Department of Economic Development), Montana (Department of Administration), Nebraska (Department of Banking and Finance), New Hampshire (Banking Department), New Jersey (Department of Banking and Insurance/Office of Consumer Finance), New Mexico (Regulation and Licensing Department), New York (Banking Department-Community and Regional Banks Division), North Carolina (Department of Commerce), North Dakota (Department of Financial Institutions), Oregon (Department of Consumer and Business Services), Pennsylvania (Department of Banking), Rhode Island (Department of Business Regulation), South Carolina (Board of Financial Institutions), Vermont (Department of Banking, Insurance, Securities and Health Care Administration), Virginia (Virginia State Corporation Commission - Bureau of Financial Institutions), West Virginia (Division of Banking), Wisconsin (Department of Financial Institutions).

[2] Prior to the middle of the twentieth century, Texas had one consolidated financial institutions agency. The Federal Reserve Bank of Dallas was not established until 1914 and had operating branches in El Paso, Houston, and San Antonio.

[3] All national banks were required to be, and the large state-chartered banks were encouraged to become, members of the Federal Reserve System and the Federal Deposit Insurance Corporation.

Texas banking operations expanded during the post-WWII years. Commercial banks, savings and loan institutions (more than 150 by the early 1950s), federal and state credit unions, investment banks that issued and distributed securities of local corporations, and brokerage houses connected with firms in New York and other financial centers all appeared. A variety of federal lending agencies emerged to fill in gaps and improve existing facilities, particularly those for agricultural credit. Lending policies and funding practices changed. As interest rates rose in the mid-1950s, there was an increased emphasis on consumer services and credit cards became available.

As a result of the growth, distinctions emerged. These distinctions between specialized real estate finance and commercial banking led to the separation of the Savings and Loan Department from the Banking Department in 1961. In 1967, the Office of Consumer Credit Commissioner was created to handle consumer issues. In 1969, the Texas Credit Union Department was created to regulate credit unions. Since 1970, the financial institutions system has grown exponentially. The pie chart below provides a visual representation of the assets currently held by deposit-taking financial institutions in Texas.[4]



For the past decade, Texas debated whether to consolidate the agencies. The 2000 Sunset Report to the Legislature highlighted this debate, which discussed the changes needed to address several key organizational problems and increase consumer protection through stronger regulatory authority.[5]

[4] Federal Deposit Insurance Corporation (FDIC). For out-of-state institutions, asset figures represent deposit information as of June 30, 2005. This chart does not include the share value held by Texas credit unions.

[5] *Report to the 77th Legislature, 2000-2001*, Sunset Advisory Commission. The consolidation debate continues, due in part to the following Sunset staff' recommendations: Combine the Department of Banking and the Savings and Loan Department into one agency the Texas Department of Banks and Thrifts; continue the Office of Consumer Credit Commissioner and strengthen its oversight of sale-leaseback transactions, pay day loans, and car dealer financing; transfer the licensing of first lien mortgage brokers from the Savings and Loan Department to the Office of Consumer Credit Commissioner.

The Finance Commission

The Finance Commission of Texas is a board of private citizens appointed by the Governor of Texas.[6] The Finance Commission is responsible for overseeing and coordinating the Texas Department of Banking, the Department of Savings & Mortgage Lending, and the Office of the Consumer Credit Commissioner.[7] Further, it serves as the primary point of accountability for ensuring that state depository and lending institutions function as a system, considering the broad scope of the financial services industry.[8] The Finance Commission is the policy-making body for those agencies and is not a separate state agency. The Commission appoints the commissioners of these three agencies.

The Legislature created the Finance Commission in 1943 and granted it power under the Texas Finance Code. The Commission consists of nine members, subject to Senate confirmation.[9] Members serve overlapping, six-year terms.[10] The Finance Code requires the composition of the Commission to include one state banker, one state savings and loan executive, one consumer credit executive, one mortgage broker and five public members, one of whom must be a certified public accountant. The Governor appoints the presiding officer. The Commission is required to meet at least six times annually and the dates of its future meetings are noted on its website.[11] All meetings are subject to the Open Meetings Act and are posted approximately seven days in advance in the *Texas Register*.

Originally, the Commission was a separate state agency, but the 2000-2001 Sunset review process recommended the elimination of that status.[12] Regardless, the Legislature did strengthen and broaden the representation and the policy role of the Finance Commission.

The Credit Union Commission

Unlike the Department of Banking, Department of Savings & Mortgage Lending and the Office of the Consumer Credit Commissioner, the Credit Union Department is governed by a separate Commission also composed of nine members, appointed by the Governor and confirmed by the Senate.[13] Each member is appointed to a six-year term, on a staggered basis for continuity and consistency, and serves until a successor is appointed and qualified. Four members are required to have at least five years active experience as an executive, officer, director, or committee member of a credit union, with such service falling within the preceding ten years. Five

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[6] TEX. FIN. CODE § 11.
[7]These three agencies are housed in the State Finance Commission Building located at 2601 North Lamar, Austin, TX 78705. The Credit Union Commission has its own separate building.
[8] Information on the Finance Commission available at: http://www.fc.state.tx.us.
[9] *See* TEX. FIN. CODE § 11.
[10] Current members of the Commission are John Snider (Chair), Gary Akright, Mike Bradford, Vernon Bryant, Hector Delgado, Kenneth Harris, Cindy Lyons, Allan Polunsky, and W.J. (Bill) White.
[11] *See* www.fc.state.tx.us for more information.
[12] The 77th Regular Legislative Session passed HB 1763 (McCall) which changed this structure. *See also Report to the 77th Legislature, 2000-2001,* Sunset Advisory Commission.
[13] Current members of the Commission are Gary Janacek (Chair), Thomas Butler, Manuel Cavazos, Rufino Carbajal, Jr., Cydney Donnell, Mary Ann Grant, Dale E. Kimble, Barbara K. Sheffield and Henry E. Snow.

members are designated as "public members" and may not be an officer or director of a financial institution.

The Commission's responsibilities include oversight of the agency and the promulgation of rules. The Commission also acts as an appeal board to hear appeals to the decisions and/or order of the Commissioner. The Commission has a separate Sunset review process and is scheduled to undergo its next review process in 2009.[14]

Department of Banking

The Department does not license and regulate all financial service providers in Texas. The Department oversees certain types of financial services including banks, trust companies, money transmitters, gift card sellers, and pre-need funeral contract providers.[15]

The agency began issuing bank charters in 1905 through the Department of Agriculture, Insurance, Statistics, and History, under the title of Superintendent of Banking. Over time, the Department acquired additional supervisory responsibilities. The Texas Legislature reviewed and modified the Department of Banking after its Sunset review in 2001.[16]

By statute, the Department is self-funding, self-leveling and has no impact on the state budget. The Commissioner is only authorized to impose and collect fees established by the Finance Commission for the cost of examination, the equitable or proportionate cost of maintenance and operation of the Department, and the cost of enforcement.[17] The agency generates its operating funds from fees assessed to the businesses supervised by the Department.[18] No general revenue funds are used to support agency operations. Actual expenditures in fiscal year 2005 were $12,923,663.[19]

The Department staff in 2006 totaled 169 full-time employees.[20] Approximately 66 percent of the agency's actual staff are financial examiners who perform on-site examinations of the different licensed entities regulated, and a large percentage of the agency's budget supports this staff and the examination process.[21] For the fiscal year ending August 31, 2005, 91 percent of

[14] Testimony of Commissioner Harold Feeney, Texas Credit Union Department, before the Texas House Committee on Financial Institutions, June 20 2006.
[15] Testimony of Commissioner Randall James before the Texas House Committee on Financial Institutions, June 20 2006; *See also* Texas Department of Banking, *Agency Strategic Plan for Fiscal Years 2007-2011*, June 23, 2006.
[16] The 77th Regular Legislative Session passed SB 314 (Sibley) which modified TEX. FIN. CODE § 12.
[17] *See* TEX. FIN. CODE § 31.1051-106.
[18] *Id*.; *see* Testimony of Commissioner Randall James before the Texas House Committee on Financial Institutions, June 20 2006; *See also* Texas Department of Banking, *Agency Strategic Plan for Fiscal Years 2007-2011*, June 23, 2006.
[19] *Id*.
[20] *Id*. However, due to financial examiner turnover and other factors, actual staffing in recent fiscal years was below this level.
[21] Testimony of Commissioner Randall James before the Texas House Committee on Financial Institutions, June 20 2006.

the Department's expenses were for salaries, other employee benefits and travel costs (relating primarily to performing on-site examinations and training).[22]

As of December 31, 2005, supervisory authority is exercised over 1,183 financial service providers that control approximately $205 billion in financial assets.[23] Agency staffing is split into several divisions that report to two deputy commissioners; these divisions include the Bank and Trust Division, Private Child Support Enforcement Agencies Division, and Special Audits Division.

The largest division is Bank and Trust which, as of February 28, 2006, accounted for 62 percent of the agency's 154 current employees.[24] Field examiners make up 81 percent of the division's total staffing. This division supervises the activities of banks, trust companies, and foreign bank agencies. Assessments to commercial banks and trust companies provide 81 percent of the Department's revenue.[25] These businesses are indicated and further illustrated in the table below.

Texas Department of Banking - Banks &Trusts[26]

Financial Service Provider	No. of Entities / Assets Under Administration (In Millions)	Applicable Law Requiring Examination and / or Licensing
Banks (1)	341 $89,422	Chapter 31 of the *Texas Finance Code* (TFC) requires the Commissioner to examine each state bank annually or more often as necessary to safeguard the interests of depositors, creditors, shareholders, participants and participant-transferees. Under certain circumstances, the timeframe between examinations may be extended to 18 months.
Trust Companies	24 $24,696	Chapter 181 of the TFC requires the Commissioner to examine each state trust company annually or more often as necessary to safeguard the interests of clients, creditors, shareholders, participants and participant-transferees. The banking commissioner may defer an examination for not more than six months if the deferment is necessary.
Offices of Foreign Bank Agencies	7 $22,784	Chapter 204 of the TFC requires the Commissioner to examine each Texas state branch, agency or representative office of a foreign bank annually or more often as necessary to determine if the office is operated in a safe and sound manner.

[22] *Id.*
[23] In 2000, the Department's budget was $10.1 million, it employed 136 examiners, regulated 370 state-chartered banks and 33 trust companies, regulated 227 perpetual care cemeteries, 438 prepaid funeral contract sellers, 49 check sellers, and 84 currency exchange and transmission businesses. *See* Report to the 77th Legislature, 2000-2001, Sunset Advisory Commission.
[24] Texas Department of Banking, *Agency Strategic Plan for Fiscal Years 2007-2011*, June 23, 2006.
[25] *Id.*
[26] Information includes information on all out-of-state, state-chartered banks operating in Texas, prepared by the Texas Department of Banking, *Agency Strategic Plan for Fiscal Years 2007-2011*, June 23, 2006.

The second group of entities the Department regulates is the registration of Private Child Support Enforcement Agencies.[27] Agency personnel investigate consumer complaints and attempt to reach an agreeable resolution. The legal staff also reviews contracts signed by consumers for clarity and appropriateness.[28] These businesses are indicated and further illustrated in the table below.

Texas Department of Banking - Private Child Support Enforcement Agencies

Financial Service Provider	No. of Entities / Assets Under Administration (In Millions)	Applicable Law Requiring Examination and / or Licensing
Private Child Support Enforcement Agencies	14 N/A	Chapter 396 of the TFC requires the Banking Commissioner to monitor private child support enforcement agencies through registration and investigation of consumer complaints.

Finally, the Department has a Special Audits Division which, as of February 28, 2006, accounts for 11 percent of the agency's 154 current employees.[29] Field examiners make up 71 percent of the division's total staffing.[30] This division supervises the activities of money services businesses, prepaid funeral contract providers, and perpetual care cemetery associations. Assessments to the division's licensed entities provide 16 percent of the Department's revenue.[31] These businesses are indicated and further illustrated in the table below.

Texas Department of Banking - Special Audits Division

Financial Service Provider[32]	No. of Entities / Assets Under Administration (In Millions)	Applicable Law Requiring Examination and / or Licensing
Money Services Businesses[33]	133 $65,182	Chapter 151 of the TFC requires that the Banking Commissioner examine each money service business licensee annually or at other times as the Commissioner may reasonably require to protect and safeguard customer funds and prevent money

[27] TEX. FIN. CODE § 396. The Private Child Support Enforcement Agencies enforcement was under the Department of Banking's supervision by the 77th Legislature. Texas Department of Banking, *Agency Strategic Plan for Fiscal Years 2007-2011*, June 23, 2006.
[28] *Id.*
[29] Texas Department of Banking, *Agency Strategic Plan for Fiscal Years 2007-2011*, June 23, 2006.
[30] *Id.*
[31] *Id.*
[32] Information by the Department of Banking as of December 2005. This chart includes currency exchange, transmission and transportation businesses, gift card, stored value card and money order sellers, and companies that deal in travelers' checks, drafts, and bill payments. The Department does not license companies that cash checks, authorized delegates of licensed businesses, or companies that issue stored value cards in a closed system. Authorized delegates are, however, subject to examination.
[33] The Special Audits Division issues licenses and performs examinations of money services businesses, or MSBs. The activities of MSBs have come under increased scrutiny after the tragic events of September 11, 2001. The early identification of possible money laundering activities from terrorists or drug traffickers has placed a heightened sense of purpose and importance to the actions of the Special Audits Division. Also, more and more transactions are being conducted using electronic methods causing changes in the industry and its regulation.

		laundering and funding of terrorist activities.
Prepaid Funeral Contract Sellers	424 $2,705	Chapter 154 of the TFC stipulates that the records of prepaid funeral contract sellers are subject to annual examination or more frequently as considered necessary to protect the prepaid funds and to assure that the contracted services and merchandise are provided at the time of death.
Perpetual Care Cemeteries	240 $186	Chapter 712 of the Texas Health and Safety Code requires that the Banking Commissioner examine each perpetual care cemetery annually or more often as necessary to protect and safeguard the perpetual care trust funds and to assure that the fund income is used to maintain and support cemetery maintenance.

The Department of Banking shares oversight of prepaid funeral contract providers and perpetual care cemetery associations with the Texas Department of Insurance and Texas Funeral Service Commission.[34] The chart below depicts the statistics of the Department of Banking Prepaid Funeral Contract Licensees.

	Number of Permits	**Number of Contracts**	**Dollars**
Trust Funded	362	375,005	$910,930,550
Insurance Funded	57	461,786	$1,939,899,062
Totals	419	836,791	$2,850,829,612

The profile of the banking industry continues to change. The number of state bank charters has decreased as mergers have outpaced conversion and de novo activity. The introduction of interstate banking in 1999 initiated wholesale changes in the structure of the banking industry in Texas, which in turn affects the Department's examination mandate.[35] Competition to provide customers with a greater variety of products, services, branches and ATM networks, as well as general economies of scale are driving bank mergers. Regulatory burden, which has a much greater impact on community banks than larger regional banks, also influences owners of smaller institutions to merge with larger ones.

Over the last 15 years, the number of state bank charters has decreased from 577 at year-end 1990 to 324 at year-end 2005.[36] However, while the number of banks is decreasing, the number of banking offices (branch locations) is increasing at a dramatic pace, from 467 in 1990 to 1,288 in 2005.[37] The number of branch applications processed in 2004 and 2005 was 184 percent and 185 percent respectively, over the number processed in 2003.[38]

As the Texas economy grows, the assets controlled by the remaining state-chartered banks have greatly increased in the last five years from $53.6 billion in 2000 to $76.7 billion in 2005.[39]

[34] TEX. FIN. CODE § 154.
[35] Texas Department of Banking, *Agency Strategic Plan for Fiscal Years 2007-2011*, June 23, 2006.
[36] *Id.*
[37] *Id.*
[38] *Id.*
[39] *Id.*

Thus, there are fewer banks but the average size bank (in terms of branch locations, deposits and assets) has increased dramatically. By the end of 2005, the average Texas state-chartered bank controlled $248 million in assets.[40]

The Department is receiving an increased number of applications for new bank charters, a trend which is expected to continue through 2007. The number of charters decreased by only 29 in the last five years, indicating that new charter and conversion activity is substantially offsetting merger activity.[41] Encouraged by the bank mergers, investors are finding new market opportunities and are filing applications for new charters to serve their communities.[42] Additionally, the number of conversion applications from national banks and thrifts has increased over the last five years.[43] This migration to a state charter reflects the merits of a more accessible and efficient state regulatory authority and the dual banking system. The chart below illustrates the new charter activity in Texas from 2003-2006.[44]

State Banks	8	1	5	1	15	7#	22
National Banks	1	7	0	1	9	2*	11
Savings Institutions	0	1	1	3	5	2*	7

Texas is currently the home state for one large interstate bank, and the relocation of others to Texas could bring substantial employment and revenue to the state.[45] Enhancements to the Texas Finance Code by the 79th Legislature, along with this state's central geographic location and strong demographics, make Texas an attractive site for a company's headquarters. A greater number of out-of-state banks are now conducting business in Texas, and experts think this trend will continue. Out-of-state banks, both state and national charters, conducting business in Texas have increased from 15 at year-end 2000 to 37 at year-end 2005.[46] Only 8 of the 20 largest banks and savings institutions currently operate offices in Texas.[47] As traditional markets for the remaining 12 approach saturation, some will be attracted to Texas by the vibrant economy. It appears likely that geographic restrictions on interstate branching and mergers will continue to fall. The following chart illustrates the out-of-state banking trend.

[40] This increase has a significant affect on the Department's operations, as banks with over $250 million in total assets are examined on an annual schedule, versus an eighteen month schedule for smaller institutions. As the average bank size increases, the Department must perform more frequent examinations. Larger institutions are also more likely to engage in sophisticated investment and lending activities.
[41] Texas Department of Banking, *Agency Strategic Plan for Fiscal Years 2007-2011*, June 23, 2006.
[42] *Id.*
[43] *Id.*
[44] This chart includes thrifts/savings institutions, which are regulated by the Department of Savings & Mortgage Lending.
[45] Texas Department of Banking, *Agency Strategic Plan for Fiscal Years 2007-2011*, June 23, 2006.
[46] *Id.*
[47] *Id.*

Out-of-State Branching Activity in Texas[48]

June 30, 2000

Bank or Branch Name	Home State	Number of Banks	Number of Branches
Texas State-chartered Banks	Texas	370	929
Branches			
Regions Bank	Alabama	1	32
Colonial Bank	Alabama	1	2
Compass Bank	Alabama	1	129
SouthTrust Bank	Alabama	1	35
Banco Popular	New York	1	6
Chase Bank	New York	1	162
Subtotal		***376***	***1,295***

June 30, 2005

Bank or Branch Name	Home State	Number of Banks	Number of Branches
Texas State-chartered Banks	Texas	330	1,248
Branches			
Regions Bank	Alabama	1	54
Compass Bank	Alabama	1	139
Banco Popular	New York	1	7
Bancorp South Bank	Mississippi	1	16
First Bank	Missouri	1	9
Cathay Bank	California	1	0
Coppermark Bank	Oklahoma	1	0
Sabine State Bank	Louisiana	1	0
First United Bank & Trust	Oklahoma	1	0
Comerica	Michigan	1	49
The F&M Bank & Trust	Oklahoma	1	0
Bank of the Ozarks	Arkansas	1	0
Wilshire State Bank	California	1	0
East West Bank	California	1	0
Less Out of State Branches:	Texas		-56
Subtotal		***344***	***1,466***

48 Prepared by the Texas Department of Banking – July 2006.

Texas National-chartered Banks	Texas	358	1,473
Branches			
Bank of America	North Carolina	1	564
Hibernia National Bank	Louisiana	1	34
Union Planters Bank	Tennessee	1	18
Whitney National Bank	Louisiana	1	2
Texas S & L's	Texas	58	619
Subtotal		***420***	***2,710***
Total		***796***	***4,005***
Grand Total - Banks & Branches			***4,801***

Texas National-chartered Banks	Texas	307	1,688
Branches			
Bank of America	North Carolina	1	485
Hibernia National Bank	Louisiana	1	89
Union Planters Bank	Tennessee	1	17
Whitney National Bank	Louisiana	1	11
First National Bank	Wisconsin	1	2
First National Bank	Nebraska	1	1
East West Bank	California	1	0
Countrywide Bank	Virginia	1	0
Stillwater National Bank	Oklahoma	1	1
Colonial Bank	Alabama	1	13
US Trust Company	Connecticut	1	2
Wells Fargo	South Dakota	1	478
Trustmark National Bank	Mississippi	1	5
Armed Forces Bank	Kansas	1	1
Fort Sill National Bank	Oklahoma	1	1
Landmark Bank	Oklahoma	1	4
JP Morgan Chase Bank	New York	1	381
Wachovia Bank	North Carolina	1	60
First Horizon Bank	Tennessee	1	2
First Texoma National Bank	Oklahoma	1	2
Commercebank	Florida	1	0
Less Out of State Branches:	Texas		-19
Texas S & L's	Texas	49	452
Subtotal		***377***	***3,676***
Total		***721***	***5,142***
Grand Total - Banks & Branches			***5,863***

Information is derived from the FDIC call report database.

66 more banks and branches have been added since June 30, 2005, and as of January 5, 2006 now total 5,929.

Report prepared by the Texas Department of Banking - July 2006.

Department of Savings & Mortgage Lending

The Texas Department of Savings & Mortgage Lending (the Department) regulates thrifts and mortgage brokers. The Department oversees the chartering, regulation, examination and supervision of state chartered savings banks and state savings and loan associations.[49]

In 1999, the Texas Legislature enacted the Mortgage Broker License Act for licensing and regulating first lien residential mortgage brokers and loan officers doing business in Texas.[50] The statute prescribes education and experience requirements for issuing or renewing a license, and pre-testing requirements for a new license, inspection of mortgage broker licensees, and a process for filing and investigating consumer complaints.[51] In 2001, the 78th Legislature promulgated the Mortgage Banker Registration Act for requiring registration of mortgage bankers conducting business in Texas.[52] The Act also provides borrowers with notice of the process for filing and investigation of consumer complaints.[53]

Several differences exist between state-chartered thrifts, banks and mutually operated credit unions. One of the most significant differences between thrifts and state-chartered banks or mutually operated credit unions is the mandate requiring thrifts to maintain at least 50 percent of its assets as residential lending or related assets.[54] Banks and credit unions can venture into the area of mortgage lending and investment, but they are not required to maintain half of their assets in real estate. As the thrift charter mission and purpose dictate, the thrift states permit institution subsidiaries to engage in residential land development and other residential real estate activities in which banks do not typically or traditionally engage.[55]

At the time of this report, the Department regulated 22 thrifts and 2 de novos.[56] Currently, the combined assets of the state-chartered savings banks are over $8.5 billion.[57] In the last two years, Texas acquired 5 new thrifts while several other thrifts merged or were purchased by other entities.[58] Thrifts are predominately engaged in residential mortgage lending with some commercial lending. The Department also regulates almost 400 Mortgage Banking Companies.[59] At the time of this report, the Department has licensed 24,300 mortgage brokers and sponsored loan officers.[60] The Department has a $4 million annual budget which is self-

[49] Texas Department of Savings & Mortgage Lending, *Agency Strategic Plan for Fiscal Years 2005-2009*.
[50] TEX. FIN. CODE § 156.
[51] *Id.*
[52] TEX. FIN. CODE §157.
[53] *Id.* The 78th Legislature passed HB 1636 (McCall).
[54] TEX. FIN. CODE § 92.204. Federally, the Office of Thrift Supervision requires 65 percent of Assets as pursuant to 12 U.S.C. §1467a(m).
[55] *Id.*
[56] Testimony of Commissioner Danny Payne of the Texas Department of Savings & Mortgage Lending, before the Texas House Committee on Financial Institutions, June 20 2006.
[57] *Id.*
[58] *Id.*
[59] *Id.*
[60] *Id.*

funded by the entities it regulates. The staff in 2006 totaled 57 full-time employees, including 21 examiners.[61] Examiners inspect thrifts annually, if not semi-annually.[62]

Office of Consumer Credit Commissioner

The Office of Consumer Credit Commissioner (OCCC) oversees the credit industry and the education of consumers. OCCC regulates businesses that advance cash or loan money and that sell merchandise on credit, including pawnshops and their employees.[63] The OCCC was established in 1967 to enforce the provisions of the Texas Credit Code, even though credit regulation has existed in Texas in some form since the state was an independent republic.[64] The Consumer Credit Commissioner is appointed by the Finance Commission of Texas.[65]

The OCCC differs from the other financial institutions agencies because it has a three-fold mission. First, the OCCC must regulate and license qualified lenders while addressing the rights of both consumers and creditors. Second, the OCCC must educate consumers and credit providers of their rights, remedies, and responsibilities. Finally, the OCCC is charged with protecting and safeguarding consumers against abusive and deceptive lending practices.[66] The OCCC regulates the following types of transactions:[67]

> **Home Equity Loans:** Home equity loans allow borrowers to use the market value of a home as collateral for a loan. Loans secured by real estate generally are considered safer by lenders, resulting in lower interest rates than other types of loans.
>
> **Secondary Mortgages:** Also known as *second lien* or *junior lien* mortgages, secondary mortgages are secured by houses that already have at least one other mortgage or lien.
>
> **Home Improvement Loans:** Home improvement loans can hold either first lien positions (the only or primary loan secured by a house) or second lien positions. Loan principal is devoted to home repairs and renovations.
>
> **Motor Vehicle Sales Financing:** Companies that finance motor vehicle sales in Texas are licensed by the OCCC. The requirement extends to dealers that provide financing themselves and to dealers that arrange financing with lenders for their customers, as well as the finance companies that provide financing to dealers' customers.
>
> **Pawnshop Transactions:** Pawnshops make loans in exchange for keeping collateral on-site at the lending locations. When borrowers pay back their loans, they get back the

[61] *Id.*
[62] *Id.*; In 2001, the Department had an annual budget of $1.2 million, with 22 examiners, 9,259 mortgage brokers and loan officers, and 26 state-chartered thrifts. See Report to the 77th Legislature, 2000-2001, Sunset Advisory Commission.
[63] Information provided by the Office of Consumer Credit Commissioner. *See also* Office of Consumer Credit Commissioner, *Agency Strategic Plan for Fiscal Years 2005-20009*.
[64] *Id.*
[65] *Id.*
[66] TEX. FIN. CODE §14.001-14.303.
[67] Information provided by the Office of Consumer Credit Commissioner.

items left as collateral. If they choose not to repay, the pawnshops keep the items for retail re-sale.

Signature Loans: Signature loans are unsecured loans, meaning that the borrower pledges no collateral but receives a loan upon putting a signature to an agreement. Lenders generally grant up to $500 for signature loans amounts.

Payday Loans: Payday loans are made for up to $500 and usually require payment in two weeks or less. Generally, the consumer writes a check as security for the loan with the understanding that the lender will not present the check for deposit until a predetermined date (such as the borrower's next payday).

Consumer Installment Loans: These are secured loans that a borrower pays off in multiple installments. Loan amounts typically range from $500 to $12,000.

Retail Credit Accounts: Some retailers act as creditors, financing the sales of their goods and services and thus allowing their customers to make payments over time. These creditors include boat and manufactured home dealers, furniture and carpet retailers, home improvement and air conditioner sales and service companies, and some medical offices, etc.

Primary OCCC functions are divided into five areas: Consumer Assistance, Consumer Protection, Licensing and Registration, Credit Education, and Legal & Administration.[68] The Consumer Assistance section helps consumers in resolving complaints with creditors and provides mediation when necessary. It has a helpline number (800-538-1579) printed on every contract used by a creditor subject to agency regulation. Consumers can call the hotline and receive assistance on various consumer complaints regarding issues such as the motor vehicle licensing program, payday loans and other credit programs.[69]

The Consumer Protection section is also known as the examination and enforcement section. The OCCC examines licensed lenders and investigates creditors, licensees, and license applicants in order to ensure compliance with the Texas Finance Code.[70] Examinations generally take place every 12 to 18 months. During an examination, the examiner will review actual contracts on a sample basis; often these reviews reveal errors. The OCCC requires licensees to make corrections either through refunding money directly to consumers, crediting their accounts, or providing updated and corrected disclosures.[71] The agency currently regulates about 5,300 licensed lending locations.

The Licensing and Registration section processes all regulated loan, motor vehicle sales financing, pawnshop, and pawnshop employee license applications, as well as creditor registrations. With the shift of motor vehicle dealers from the relatively simple process of

[68] Information provided by the Office of Consumer Credit Commissioner. *See also* Office of Consumer Credit Commissioner, *Agency Strategic Plan for Fiscal Years 2005-20009*.
[69] *Id*.
[70] Testimony of Commissioner Leslie Pettijohn of the Office of Consumer Credit Commissioner, before the Texas House Committee on Financial Institutions, June 20 2006.
[71] Information provided by the Office of Consumer Credit Commissioner. See also Office of Consumer Credit Commissioner, *Agency Strategic Plan for Fiscal Years 2005-20009*.

registration to the far more rigorous license application process, this section has seen a drastic increase in activity since September 2002. Since that time, almost 5,800 motor vehicles sales finance licenses have been issued, increasing by 66 percent the number of licenses in force.[72] The chart on the following page depicts the licensing activity trends over the past four years.

Coupled with its complaint resolution, the OCCC also educates consumers on credit use and promotes consumer resources and assistance as part of its Credit Education section. The OCCC distributes information to the public via their website, training videos, newsletters, and educational displays. The OCCC also focuses education efforts on the elderly, students, and low-income groups since these groups are the predominant targets of predatory lending and abusive creditors.[73] Finally, the OCCC develops educational programs for financial literacy aimed at high school and college students to prepare them for their future use of credit products.

The final department of the OCCC is the Legal & Administration department. This department handles all personnel, accounting, purchasing, agency publication management, media relations, and record retention.[74] The agency relies on outside sources for some operational support by sharing personnel with the Department of Banking and the Savings and Loan Department and by contracting with private providers.

The OCCC's budget for fiscal year 2006 was about $4.4 million.[75] The agency collects all of its revenue from fees levied from the regulated industries. OCCC employs 53 full-time employees, with offices in Austin, Dallas, Houston, San Antonio, and the Rio Grande Valley.[76] Similar to the Department of Banking, the Credit Union Department and Department of Savings & Mortgage Lending, the OCCC finances its budget through fees collected from the entities it regulates.[77]

Unlike the other financial institution agencies, the OCCC can issue interpretations of Title 4 that relate to consumer credit transactions.[78] The Commissioner receives requests for interpretations, which must be published in the *Texas Register*.[79] The Finance Commission must approve the interpretation before the OCCC issues and publishes it.[80]

[72] *Id.*
[73] Testimony of Commissioner Leslie Pettijohn of the Office of Consumer Credit Commissioner, before the Texas House Committee on Financial Institutions, June 20 2006.
[74] *Id.*
[75] Information provided by the Office of Consumer Credit Commissioner. See also Office of Consumer Credit Commissioner, *Agency Strategic Plan for Fiscal Years 2005-20009*.
[76] Testimony of Commissioner Leslie Pettijohn of the Office of Consumer Credit Commissioner, before the Texas House Committee on Financial Institutions, June 20 2006.
[77] *Id.*
[78] *See* TEX. FIN. CODE § 14.108.
[79] *Id.*
[80] *Id.*

Office of Consumer Credit Commissioner - Historical Overview of Licensing Activity[81]

License Information	FY 2003	FY 2004	FY 2005	2006 FYTD
Total Regulated Loan Licenses	4,903	4,997	5,363	5,303
Active	4,377	4,501	4,879	4,503
Inactive	526	496	484	800
Licenses Canceled	604	535	324	664
Licenses Revoked	9	3	6	0
Breakdown of Mortgage Lenders				
Total 342-G (Secondary Mortgage) Lenders	*	519	671	891
Active	*	508	643	845
Inactive	*	11	28	46
Total A6 (Home Equity) Lenders	*	556	589	622
Active	*	516	552	590
Inactive	*	40	37	32
Total Pawnshop Licenses	1,513	1,506	1,501	1,512
Active	1,218	1,209	1,209	1,210
Inactive	295	297	292	302
Licenses Canceled	15	14	13	1
Licenses Revoked	0	2	0	0
Total Motor Vehicle Sales Finance Licensed Locations	2,452	4,093	5,288	5,778
Active	2,448	4,085	5,280	5,767
Inactive	4	8	8	11
Licenses Canceled	65	284	417	83
Licenses Revoked	0	0	0	0
Total Registered Offices	717	1,089	1,389	1,482
Licenses Canceled	92	170	198	117
Licenses Revoked	0	0	0	0
Application Activity:Total Number Processed	**FY 2003**	**FY 2004**	**FY 2005**	**2006 FYTD**
Regulated Applications	1,429	1,024	1,008	900
Pawnshop Applications	110	96	107	143
Motor Vehicle Sales Finance Applications	2,601	2,325	1,938	739

****Not Available***

[81] Information provided by Commissioner Leslie Pettijohn of the Office of Consumer Credit Commissioner following her testimony before the Texas House Committee on Financial Institutions, June 20, 2006.

Credit Union Department

The Credit Union Department was created by the Texas Legislature in 1969.[82] The Department consists of a policy and oversight board called the Credit Union Commission and the Credit Union Commissioner and his staff.

The purpose of the department is to charter, examine, and supervise the credit unions operating under the authority of the Credit Union Act.[83] The Department fulfills its responsibilities through appropriate means of investigating the feasibility of proposed credit unions prior to issuance of charters, and by assisting and counseling applicants in the early stages of development.

The Department's regulatory responsibility covers 225 credit unions with approximately $17.6 billion in total assets that serve almost 3 million members.[84] The Department promulgates rules, which define and support the provisions of the Act, and conducts annual examination of each credit union under its jurisdiction. Examinations determine whether certain credit unions have minor to major deficiencies and the Department has the authority to issue demand letters for corrective actions of such deficiencies. In addition, for more serious or ongoing concerns the Commissioner may enter into written agreements, or, if need be, issue a "cease and desist" order. The Commissioner also has the authority to issue orders of conservatorship and orders of involuntary liquidation.

Unlike the Department of Banking, Department of Savings & Mortgage Lending and the OCCC, the Credit Union Department is governed by a separate Commission composed of nine members, appointed by the Governor, with the advice and consent of the Senate.[85] Each member is appointed for a six-year term, on a staggered basis for continuity and consistency, and serves until a successor is appointed and qualified. Four members shall have had at least five years active experience as an executive, officer, director, or committee member of a credit union, such service to have been within the preceding ten years. Five members are designated as "public members" and may not be an officer or director of a financial institution. The Commission's responsibilities include oversight of the agency and the promulgation of rules. The Commission also acts as an appeal board to hear appeals to the decisions and/or order of the Commissioner.

Overhead and all personnel costs are entirely covered by revenue generated from credit unions. The Department derives all of its revenue from assessments and fees paid by credit unions under its supervision.[86] The assessments and fees are set to cover the Department's direct and indirect expenses. Assessments are calculated on a sliding scale based on the credit union's asset size.

The Department's only office is a stand-alone facility that was built in 1978 and paid for by all the credit unions then in business. It was donated to the State of Texas for the use of the Credit

[82] Information provided by Commissioner Harold Feeney, Texas Credit Union Department.
[83] *Id.*
[84] *Id.*
[85] Current members of the Commission are Gary Janacek (Chair), Thomas Butler, Manuel Cavazos, Rufino Carbajal, Jr., Cydney Donnell, Mary Ann Grant, Dale E. Kimble, Barbara K. Sheffield and Henry E. Snow.
[86] Information provided by Commissioner Harold Feeney, Texas Credit Union Department.

Union Department. There are 10 full-time employees housed in the headquarters, and there are 16 examiners in the field, working from their homes, in two geographical areas: North and South Texas zones.[87]

ANALYSIS

Committee Hearing

The Committee held a public hearing at the Texas State Capitol on June 20, 2006 to hear invited testimony on its interim charges. In preparation for the hearing, the Committee asked the Commissioners to address the following questions during their testimony:

- What operational or legal problems or concerns do you see regarding consolidating the departments?
- What functions in the departments possibly could be consolidated that relate to effectiveness, enforcement, or management?
- What are the similarities and differences between the departments?
- What is the agency's progress based on the 2000 Sunset Report?[88]

The Committee invited Commissioner Leslie Pettijohn (Office of the Consumer Credit Commissioner), Commissioner Danny Payne (Department of Savings & Mortgage Lending), Commissioner Randall James (Department of Banking) and Commissioner Harold Feeney (Texas Credit Union Department) to provide testimony on this interim charge.[89]

Office of the Consumer Credit Commissioner

Commissioner Leslie Pettijohn testified that consolidation of all four financial agencies would conflict with the missions of the agencies.[90] The Office of Consumer Credit Commissioner regulates non-depository institutions which include pawnshop transactions, second mortgages, motor vehicle sales financing, signature loans, payday loans, consumer installment loans and retail credit accounts. At the time of this report, the licenses issued by the OCCC total between 27,000-28,0000 licenses.[91]

[87] Information provided by Commissioner Harold Feeney, Texas Credit Union Department.
[88] These questions were submitted to the agencies on May 22, 2006; *See also Report to the 77th Legislature, 2000-2001*, Sunset Advisory Commission.
[89] The Committee chose to hear testimony from the agencies which are directly affected by potential consolidation. During the hearing, the Committee invited stakeholders and industry representatives to submit written testimony by July 15, 2006 to determine if the consolidation issue required additional public discussion. Based on the comments received (two groups submitted comments relating to consolidation), the Committee concluded the Commissioners' testimony sufficed.
[90] Testimony of Commissioner Leslie Pettijohn of the Office of Consumer Credit Commissioner, before the Texas House Committee on Financial Institutions, June 20 2006.
[91] *Id.*

The OCCC focuses on consumer protections, which Commissioner Pettijohn believes would conflict with the other three agencies that focus on management safety and soundness issues.[92] Legally, the four agencies are authorized by separate statutes and also have different procedures to license businesses and individuals. Consolidation would affect the agencies' missions and licensing processes. Texas would face the same situation that challenges other states that consolidated their financial institutions; the issues of safety and soundness could potentially override the issues of consumer protection due to competing resources.[93]

Unlike the other financial institution agencies, the OCCC can issue interpretations that relate to consumer credit transactions.[94] The Commissioner receives requests for interpretations, which must be published in the *Texas Register*.[95] The Finance Commission must approve the interpretation before the OCCC issues and publishes interpretation in the Texas Register.[96]

In response to the Sunset issues, the OCCC has implemented motor vehicle sales finance - requiring licensing, not only registration.[97] Since the licensing requirement went into effect, it provided the OCCC the ability to enforce the license holders. Another issue the OCCC has addressed is the plain language contracts. As of 2006, a total of six different types of plain language contracts have been put into effect.[98]

Department of Savings & Mortgage Lending

Commissioner Danny Payne testified that consolidation would not result in material cost savings or significant staff reductions to the state.[99] The activities of oversight would still require essentially the same level of management effort and staffing as presently exists for the chartering of savings banks (numbering 22 with two charter applications pending), licensing and examination of mortgage brokers and sponsored loan officers (numbering 24,300+), registration of mortgage banking companies (numbering 400), management of signification mortgage consumer complaint levels (numbering 950-1,000 annually) and related investigations, assisting and hearing scheduling for the Administrative Law Judge, and preparing for and participating in appeals cases.

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[92] *Id.*
[93] *Id.*
[94] TEX. FIN. CODE § 14.108. Stakeholders expressed strong support for this authority, which includes appropriate Finance Commission oversight. Due to the complexity of Texas usury law, stakeholders have relied on the informed, expert agency to provide interpretations on how to fully comply with Texas law. In comparison, the Governors of the Federal Reserve issue commentary on federal consumer regulations.
[95] *Id.*
[96] *Id.*
[97] During the 77th Regular Legislative Session, HB 1816 (McCall) modified TEX. FIN. CODE § 348.501.
[98] Testimony of Commissioner Leslie Pettijohn of the Office of Consumer Credit Commissioner, before the Texas House Committee on Financial Institutions, June 20 2006.
[99] Testimony of Commissioner Danny Payne of the Department of Savings & Mortgage Lending, before the Texas House Committee on Financial Institutions, June 20 2006.

According to Commissioner Payne, the primary difference between the Department of Banking and the Department of Savings and Mortgage Lending was their respective business plans.[100] The financial institutions agencies already consolidated its duties/efforts in areas where deemed functional and practical. The agencies share a common telephone receptionist, T-1 computer lines, document imaging, building maintenance and management, the Administrative Law Judge and related administrative activities, and common areas in the office facility (reception/waiting areas, mailroom, supplies and hearing, conferences and meeting rooms). Further, the Department of Savings & Mortgage Lending works with OCCC to coordinate dual licensed first lien residential loan mortgage brokers/loan officers and second lien licenses.

Commissioner Payne acknowledged that other states are consolidating their agencies; however, Texas is similar to the organization of the federal government in that the state thrifts, state banks and state credit unions are governed by different statutes and regulators. While many states have consolidated their financial agencies into a single agency, it should be noted that other states have different funding structures and different charter regulations than Texas. When other states have consolidated, it usually does not equal a growth in new state bank, thrift and credit union charters. Actually, the opposite is true. The "post consolidation" thrift charter activity in those states over the past ten years indicates a federal charter preference rather than state charter.[101] The vast majority of new thrifts chartered in other states have chosen the federal specialized regulator.[102] During the same period, Texas attracted 75 percent of de novo state chartered thrifts nationwide.

The structure of Texas financial statutes not only attracts more businesses, but the 79th Legislature strengthened this structure with recent changes. The Legislature gave Texas financial agencies additional statutory authority to strengthen their licensing requirements.[103] These changes also permit mutual holding charters to convert to thrifts. The Department is resolving more complaints than prior. With the addition of new requirements for licensing, the examiners are cross-trained to investigate the thrifts and inspect mortgage brokers.

Commissioner Payne testified that the industry thinks consolidation will have more negative than positive effects. Consolidation would require training all examiners to handle needs of thrifts, mortgage brokers, specialization for industry stakeholders. Thrifts and mortgage brokers do not want consolidation for three reasons. First, the stakeholders believe consolidation would slow de novo based on other states' progress since consolidation. Second, the stakeholders believe that thrifts would convert to federal charters because the federal government has a separate thrift agency (Office of the Thrift Supervision) from banking agency.[104] Finally, keeping separate agencies would allow the four agencies to ensure management safety and soundness.

[100] Testimony of Commissioner Danny Payne of the Department of Savings & Mortgage Lending, before the Texas House Committee on Financial Institutions, June 20 2006.
[101] Information provided to the Committee by Commissioner Payne in preparation for June 20, 2006 hearing.
[102] *Id.*
[103] See Texas Finance Code Modernization Act (HB 955 by Solomons).
[104] *Id.*

Department of Banking

Commissioner Randall James testified that consolidation would be difficult to achieve without major statutory changes.[105] Also, due to the financial climate in Texas, many businesses are coming to Texas, including new banking activity.[106] Over half of the new commercial banks organized in Texas since the beginning of 2003 have opted for state charters.[107] Start-up costs for Texas state-chartered banks are 60 percent less than a national-chartered bank, and scheduled exam fees are 33 percent to 56 percent less than the Office of the Comptroller of the Currency, depending on asset size.[108]

If consolidation were to occur, consolidated functions could be broken down between administrative areas and statutory responsibilities. Consolidating administrative areas without consolidating statutory authorities could pose perceptions of, or actual, preferences of attention. But, consolidation would not result in cost savings because the Department of Banking, Department of Savings & Mortgage Lending and Office of the Consumer Credit Commissioner currently share the same building and support staff.

Maintaining distinct statutory authorities essentially requires distinct accounting and reporting functions, such as performance standards, strategic plans and sources of funds accountability. Current areas combined through cooperation and interagency contract among the three Finance Commission agencies include: external audit functions, building services, mail services, Administrative Law Judge, imaging information technology and support, security systems and receptionist and switchboard.[109]

There are many similarities between the agencies. All four agencies are regulatory by definition and substance: all perform examinations and process applications, all have similar board-approved rulemaking processes, all operate consumer complaint and assistance areas, all are self-funded by the industries they supervises, and all are self-leveling in that their funding sources do not contribute to nor receive other state revenue sources.[110]

Despite the similarities, Commissioner James argued that the agencies have primary distinctions in that they oversee four different financial arenas. Upon asking Commissioner James to specify the primary difference was between the Department of Banking and the Department of Savings and Mortgage Lending, Commissioner James replied the difference was the agencies' respective

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[105] Testimony of Commissioner Randall James, Texas Department of Banking, before the Texas House Committee on Financial Institutions, June 20 2006.

[106] *Id. See also* Chad Eric Watt, *Lots of baby banks being birthed in Texas*, Dallas Business Journal, July 17, 2006.

[107] *Id*. Testimony of Commissioner Randall James, Texas Department of Banking, before the Texas House Committee on Financial Institutions, June 20 2006. *See also* Marissa Fajt, *State Clear Favorite over Federal Among Tex. Charter Choosers*, American Banker, July 21, 2006.

[108] Testimony of Commissioner Randall James, Texas Department of Banking, before the Texas House Committee on Financial Institutions, June 20 2006. *See also* American Banker, *Citigroup to Drop Two of Its Thrift Charters, OTS: No fee increase seen despite expected 9 percent hit to '07 budget*, July 21, 2006.

[109] Testimony of Commissioners Danny Payne, Randall James and Leslie Pettijohn, before the Texas House Committee on Financial Institutions, June 20, 2006.

[110] Testimony of Commissioner Randall James, Texas Department of Banking, before the Texas House Committee on Financial Institutions, June 20 2006.

business plans.[111] Also, the uniqueness of each of the different regulated industries requires different training, experience and expertise for personnel. Cross-over examination staff utilization could be difficult, and require significant training time and costs.

Unlike the other financial institution agencies, the Department of Banking regulates the Private Child Support Enforcement, Money Services Businesses, Prepaid Funeral Contract Sellers and Perpetual Care Cemeteries. These divisions require a separate type of regulation, licensing and training staff to handle its oversight. [112] These divisions have separate statutory authority and do not have the emphasis on safety and soundness on which the banking statutes hinge. The Money Services Businesses came under the authority of the Department of Banking and prior to 9/11, the focus was on drug money and money laundering. Now, the focus has shifted to deal with homeland security and terrorism issues.[113]

Credit Union Department

Commissioner Harold Feeney testified that consolidation would not be in the best interest of Texas financial institutions and concurred with the testimony of the other Commissioners.[114] Since all the financial institutions are self-funding, consolidation would only result in savings for the licensees. As a result, consolidation would not result in savings to the state budget process.

Over the years, the ability of credit unions to have their own separate regulatory agency contributed to their growth in Texas.[115] Of all Texas credit unions, only 25 percent have less than $5 million in assets. [116] The Department is self-funded and maintains a separate building, which was given to the State by the Texas credit unions. Efficiency and attention to detail are strong benefits of a separate agency, which might be lost in consolidation.

[111] *Id.*
[112] *Id. See* p. 9-11 of this report for further explanation.
[113] *Id.*
[114] Testimony of Commissioner Harold Feeney, Texas Department of Credit Union, before the Texas House Committee on Financial Institutions, June 20 2006.
[115] Prior to becoming Commissioner of the Texas Credit Union Department, Commissioner Feeney used to work with a consolidated agency in another state. Unlike a consolidated agency, Commissioner Feeney noticed that the structure of the financial institutions in Texas enables each agency to focus on the nuances of financial law in regards to their specific needs.
[116] Testimony of Commissioner Harold Feeney, Texas Department of Credit Union, before the Texas House Committee on Financial Institutions, June 20 2006.

Discussion and Opinions from Industry Stakeholders

The Committee requested and received input from industry stakeholders regarding their opinions on consolidation.[117] Their letters illustrated the following reasons to not consolidate the financial agencies:

1. All of the agencies under review are self-funded and self-leveling. The various industries pay for the cost of regulation, and these industries are very satisfied with their state regulatory agencies. There is no cost to the state for the regulation and supervision of any agencies.
2. The current system mirrors in many respects what occurs at the federal level, only at a reduced cost to the institution using the state system. It is our belief that a dual charter system is paramount to a thriving environment for financial institutions.
3. Having smaller agencies is an advantage that allows the agencies to be more responsive to changing conditions.
4. The Finance Commission has addressed the issue of consolidation over the years and has never recommended this course of action. Agencies under the Finance Commission or the Credit Union Commission are instructed to utilize common efforts wherever it is deemed to be cost saving.

Overall, the stakeholders pointed out the two greatest assets to the current structure, which arguably support maintaining its independence. First, state regulators know and understand the economy of Texas and the current trends in business. Second, the accessibility of the current system is ideal. The consumer or the large national bank can receive assistance directly from the Commissioners and their support office. Overall, the stakeholders support the current structure and think it best addresses the needs of Texas.

[117] The Committee received letters supporting the current financial structure from the Independent Bankers Association of Texas, Texas Bankers Association and the Texas Savings & Community Bankers Association.

FINDINGS

1. Texas split its financial institutions in the 1960s into the separate agencies that currently exist in order to best address its citizens' financial needs.

2. Since all the financial institutions are self-funding, consolidation would result in savings for the licensees.

3. As financial institution regulations change to keep up with federal activity and technology, consumers need more accessibility to regulators.

4. The mission of safety and soundness by the Department of Banking, Department of Savings & Mortgage Lending, and the Credit Union Department would conflict with the Office of Consumer Credit Commissioner's mission of consumer protection if the Legislature chose to consolidate the agencies, without further change.

5. Instead of streamlining the institutions, consolidation may have an adverse affect in that it would create further bureaucracy and staff to manage four agencies.

MORTGAGE LENDING

Fraud claims a new victim every day. From telemarketing scams to bank email scams, fraudulent activity is everywhere. Previously, fraud was easy to spot - the telemarketer offering a customer the opportunity to win a $1,000,000 in exchange for his personal information. Today, fraud has reached a new target: mortgage lending.

Mortgage lending fraud has cleverly evolved in such a manner that it can be disguised as a legitimate business. In order to address all relevant concerns, this issue is divided into two subparts according to its interim charges: 1. mortgage fraud involving the relationship between the mortgage broker and the residential homebuyer, and 2. mortgage fraud involving subprime and predatory lending.[118]

Mortgage Fraud and the Broker-Residential Relationship

Despite appearances of a very favorable economic outlook, a number of issues are worrisome and could present challenges for sustained economic growth and continued success in the mortgage lending industry.[119] Factors that can cause repayment difficulties reflect the interconnection between the Texas economy and events or conditions around the world. In the last decade the economy was supported by a vibrant housing market and strong consumer spending. However, recent trends suggest that the housing market may be cooling off in other parts of the nation, though the Texas housing market continues to be strong. Rising interest rates, reduced home value appreciation, and unaffordable mortgage payments resulting from new loan products lead to increased foreclosures in some U.S. cities, including Texas.[120]

Currently, Texas ranks sixth in the nation in mortgage foreclosures.[121] While foreclosures can result from several factors, the most prominent factor illustrated in this report is mortgage fraud. Mortgage fraud is a burgeoning crime that is affecting more and more companies and communities.[122] The most recent statistics from the FBI indicate that there was a seven-fold increase in reports of mortgage fraud – from over 3,000 in FY 1999 to almost 22,000 in FY 2005. The FBI also reports that federally-regulated institutions alone reported over $1 billion in losses due to mortgage fraud in FY 2005.[123]

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[118] 79th Legislature Interim Study Charges to the House Committee on Financial Institutions. The Committee's second interim charge is:

> Evaluate predatory lending practices involved with subprime mortgage lending within the state, primarily in the border counties including:
>
> - Study the patterns of mortgage fraud and develop statutory changes to reduce incidences of mortgage fraud and punish violators.
> - Study the relationship between mortgage brokers and residential borrowers including: whether or not the mortgage broker is the agent of the residential borrower; the types of disclosures which should be required; and, the sources and nature of compensation.

[119] Texas Department of Banking, *Agency Strategic Plan for Fiscal Years 2007-2011*, June 23, 2006, pg. 11.

[120] Mara Der Hovanesian, *Nightmare Mortgages*, Business Week, September 11, 2006.

[121] Testimony before the Committee on Financial Institutions, June 20, 2006.

[122] Merle Sharick, Erin E. Omba, Nick Larson & D. James Croft, *Eighth Periodic Mortgage Fraud Case Report*, April 2006, Mortgage Asset Research Institute, Inc., Virginia.

[123] *Id*.

Mortgage Brokers and Regulators

Mortgage brokers play an integral role in the housing market and current trends in real estate. Mortgage brokers originate approximately 70 percent of all mortgages nationwide, accounting for over $30 billion in mortgage loans in Texas in 2005.[124] While they are not the actual 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 complicated aspects of a mortgage loan and, thus, act as an intermediary between the borrower and the lender.

Texas defines a mortgage loan as "a debt against real estate secured by a first-lien security interest against one-to-four family residential real estate created by a deed of trust, security deed, or other security instrument."[125] While bankers and financial groups provide mortgage services, the Finance Code defines the role of a mortgage broker in the following manner:

> "Mortgage broker" means a person who receives an application from a prospective borrower for the purposes of making a mortgage loan from that person's own funds or from the funds of another person. The term does not include:
>
> (A) a person who performs only clerical functions such as delivering a loan application to a mortgage broker or mortgage banker or gathering information related to a mortgage loan application on behalf of the prospective borrower, mortgage broker, or mortgage banker; or
>
> (B) a person who performs functions of a loan processor[126]

The mortgage broker is an important part of the home-buying process on whose advice and knowledge the residential buyer relies. The Texas Department of Savings & Mortgage Lending oversees the licensing of mortgage brokers and loan officers, and regulates first-lien mortgages. The Mortgage Broker License Act (Act) was originally passed by the 76th Legislature and required specific licensing qualifications in order to receive the issuance of a license.[127] A mortgage broker may conduct loan origination for multiple companies and lenders; however, a loan officer can only conduct business under the direct sponsorship of a single active mortgage broker.[128]

The Division of Licensing is responsible for the handling and processing of applications. The division currently receives an average of 400-450 new applications each month, along with over 600 renewal applications and over 700 requests for miscellaneous changes to an existing license.[129] The division reached its peak count of 29,000 licensees during the mid-FY 2004

[124] Testimony before the Committee on Financial Institutions, June 20, 2006.
[125] TX. FIN. CODE § 156.002(10).
[126] TX. FIN. CODE § 156.002(9).
[127] TX. FIN. CODE § 156; Tx. Dept. of Savings & Mortgage Lending.
[128] *Id.*
[129] Data provided by the Department of Savings & Mortgage Lending to the Committee.

following a deluge of applications received during the last months of FY 2003. At the time of this report, the Department has licensed 24,300 mortgage brokers and sponsored loan officers.[130]

Defining Mortgage Fraud

The apex of public perception that mortgage fraud is rampant has caught the attention of federal and state legislatures. The amount of fraud and its costs are unknown and, perhaps, unknowable at this time because no central organization to collect this information exists.

The closest organization is the Financial Crimes Enforcement Network (FinCEN).[131] FinCEN is an agency under the U.S. Department of the Treasury that collects Suspicious Activity Reports (SARs) from all federally insured financial institutions.[132] In 1999, the Financial Crimes Enforcement Network (FinCEN) extended its jurisdiction to Money Service Businesses (MSBs), that is, certain non-bank financial institutions that engage in a variety of financial services. A person or other entity that qualifies as an MSB,[133] whether or not licensed as such by a state, must register with FinCEN and, as part of that registration, maintain a list of any agents.[134]

While FinCEN gathers information on mortgage fraud, the primary purpose of its data collection activities in the past has been to track money laundering. Further, the SARs only cover activities at federally insured financial institutions. A SAR is not required by state-chartered mortgage lenders that are not affiliated with an insured financial institution.

Based on FinCEN statistics and MARI data, the number of mortgage fraud incidents is increasing and the types of incidents are becoming more severe and costly to the industry.[135]

[130] Testimony of Commissioner Danny Payne of the Texas Department of Savings & Mortgage Lending, before the Texas House Committee on Financial Institutions, June 20 2006.
[131] Financial Crimes Enforcement Network, *SAR Activity Review - Issue 10 May 2006*, United States Department of the Treasury, May 10, 2006. *See also* Richard Landau and Kristen Tsangaris, *The Mortgage Fraud Epidemic*, The Review of Banking & Financial Services, Vol. 22 No. 4, April 2006.
[132] Financial Crimes Enforcement Network, *SAR Activity Review - Issue 10 May 2006*, United States Department of the Treasury, May 10, 2006.
[133] Under 31 C.F.R. § 103.11(uu), the definition of MSB includes each agent, agency, branch, or office within the United States doing business, whether or not on a regular basis or as an organized business concern, in one or more of the following capacities; (1) currency dealer or exchanger; (2) check casher; (3) issuer of traveler's checks, money orders or stored value; (4) seller of traveler's checks, money orders or stored value; (5) money transmitter, regardless of the amount of money transfer services offered; and (6) the U.S. Postal Service, except with respect to the sale of postage or philatelic products. A person who does not offer one or more of the financial services specified in (1) through (4) above in an amount greater than $1,000 in currency or monetary or other instruments for any person (in one type of activity) on any day in one or more transactions is not included in the definition of an MSB. For additional information, see 31 C.F.R. § 103.11(uu) and www.msb.gov.
[134] Currently, the regulation requiring the registration of MSBs does not apply to the U.S. Postal Service, to agencies of the United States, of any State, or of any political subdivision of a State, or to a person to the extent that the person is an issuer, seller, or redeemer of stored value. (See 31 C.F.R. §103.41(a)).
[135] Financial Crimes Enforcement Network, *SAR Activity Review - Issue 10 May 2006*, United States Department of the Treasury, May 10, 2006. *See also* Merle Sharick, Erin E. Omba, Nick Larson & D. James Croft, *Eighth Periodic Mortgage Fraud Case Report to the Mortgage Bankers Association*, April 2006, Mortgage Asset Research Institute, Inc., Virginia.

The effects of mortgage fraud to the industry range from monetary losses incurred by financial companies to destroyed professional reputations and even criminal and administrative actions.

The financial losses incurred can be catastrophic. Consequences to the consumer are higher loan rates and fees, stolen identities, and possibly impaired credit ratings. Ramifications to a neighborhood victimized by mortgage fraud can include higher property taxes, inability to sell homes, increased criminal activity and abandoned properties.[136] It often takes years for a neighborhood to recover from the damage caused by mortgage fraud.

Based on the collected SARs data, there are three basic types of fraud in the residential mortgage industry: consumer fraud, commission fraud, and fraud for profit.[137] Consumer fraud, or fraud for property, is perpetrated by borrowers when they misrepresent information on the loan application in order to purchase a more expensive home than one for which they would normally qualify.[138] Consumer fraud is relatively minor and does not usually result in significant losses to a financial institution.

Commission fraud is defined by one or more industry professionals misrepresenting information in a loan transaction in order to receive a commission on a loan that would not normally be acceptable to a lender.[139] Commission fraud is a more common practice in the industry and is a concern to financial institutions. It can result in harm to the consumer and losses to lenders and insurers.

Fraud for profit consists of systematic transactions by industry professionals who are attempting to steal a significant amount of the funds associated with one or more mortgage transactions.[140] This type of fraud usually involves multiple parties in various disciplines within the mortgage industry, such as mortgage originators, appraisers, real estate agents, closing agents, builders and title companies. Fraud for profit usually results in significant—if not catastrophic—losses to financial entities involved in mortgage loan transactions and is of major concern to the mortgage industry. A few examples of this type of fraud include land flips, fictitious lien releases, and diversion of funds at closing.[141]

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[136] Testimony of Commissioner Danny Payne of the Texas Department of Savings & Mortgage Lending before the Committee on Financial Institutions, June 20, 2006.
[137] Financial Crimes Enforcement Network, *SAR Activity Review - Issue 10 May 2006*, United States Department of the Treasury, May 10, 2006. *See also* Merle Sharick, Erin E. Omba, Nick Larson & D. James Croft, *Eighth Periodic Mortgage Fraud Case Report to the Mortgage Bankers Association*, April 2006, Mortgage Asset Research Institute, Inc., Virginia.
[138] Financial Crimes Enforcement Network, *SAR Activity Review - Issue 10 May 2006*, United States Department of the Treasury, May 10, 2006.
[139] *Id.*
[140] *Id. See also* Merle Sharick, Erin E. Omba, Nick Larson & D. James Croft, *Eighth Periodic Mortgage Fraud Case Report to the Mortgage Bankers Association*, April 2006, Mortgage Asset Research Institute, Inc., Virginia.
[141] Financial Crimes Enforcement Network, *SAR Activity Review - Issue 10 May 2006*, United States Department of the Treasury, May 10, 2006. *See also* Merle Sharick, Erin E. Omba, Nick Larson & D. James Croft, *Eighth Periodic Mortgage Fraud Case Report to the Mortgage Bankers Association*, April 2006, Mortgage Asset Research Institute, Inc., Virginia.

ANALYSIS

The housing boom has slowed for most states with housing construction expected to slow by 5 percent or 6 percent this year.[142] Conversely, the housing market in Texas is flourishing. In San Antonio, builders are constructing new homes at a record pace.[143] Builders started 18,598 houses between July 2005 and June 2006, a 26 percent increase from the previous year.[144]

With new house financing opportunities, the possibility of mortgage fraud also increases. While the no legal definition exists for "mortgage fraud,"[145] a basic industry definition of mortgage fraud is when a consumer or professional intentionally causes a financial entity to fund, purchase or insure a mortgage loan when the entity otherwise would not have done so if it had possessed the correct information.[146]

According to the Federal Reserve Board, credit quality remains strong over the summer months in 2006, but tough competition for loans is eroding some banks' underwriting standards.[147] The Dallas Federal Reserve Bank reported some bankers were "cutting corners, weakening loan covenants, or using 'air ball' financing, where a portion of the loan is backed by expectations of business growth rather than hard assets."[148]

Statistics

The mortgage industry's interest in fraud increased dramatically in 2005 and continues to be very high through 2006. The heightened interest is shared by the press and regulators of financial institutions. Foreclosures are reaching record numbers across the country. The states with the largest total number of foreclosures were Texas, with 14,669 foreclosures; Florida, with 10,334; and California, with 9,354.[149]

FinCEN released the following data which shows a dramatic increase in mortgage-related SARs.[150] The table below shows almost 22,000 mortgage-related SARs were filed in fiscal 2005, compared to slightly fewer than 7,000 only two years earlier.

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[142] Annette Haddad, *Home-Price Leader Sees Slight Drop,* San Diego Times, July 13, 2006
[143] Jennifer Hiller, *Houses are popping up at a record pace,* San Antonio Express-News, July 27, 2006.
[144] *Id*.
[145] Texas Finance Code refers to "fraud "or "fraudulent activities."
[146] Financial Crimes Enforcement Network, *SAR Activity Review - Issue 10 May 2006*, United States Department of the Treasury, May 10, 2006. *See also* Merle Sharick, Erin E. Omba, Nick Larson & D. James Croft, *Eighth Periodic Mortgage Fraud Case Report to the Mortgage Bankers Association,* April 2006, Mortgage Asset Research Institute, Inc., Virginia.
[147] Joe Adler, *Federal Competition Dragging Down Lender Standards*, American Banker, July 27, 2006.
[148] *Id*.
[149] Melinda Fulmer, *More Americans are losing their homes*, MSN: Real Estate, August 17, 2006.
[150] Financial Crimes Enforcement Network, *SAR Activity Review - Issue 10 May 2006*, United States Department of the Treasury, May 10, 2006. *See also* Merle Sharick, Erin E. Omba, Nick Larson & D. James Croft, *Eighth Periodic Mortgage Fraud Case Report to the Mortgage Bankers Association,* April 2006, Mortgage Asset Research Institute, Inc., Virginia.

Mortgage Fraud SAR	
Fiscal Year	**SAR Submissions**
2005	23,018
2004	18.391
2003	9,539
2002	5,387
2001	4,696
2000	3,515
1999	2,934

These changes in SARs figures, however, are not entirely reflective of increased fraud activity because only federally insured financial institutions and their affiliates are required to submit SARs reports. The fraud experiences of independent mortgage banking companies are not reflected in Table 1. However, the number of mortgage originators covered by the SARs submission requirement has been growing significantly in recent years. Commercial banks and thrifts (which are required to make SARs) acquired almost 150 independent mortgage banks between 1997 and 2005.[151] Many of the acquired companies were among the largest originators in the country.

Some of the increased activity is due in part to the increased numbers of mortgage originators that submit SARs. Nevertheless, most companies do not discover fraud until a loan has seasoned one to four years.[152] By the time an incident of fraud is fully investigated and reported in a SAR, it may be two to five years old. The increase of SARs from 2004-2006 is attributed in part to origination volumes in the 2001-2003 period.

There are several other factors contributing to both perceived and reported fraud cases. These include:

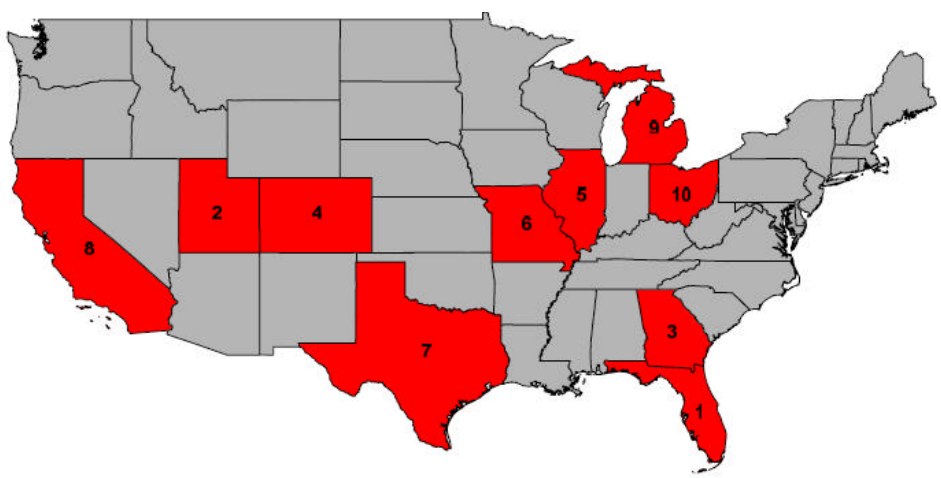
- Recent high origination volumes that strained quality control processes originators had in place—processes which were adequate for more normal periods.
- Concentration of companies' resources on managing production demands
- Need to assign newer, less-well-trained staff to points in the production process where seasoned employees might more readily detect fraud.
- Introduction of non-traditional loans for which lenders have fewer quality checks in place, and through which fraud is more easily perpetrated.[153]

[151] *Id.*
[152] Fraud in the underwriting process is sometimes not transparent until the foreclosure process. *See also* Testimony of Commissioner Danny Payne of the Texas Department of Savings & Mortgage Lending, before the Texas House Committee on Financial Institutions, June 20 2006.
[153] Merle Sharick, Erin E. Omba, Nick Larson & D. James Croft, *Eighth Periodic Mortgage Fraud Case Report to the Mortgage Bankers Association*, April 2006, Mortgage Asset Research Institute, Inc., Virginia. Data is maintained by MARI's Mortgage Industry Data Exchange (MIDEX). In addition, LoanPerformance, Inc.4, a subsidiary of First American Financial Services, collects monthly payment data on more than 40 million active

MARI's Mortgage Industry Data Exchange (MIDEX) released the following table which shows the rankings of states with the most serious mortgage fraud problems in loans originated during 2005. The remaining columns of the table show the rankings and a numerical measure of the same 10 states in the years from 2004 back to 2001. The numerical measure of each state's fraud problem is represented by the MARI Fraud Index (MFI).[154] An MFI of 0 would indicate no reported fraud from a state. An MFI of 100 would indicate that the reported fraud for a state is exactly what one would expect in terms of fraud rates, given the level of loan originations in that state. That is, a state with an MFI of 100 is "average."

2001-2005 MARI Fraud Index (MFI) by State

State	2005		2004		2003		2002		2001	
	Rank	MFI	Rank	MFI	Rank	MFI	Rank	MFI	Rank	MFI
Florida	1	224	2	244	2	165	10	146	6	162
Utah	2	209	4	142	3	161	3	215	3	183
Georgia	3	193	1	294	1	436	1	304	2	233
Colorado	4	175	3	169	5	156	18	82	21	77
Illinois	5	163	6	122	9	140	11	120	11	130
Missouri	6	135	10	111	4	157	6	175	5	165
Texas	7	126	8	115	6	148	9	149	15	111
California	8	122	17	90	18	75	23	63	18	79
Michigan	9	117	5	135	8	141	12	115	12	117
Ohio	10	112	15	95	15	106	5	194	4	181
***	***	***	***	***	***	***	***	***	***	***
So. Carolina	19	71	11	106	7	145	2	275	1	479



residential loans. Over the past several years, LoanPerformance has graciously provided MARI with information about serious early payment defaults for use in our annual Periodic Case Report to the MBA.

[154] MARI's Mortgage Industry Data Exchange (MIDEX).

Several areas of the country have seen substantial residential property inflation rates. California has experienced exceptional price increases; therefore, California's low 2005 MFI score may be somewhat deceptive. Many lenders are concerned that fraud is still very high in California loan applications, but much of that fraud is being masked by unusually high property appreciation. Additionally, these rapidly rising property values may be adding to the fraud problem.

The California scenario is now affecting Texas. Texas has seen a rapid increase in property appreciation, especially in the Austin/San Antonio area.[155] Some potential homeowners in hot real estate markets worry about the ability to afford a home. This worry leads to problems when borrowers, often with the help of loan originators, misrepresent their circumstances in an effort to get into homes before they are further priced out of the market. Multiple families may purchase a house together, but the loan application is made in the name of the family that has the best credit score. The "income" shown on the application is really the combined income of all the families.

MARI's MIDEX system classifies the types of alleged fraud involved in each incident reported by its cooperating subscribers.[156] The following chart illustrates each type of fraud as a percentage of all fraud cases submitted to the MIDEX database. For instance, 59 of the fraud incidents reported to the database for mortgages originated in 2005 contained application fraud.[157]

Mortgage Fraud Types				
Fraud Classification	Mortgage Origination Year			
	2005	2004	2003	2002
Applications	59%	61%	63%	60%
Tax and Financial Statements	22%	27%	22%	18%
Verifications of Deposit	16%	17%	18%	15%
Appraisals/Valuations	14%	16%	26%	40%
Verifications of Employment	13%	14%	15%	13%
Escrow/Closing	7%	7%	14%	18%
Credit Reports	4%	8%	7%	5%

The chart illustrates the amount of appraisal fraud reported is lower than in previous years, especially in 2004 and 2005. The reported low levels are due to the fact that most reported

[155] For instance, in 1999 a house in downtown Austin was worth approximately $208,884.00. As of July 2006, the same house is appraised at $523,649.00. This house was neither remodeled nor renovated. Data according to Travis County Appraisal District.
[156] Data provided by MARI's Mortgage Industry Data Exchange (MIDEX).
[157] Merle Sharick, Erin E. Omba, Nick Larson & D. James Croft, *Eighth Periodic Mortgage Fraud Case Report*, April 2006, Mortgage Asset Research Institute, Inc., Virginia.

incidents typically involve more than one type of fraud. If the reporting lender finds misrepresentation in the verification of employment and in occupancy status, that lender is not likely to pay for the review appraisal that would be necessary to verify appraisal fraud, even if the appraisal appears to be inflated.[158] Some loans are not closed due to faulty appraisals' comparisons to the values produced by automated valuation models (AVMs). Some lenders are also concerned about the accuracy of AVMs in areas hit by property flipping.

Mortgage Products

Historically, the mortgage market offered consumers a limited choice of loan products based on strict underwriting criteria.[159] If the borrower did not meet the requirements, they were denied a loan. Today, new products and incentives have made it possible for all applicants to qualify for a loan.

These new products are designed to provide an important gateway to people wanting to purchase a home.[160] These products include adjustable rate mortgages (also called "ARMs" by the industry), interest-only loans and other incentives offered by lenders. In the hottest real estate markets in the country, statistics show that almost 70 percent of new loans are the result of these new loan products.[161]

Adjustable rate mortgages account for 40 percent of all mortgage loans in the United States.[162] An adjustable rate mortgage is a mortgage with an interest rate that is linked to an economic index. The interest rate and the homeowner's payments are periodically adjusted up or down as the index changes; if interest rates increase, the mortgage payment also increases.

Interest-only loans occur when the homeowner pays the interest part of the loan first, for a period of 5, 7 or 10 years. After the interest period, the mortgage becomes fully amortizing, and the homeowner must pay both interest and principal. Because the homeowner is repaying the principal in 20 or 25 years, not 30, those principal payments at year 5, 7, or 10, are higher than payments for a traditional fix-rate mortgage. If a person cannot make the higher payments, foreclosure could occur and the person would have no equity in their house.

Fraud & the Scam

The true cause of mortgage fraud is the same cause of any fraud: the scam. The following three examples are real estate scams which usually involve people posing as real estate brokers.[163]

[158] Merle Sharick, Erin E. Omba, Nick Larson & D. James Croft, *Eighth Periodic Mortgage Fraud Case Report*, April 2006, Mortgage Asset Research Institute, Inc., Virginia.
[159] The traditional mortgage loan involves a buyer putting 20 percent of the value of the home down as collateral for the 80 percent loan they need to purchase the home.
[160] Robert B. Avery, Kenneth P. Brevoort, and Glenn B.Canner, *Higher-Priced Home Lending and the 2005 HMDA Data*, Federal Reserve Bulletin, September 8, 2006.
[161] Lenders are also providing additional incentives, including "no-closing costs" advertisement. Cybele Weisser, *The Miracle Mortgage*, Money Magazine, June 2005.
[162] Federal Reserve Board, *Study on Home Lending*, July 11, 2006.
163 Testimony of Commissioner Danny Payne of the Texas Department of Savings & Mortgage Lending, before the Texas House Committee on Financial Institutions, June 20 2006. *See also* Christopher Solomon, *Don't hand your*

The bailout, aka 'equity stripping' **-** In theory, a person or company could help a homeowner keep her house via a process in which the homeowner sells the house very cheaply to them while the homeowner gets her finances in order. The new owner pays the mortgage, and the old homeowner pays to live in the home in the meantime, buying back the home (with interest) in a fixed amount of time. If the financial setbacks are temporary, and the company is above-board, everybody can win: The homeowner keeps the house and the company earns a profit for its role as rescuer. But reconveyance is ripe for abuse and, ultimately, default and foreclosure often occur.[164]

Phantom help scam - This scheme is fairly simple. A homeowner is behind on mortgage payments and is facing foreclosure. An individual or group approaches and offers to help. The group charges the homeowner thousands of dollars for various administrative duties like filing forms and phone calls, or else simply keeps promising a big rescue later. The group instructs the homeowner to make home mortgage payments directly to them or to their company instead of the mortgage lender. In the end, the home is foreclosed and the homeowner does not know it until it is too late.

The final type of scam is the bait-and-switch scam. In this scam, the homeowner is lured in by a promise and then given something else. Con artists actually trick homeowners into signing over their deeds to their homes without their knowledge. The con artist gets the home, leaving the homeowner with nothing.

Relationship between Brokers and Homeowners

The debate continues over whether a mortgage broker has a fiduciary duty to the prospective homeowner. The Texas Finance Code requires that the "mortgage broker shall provide to the applicant a disclosure that specifies the nature of the relationship between applicant and broker, the duties the broker has to the applicant, and how the mortgage broker will be compensated."[165] The industry argues that the mortgage broker is not the agent of the borrower, but maintains an arms-length transaction between creditor (lender) and debtor (borrower).[166]

In a typical real estate transaction, the real estate broker creates an agency relationship with the seller by means of a written agreement, known as a listing agreement. Some advocate the same

house to a thief: Three top choices of con artists and how to avoid them, MSN: Real Estate, August 17, 2006. available at: http://realestate.msn.com/buying/Articlenewhome.aspx?cp-documentid=546052.

[164] Testimony of Commissioner Danny Payne of the Texas Department of Savings & Mortgage Lending, before the Texas House Committee on Financial Institutions, June 20 2006.

[165] TEX. FIN. CODE § 156.004.

[166] See *Weinberger v. Kendrick*, 698 F.2d 61, 79 (2d Cir. 1982); *Mid-America Nat'l Bank v. First Sav. & Loan of South Holland*, 515 N.E.2d 176, 181 (Ill. App. Ct. 1987) ("[T]he conventional mortgagor-mortgage relationship ... , standing alone, is insufficient to sustain an allegation of a fiduciary or special relationship"); *See also Ohio Co. v. Nemecek*, 886 F. Supp. 1342, 1346 (E.D. Mich. 1995); *Production Credit Ass'n v. Croft,* 423 N.W.2d 544, 546 (Wis. Ct. App. 1988) ("[T]he mere existence of a lender-borrower-customer relationship does not create a fiduciary relationship"); *Bank of Red Bay v. King*, 482 So. 2d 274, 285 (Ala. 1985); *Dolton v. Capitol Fed. Sav. & Loan Ass'n*, 642 P.2d 21, 23 (Colo. Ct. App. 1981); *Deist v. Wachholz*, 678 P.2d 188, 193 (Mont. 1984); *Umbaugh Pole Bldg. Co., Inc. v. Scott*, 390 N.E.2d 320, 321 (Ohio 1979).

relationship exists with a mortgage broker, relying on the basic principles of agency law.[167] However, even when a court determines the mortgage broker breached a general fiduciary duty, the courts determine it is due to the financial naiveté of the borrower.[168]

Committee Hearing

As part of its interim charges, the Committee addressed the issue of mortgage fraud when it held a public hearing at the Texas State Capitol on June 20, 2006. The Committee invited Commissioner Danny Payne (Department of Savings & Mortgage Lending), Ben Streusand (Texas Mortgage Bankers Association) and Everett Ives (Texas Association of Mortgage Brokers) to discuss the "Mortgage Fraud & Broker-Residential Relationships" issue. The "Predatory & Subprime Lending" issue is discussed in the following section.[169]

Department of Savings & Mortgage Lending

Commissioner Danny Payne testified that, as of June 20, 2006, the Department oversees 23,810 active mortgage licenses for brokers and loan officers and has an additional 3,815 applications for licensure pending.[170]

Currently, there is no universally accepted definition of mortgage fraud. Local, state and federal governments must work together to resolve complaints about mortgage fraud. There are two problems that the Department sees frequently and these problems result in mortgage fraud/broker fraud practices:

1. Placing borrowers into loans which they cannot afford
2. Forged documents, deposit verification, overstating income in order to qualify for a loan

However, mortgage broker fraud in connection with loan origination is different from predatory lending.[171] The Department conducts a case-by-case search to determine whether fraud occurred or whether a misleading practice occurred, which is a regulatory violation. Commissioner Payne clarified that, "any lure by marketing or advertising to attract consumers to the table and the final product is somewhat different, but not disclosed to the consumer, constitutes predatory lending."[172] By defining mortgage fraud, the Department can better combat it.

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[167] Restatement 2d of Agency § 1:

(1) Agency is the fiduciary relation which results from the manifestation of consent by one person to another that the other shall act on his behalf and subject to his control, and consent by the other so to act.

(2) The one for whom action is to be taken is the principal.

(3) The one who is to act is the agent.

[168] David Unseth, *What Level of Fiduciary Duty Should Mortgage Brokers Owe Their Borrowers?*, 75 Wash. U. L. Q. 1737 (1997).

[169] During the hearing, the Committee invited stakeholders and industry representatives to submit written testimony by July 15, 2006 to determine if Interim Charge #2 required additional public discussion.

[170] Data provided by the Department of Savings & Mortgage Lending.

[171] Predatory lending usually is seen as misleading information, bate & switch advertising, purposefully designed to be confusing. The second part of Interim Charge #2 addresses predatory lending.

[172] Testimony of Commissioner Danny Payne of the Texas Department of Savings & Mortgage Lending, before the Texas House Committee on Financial Institutions, June 20 2006.

The Department receives 950-1000 consumer complaints per year.[173] If a complaint results in a criminal violation, the Department notifies local and federal law enforcement agencies. The Department does not find a concentration of mortgage fraud in certain geographical or ethnic communities.[174] However, the major metropolitan areas seem to attract fraudulent activity because it is easier for violators to "run and hide" from investigators and prosecutors. The Department did not find a correlation between fraud and areas with less access education or lower income.[175]

Usually, a case that involves fraud has other regulatory violations. The Department is working with lenders to put more "fraud flags" in files to prevent fraudulent loans.[176] When fraud occurs, the Department steps in and assesses penalties or suspends licenses and requires restitution.[177] The Committee asked whether mail advertising, especially advertising in Spanish-only to a known Hispanic community, constitutes predatory lending.[178] Commissioner Payne states that such action constitutes a "bate & switch" which is predatory and could be fraudulent, depending upon the act.[179]

Of complaints filed annually, 85 percent of mortgage brokers are compliant with current laws.[180] Roughly, 15 percent are not compliant, which is where the problems occur. Of the 15 percent that are non-compliant, 1500 brokers need more education or third party consultants to assist with behavior and discipline.[181] The Legislature gave additional resources that have helped combat fraudulent activity.[182] With these resources, the Department can better focus on the 500-1000 brokers engaged in serious fraudulent activity.

The Department revokes the broker's license and, if necessary, the Attorney General's Office issues a temporary or permanent injunction against violators. Overall, approximately 25-30 licenses are revoked per year.[183] Please see the following chart for further illustration.

[173] *Id.*
[174] .*Id*
[175] *Id*.
[176] Possible discussion includes amending the Mortgage Broker License Act regarding ethical enforcement.
[177] Testimony of Commissioner Danny Payne of the Texas Department of Savings & Mortgage Lending, before the Texas House Committee on Financial Institutions, June 20 2006.
[178] *Id*.
[179] Testimony of Commissioner Danny Payne of the Texas Department of Savings & Mortgage Lending, before the Texas House Committee on Financial Institutions, June 20 2006.
[180] Testimony of Commissioner Danny Payne of the Texas Department of Savings & Mortgage Lending, before the Texas House Committee on Financial Institutions, June 20 2006.
[181] Testimony of Commissioner Danny Payne of the Texas Department of Savings & Mortgage Lending, before the Texas House Committee on Financial Institutions, June 20 2006.
[182] HB 955 gave the Department of Savings & Mortgage Lending additional resources to combat mortgage fraud.
[183] Testimony of Commissioner Danny Payne of the Texas Department of Savings & Mortgage Lending, before the Texas House Committee on Financial Institutions, June 20 2006.

Mortgage Broker and Loan Officer Licensing Historical Overview[184]

Mortgage Broker & Loan Officer	FY 2006	FY 2005	FY 2004	FY 2003
Total Active Licensee @EOY	23810	27820	26685	22694
Applications Received	3815	6753	5558	15588
Denied Issuance	45	141	68	90
Licenses Issued	3986	4988	11982	10449
Probationary Licenses Issued	185	120	81	13
Suspended Licenses	87	1	n/a	n/a
Revoked Licenses	8	46	3	46
Expired Licenses	7548	7468	6679	2514

In regards to the consumer complaints received, the Committee was concerned with the low number of revoked licenses. However, the Department responded that it only regulates the origination process and state savings banks. If the loan originated with a state savings bank, the Department has the authority to investigate.

The Department does not have any statutory authority to regulate loans during foreclosure. The Finance Code only gives the Department authority to regulate loan origination, but not the life of the loan.[185] Furthermore, the Department does not have statutory authority over lender underwriting.

Commissioner Payne explained that recent statutory changes have helped the process, but criminals still manage to outwit the system. Agencies need to work with lenders to get the industry to monitor itself better. He suggested that the industry should to put more "red flags" in brokers' files to keep brokers accountable and prevent future fraudulent transactions. Consumers need to educate themselves or have access to additional education about mortgage lending. Further, the market needs more accurate appraisals and education on appraisals.

[184] Data provided by the Department of Savings & Mortgage Lending after June 20, 2006 hearing.
[185] TX. FIN. CODE § 156.

TEXAS DEPARTMENT OF SAVINGS & MORTGAGE LENDING[186]
CONSUMER COMPLAINTS RECEIVED
Fiscal Year 2005 and YTD 2006

	May 2006	April 2006	March 2006	Feb 2006	Jan 2006	Dec 2005	Nov 2005	Oct 2005	Sept 2005	2006 Total	2005 Total
State Savings Institution											
Loan issue	0	0	0	0	0	1	2	2	1	**6**	6
Deposit issue	0	0	0	1	0	0	0	0	0	**1**	4
Uninsured product	0	0	0	0	0	0	0	0	0	**0**	0
Other	0	0	0	0	0	0	0	0	0	**0**	0
SUB TOTALS	**0**	**0**	**0**	**1**	**0**	**1**	**2**	**2**	**1**	**7**	**10**
Mortgage Broker/ Loan Officer											
Improper Advertising	3	6	4	2	2	5	2	1	3	**28**	37
Permissible Charges/Fees	6	2	5	2	3	1	2	5	4	**30**	44
Bait and Switch	2	0	4	2	3	4	1	0	3	**19**	33
Refunds and File Transfers	3	4	6	10	7	12	4	4	7	**57**	75
Inadequate Disclosures	3	1	1	2	2	1	0	0	0	**10**	15
Unlicensed Activities	6	10	7	22	4	2	7	6	6	**70**	73
Failure to Pay Appraisers/Vendors	4	4	11	7	6	9	5	7	3	**56**	75
Failure to Pay Appraisers From Borrower	0	1	0	0	0	0	0	0	0	**1**	26
Fraud	20	20	23	13	4	12	11	16	11	**130**	152
Misleading Practices	18	8	12	20	16	15	14	16	10	**129**	159
Sponsor Issues	3	3	2	2	3	0	0	0	1	**14**	20
Identity Theft	0	0	0	0	1	0	0	3	1	**5**	6
Customer Relations Issues	8	6	4	3	3	0	2	3	4	**33**	37
Loan Servicing Issues	17	13	14	16	13	9	9	10	7	**108**	68
Other	0	0	0	0	0	0	0	0	0	**0**	109
SUBTOTALS	**93**	**78**	**93**	**101**	**67**	**70**	**57**	**71**	**60**	**690**	**929**
TOTALS	**93**	**78**	**93**	**102**	**67**	**71**	**59**	**73**	**61**	**697**	**939**

[186] Information provided by Commissioner Danny Payne, Texas Department of Savings & Mortgage Lending.

The Office of Consumer Credit Commissioner

The Office of Consumer Credit Commissioner regulates the second lien mortgage industry. The following data represents the number of enforcement actions initiated against mortgage lenders that hold Regulated Loan Licenses with the Office of Consumer Credit Commissioner (OCCC). When a licensee fails to file their annual report with the OCCC, a motion to revoke the license and a preliminary report assessing administrative penalties are filed against the licensee. The table below provides the number of revocation actions initiated for failure to file an annual report, the number of administrative penalties initiated, and the number of those penalties that became final and paid.

ENFORCEMENT ACTIVITY ON MORTGAGE LENDERS[187]

	FYTD 2006	FY 2005
Unlicensed Activity	0	1
Failure to Meet Net Assets	0	1
Failure to File Annual Report	22	35
Administrative Penalty	22	35
Administrative Penalty Final	9	19
Revocations Final	0	4
Licenses Surrendered	3	7

A revocation action for unlicensed activity was initiated when a mortgage lender changed their corporate structure and filed a transfer application to reflect this change. The transfer application was denied and the lender failed to provide proof that the company was operating under the corporate structure in which the license was issued.

The actions initiated for failure to file an annual report resulted in four revocations in 2005, but none in 2006. In addition, seven licensees surrendered their licenses as a result of the initiated actions in 2005; three licensees surrendered their licenses in 2006.

Discussion and Opinions from Industry Stakeholders

Ben Streusand of the Texas Mortgage Bankers Association (TMBA) testified that mortgage fraud is a growing problem in the industry.[188] Mr. Streusand gave the Committee several examples of mortgage fraud. Two exacerbating factors have combined over the past few years to pressure the industry into non-traditional practices that will contribute to future fraud reports. First, there exists the ever-present drive to speed up the mortgage approval process. Second, escalating home prices in many markets drive up appraisals everywhere. Mortgage fraud can involve several factors, including the use of a shell company to scam money from the legitimate deal, over inflating appraisals, and parties that know fraud is occurring, but do not stop or report it.

[187] Office of Consumer Credit Commissioner, July 2006
[188] Testimony of Ben Streusand representing the Texas Mortgage Bankers Association before the Texas House Committee on Financial Institutions, June 20 2006.

Once a mortgage broker or person pretending to be a mortgage broker is caught committing fraud, the person needs to face criminal prosecution. While the Department of Savings & Mortgage Lending informs law enforcement of fraud cases, law enforcement needs to follow through and prosecute the perpetrators.[189] Currently, the Texas Attorney General's Office prosecutes, but needs more cooperation with local district attorneys. TMBA notifies local district attorneys of abusive and fraudulent behavior, but the district attorneys have yet to prosecute. In the last two years, TMBA has reported between 40-50 cases of mortgage fraud to local district attorneys, which amounts to millions of dollars.[190] Additionally, insurance does not protect a lender when fraud occurs.

Further, the Department should hold the passive but knowledgeable players accountable for fraud. The knowledgeable players include lenders, title companies, and brokerage firms. The industry also needs stricter underwriting process and enforce accurate appraisals.

Everette Ives, representing the Texas Association of Mortgage Brokers, testified that fraudulent originations are not committed only by mortgage brokers, but by all originators - brokers, lenders and loan underwriters.[191] Several factors can lead to mortgage fraud. While the following list is no indicator of fraudulent activity, some factors can attribute to the occurrence of fraud:

- Underwriters of loans are not paying attention
- Equity stripping, escrow accounts (Subprime are not able to get escrow accounts, but there is a new push in lending to offer it)
- Refinancing tax liens
- Internet lenders
- Interest only loans/adjustable rate mortgages
- Lenders are making loans they should not make
- Subprime lenders are not capped
- Credit repair companies are not regulated in Texas
- Consumers do not read the fine print on mortgage documents
- Consumers need more education before entering a mortgage loan

Mr. Eves testified that advertising gimmicks can lead consumers to enter a mortgage transaction to which they are not qualified. Many companies advertise themselves as the actual lender, when in fact they sell the consumer's information to mortgage brokers.[192] These companies are completely unregulated.

Also, new mortgage products can also lead to foreclosures because consumers do not understand the terms of the loan. The adjustable rate mortgages are part of the problem. Consumers pay an interest rate of 2 percent for year one and then have to pay 8 percent for year two. When these loans were introduced, borrowers had to meet relatively strict requirements before qualifying.

[189] *See* TEX. PEN. CODE § 32.32.
[190] Testimony of Ben Streusand representing the Texas Mortgage Bankers Association before the Texas House Committee on Financial Institutions, June 20 2006.
[191] Testimony of Everette Ives, representing the Texas Association of Mortgage Brokers, before the Texas House Committee on Financial Institutions, June 20 2006.
[192] *Id.*

However, competitive pressures have caused many lenders to loosen these requirements.[193] These loan products are being advertised widely; people with fixed incomes are given these loans without fully understanding the terms. These loans are very complex and sophisticated; most consumers lack the financial understanding to enter these loans. Consumer are also entering tax lien loans that end up hurting them in the future. Federal regulators of insured financial institutions have expressed safety and soundness concerns over these loans with lower documentation requirements and other “nontraditional” loans. If these loans go into default, it is inevitable that investigations will find that innovative fraudsters have perpetrated new types of misrepresentations that the product designers did not anticipate. The fraud-proof loan has yet to be developed.

The relationship between the mortgage broker and residential buyer was the sub-issue of the hearing. Mr. Ives testified that TAMB views the broker as neither the agent of the buyer nor the lender. The broker has a duty to make an "honest/good faith assessment." A broker's duty is qualified under the mortgage broker's ethical code. However, there is very little enforcement of the ethical code as compared to other professions' ethical duties. The Committee asked whether mortgage brokers would want ethical enforcement similar to the real estate agents and Mr. Ives said the Department of Savings & Mortgage Lending would handle that issue.

During the hearing, the Committee invited industry stakeholders and representatives to submit written testimony by July 15, 2006 to determine if Interim Charge #2 required additional public discussion. On this issue, several stakeholders submitted comments to the Committee.[194] Stakeholders recognize the problem exists and are working to increase the awareness of real estate scams as well as helping their members identify the "red flags" in mortgage fraud. The Independent Bankers Association of Texas reported that requiring counseling before consumers enter into adjustable rate mortgages would be unnecessary and extremely costly. While "adjustable rate mortgages are certainly not the appropriate product for every consumer…[they] are an important tool for residential mortgage lenders."[195] Texas allows consumers to refinance loans over 12 percent without a prepayment penalty.[196]

The Texas Association of Mortgage Brokers (TAMB) submitted written testimony addressing the relationship of the mortgage broker to the residential buyer.[197] TAMB notes that the Texas Mortgage Broker License Act exempts mortgage bankers from licensure. The Act does not correspond to the mortgage bankers' method of doing mortgage loan business, but rather their status as having specific approval to engage in mortgage lending. Mortgage bankers in Texas make a significant number of loans utilizing their own warehouse facilities but mortgage banks do not have an agency relationship with borrowers. TAMB argues that it would be unfair and illogical to impose the relationship on licensed mortgage brokers who engage in the same business as mortgage bankers.

[193] *Id.*
[194] Independent Bankers of Texas, Texas Association of Mortgage Brokers and the Texas Land Title Association submitted written comments to the Committee.
[195] Karen Neely, Letter to the Committee, Independent Bankers of Texas, July 11, 2006.
[196] TEX. FIN. CODE § 302.102.
[197] Everett Anschultz, *Letter to the Committee*, Texas Association of Mortgage Brokers, June 19, 2006; Everett Anschultz, *Interim Charges 1 & 2*, Texas Association of Mortgage Brokers, July 12, 2006.

FINDINGS

1. Texas ranks sixth in the nation in mortgage foreclosures.

2. Mortgage brokers do not view themselves an agent of the borrower or the lender. They consider themselves a neutral party to the transaction. Legislation may be necessary to clarify the relationship between residential borrower and mortgage broker.

3. Consumers need more protections, including accountability from mortgage brokers that engage in fraudulent activities.

4. The industry needs stricter underwriting of mortgage loans to ensure that borrowers are placed in mortgage loans they understand and can afford.

Predatory Lending and Subprime Lending

Overview

Mortgage fraud and predatory lending are becoming more prevalent.[198] And it's no wonder; obtaining approval for a mortgage loan has never been easier, especially in light of internet advertisements. Using an internet search engine, a person will see an example of the following:[199]

Lending
Find The Right Lender For You.

Free Loan Assessment.
No Obligation Lower Payments - Prequalify Online

Refinance Now
$170,000 loan for $561/month. Apply online today!

Confusion exists between predatory lending and subprime lending. Many consumers think that subprime lending is predatory lending; however, two are very distinct.

Subprime Lending

Prime lenders (banks, thrifts and credit unions) typically offer loan products to borrowers with the best credit ratings. Borrowers who cannot qualify for prime loans can often qualify for subprime loans. 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.

The federal agencies that oversee the financial institutions industry define the term "subprime" as referring to the credit characteristics of individual borrowers.[200] Subprime borrowers typically have weakened credit histories that include payment delinquencies and possibly more severe problems such as charge-offs, judgments, and bankruptcies. They may also display reduced repayment capacity as measured by credit scores, debt-to-income ratios, or other criteria that may encompass borrowers with incomplete credit histories. Subprime loans are loans to borrowers displaying one or more of these characteristics at the time of origination or purchase. Such loans have a higher risk of default than loans to prime borrowers.

[198] Texas ranks sixth in the nation in mortgage foreclosures according to testimony before the Committee on Financial Institutions, June 20, 2006.

[199] On an internet search for "mortgage lending" these advertisements appear. While this report does not claim or have knowledge of the surveyed companies' lending practices, these examples illustrate the ease with which unassuming consumers can obtain financing to which they may not be qualified.

[200] The Office of the Comptroller of the Currency, the Federal Reserve Board, the Federal Deposit Insurance Corporation, and the Office of Thrift Supervision.

Generally, subprime borrowers will display a range of credit risk characteristics that may include one or more of the following:

- Two or more 30-day delinquencies in the last 12 months, or one or more 60-day delinquencies in the last 24 months;
- Judgment, foreclosure, repossession, or charge-off in the prior 24 months;
- Bankruptcy in the last 5 years;
- Relatively high default probability as evidenced by, for example, a credit bureau risk score (FICO) of 660 or below (depending on the product/collateral), or other bureau or proprietary scores with an equivalent default probability likelihood; and/or
- Debt service-to-income ratio of 50 percent or greater, or otherwise limited ability to cover family living expenses after deducting total monthly debt-service requirements from monthly income.[201]

Most subprime lenders are currently regulated in Texas by the Office of Consumer Credit Commissioner (the "OCCC"). OCCC licenses secondary mortgage lenders and home equity lenders. The secondary market for mortgage loans allows lenders and investors to sell and buy mortgages and mortgage-backed securities. This provides lenders with an additional source of liquidity and may benefit borrowers by increasing access to credit and lowering interest rates. The chart depicts the recent license activity by the OCCC.

Office of Consumer Credit Commissioner
Historical Overview of Licensing Activity

License Information	FY 2003	FY 2004	FY 2005	2006 FYTD
Total Regulated Loan Licenses	4,903	4,997	5,363	5,303
Active	4,377	4,501	4,879	4,503
Inactive	526	496	484	800
Licenses Canceled	604	535	324	664
Licenses Revoked	9	3	6	0
Breakdown of Mortgage Lenders				
Total 342-G (Secondary Mortgage) Lenders	*	519	671	891
Active	*	508	643	845
Inactive	*	11	28	46
Total A6 (Home Equity) Lenders	*	556	589	622
Active	*	516	552	590
Inactive	*	40	37	32

[201] Federal Deposit Insurance Corporation, *Subprime Lending*, January 2001.

Predatory Lending

Predatory lending is often inaccurately confused with subprime lending. While there seems to be no definitive definition for predatory lending, the United States General Accounting Office defines the term "predatory lending" to characterize a range of practices, including deception, fraud, or manipulation, that a mortgage broker or lender may use to make a loan with terms that are disadvantageous to the borrower.[202]

The elderly, minorities, and low-income homeowners are the most common targets for predatory lenders.[203] Predatory lending (which involves mortgage fraud) involves a transaction which may include fraudulent or forged documents, false income verification or overstating income, bait and switch advertising, misleading information, unethical behavior, charging excessive fees and interest rates, lending without regard to borrowers' ability to repay, refinancing borrowers' loans repeatedly over a short period of time, intentionally misinforming borrowers about the terms of a loan, or putting consumers in mortgage payments that they cannot afford.[204] These practices are often combined with loan terms that, alone or in combination, are abusive or make the borrower more vulnerable to abusive practices. The following chart further defines some of the practices the state government considers predatory.

Practices Commonly Pointed Out as Predatory[205]

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.[206]	Home Equity Constitutional Protections: 1. Restricts the amount of equity that can secure the loan to 80% providing some equity remains with the homeowner 2. Restricts a borrower to one home equity loan per year limiting refinance fees and protecting the borrower's equity. 3. 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.[207]	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	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

[202] United States General Accounting Office, *Federal and State Agencies Face Challenges in Combating Predatory Lending*, January 2004. *See also* Mary Branham Dusenberry, *Loans of Prey, States' efforts to stop predatory lending could be blocked by federal pre-emption*. Statenews, The Council of State Governments. May 2006.
[203] United States General Accounting Office, *Federal and State Agencies Face Challenges in Combating Predatory Lending*, January 2004.
[204] Office of Thrift Supervision
[205] Provided by Commissioner Leslie Pettijohn, Office of Consumer Credit Commissioner.
[206] Financial Crimes Enforcement Network, The SAR Activity Review: By the Numbers, Issue 5, February, 2006.
[207] Data as of February 10, 2006, found at www.FinCEN.gov/SARS/depository_insitution_SARS, Exhibit 5.

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
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 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. 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 directing the borrower to locations where counseling can be obtained
Fraud and Abuse	In many cases, lenders utilize 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. [208]	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 directing the borrower to locations where counseling can be obtained Deceptive Trade Practices Act Protections: Restricts lender advertising and sales to ensure that the borrower is not mislead by misrepresentations and false claims

Regulators, consumer advocates, and industry members agree that predatory loans are more likely to occur in the subprime market than in the conventional market.[209] The entire subprime lending industry, however, should not be under attack because its lenders provide valuable credit

[208] The dates used in MARI's Fraud Index refer to when the fraud occurred, which are typically the loan origination dates. Subscribers to the MIDEX system may not discover that a loan involved fraud for several months, or even one or two years after it was originated. So numbers for recent years are dynamic. Financial Crimes Enforcement Network, *SAR Activity Review - Issue 10 May 2006*, United States Department of the Treasury, May 10, 2006. *See also* Merle Sharick, Erin E. Omba, Nick Larson & D. James Croft, *Eighth Periodic Mortgage Fraud Case Report*, April 2006, Mortgage Asset Research Institute, Inc., Virginia.

[209] Information from the Office of Consumer Credit Commissioner.

to individuals unable to secure it through more traditional means. Legitimate subprime lenders should not be stripped of their ability to offer products to consumers who truly need credit.

State and Federal Regulations

Congress has empowered several agencies to combat mortgage fraud and predatory lending. The Federal Reserve Board strengthened provisions of the Home Ownership and Equity Protection Act (HOEPA) of 1994 to help combat problems and enhance consumers' opportunity for disclosure. HOEPA places restrictions on certain high-cost loans, including limits on prepayment penalties and balloon payments and prohibitions against negative amortization; however, it covers only loans that exceed certain rate or fee triggers and thus only a portion of all subprime loans.[210]

The Federal Trade Commission (FTC) is authorized to prohibit and take action against unfair or deceptive acts or practices in or affecting commerce. The Federal Deposit Insurance Corporation, the Board of Governors of the Federal Reserve System, the Office of the Comptroller of the Currency, the Office of Thrift Supervision, and the National Credit Union Administration (known collectively as the federal banking regulators) also regulate the depository institutions that they supervise for abusive or predatory practices. Although these agencies report little evidence of predatory lending by their supervised entities, there have been several enforcement actions involving allegations of abusive lending practices against non-bank mortgage lending companies owned by financial or bank holding companies.[211] These agencies also use the Fair Housing Act and Equal Credit Opportunity Act in cases against abusive lenders that have targeted certain protected groups.[212]

In Texas, the Office of the Consumer Credit Commissioner oversees the secondary mortgage and home equity lending markets. The Department of Savings & Mortgage Lending oversees first lien mortgages and mortgage brokers. Texas passed the Home Equity Lending Amendment that contains numerous protections against predatory lending practices. In 2001, Texas banned single-premium credit insurance in a mortgage loan unless offered with a competing monthly premium policy. Texas also prohibited refinancing certain low-rate loans with higher-rate loans, restricted balloon payments and prepayment penalties for high cost home loans.[213] Additionally, the Texas Legislature mandated that lenders provide a written notice to a borrower who applies for a home loan with an interest rate of 12 percent 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), provides direct access to the regulatory oversight bodies. The OCCC's

[210] United States General Accounting Office, *Federal and State Agencies Face Challenges in Combating Predatory Lending*, January 2004.
[211] *Id.*
[212] See 42 U.S.C. 3601 and 15 U.S.C. 1691.
[213] Information from the Office of Consumer Credit Commissioner and Department of Savings & Mortgage Lending.

complaint resolution section handles calls to this number and maintains complaint and inquiry volume data for all three Finance Commission of Texas agencies.[214]

ANALYSIS

In June 2006, Texas Attorney General Abbott prosecuted a housing scam that allegedly defrauded primarily Hispanic consumers out of tens of thousands of dollars in the Dallas area.

> The scam was carried out under the direction of Freddrick Ray Cartwright, owner of FCI, and was fronted by Murrugarra. FCI Equities and other defendants told primarily Hispanic consumers they could buy homes in the Dallas area between $20,000 and $40,000. Also named in the lawsuit was Menjarez for misleading consumers into believing that he was authorized to provide legal services to help them recoup losses to FCI. Murrugarra allegedly met most of the victims through a small Mexican restaurant he owned. He convinced the consumers he or other defendants owned all the properties being offered outright and would produce a valid title after the sale was completed. Sales were often carried out quickly using handwritten agreements. The homes, most of which were in the Oak Cliff area of Dallas, were generally paid for in cash. After consumers bought the homes, they discovered their titles were not valid because the homes were in foreclosure, had been condemned, or had liens for substantial unsatisfied debts that were often in excess of the properties' market value. As a result, consumers were evicted from homes they thought they had legitimately purchased. When consumers confronted Murrugarra or Cartwright about the faulty titles and demanded refunds, the defendants either dismissed their concerns or falsely promised to provide an unencumbered title. The defendants never provided a refund to any of the consumers.[215]

The Attorney General obtained a permanent injunction and default judgment against FCI Equities, Inc. and several individuals who participated in a scheme that involved the sale of homes without valid property titles.[216]

Banking Statistics

In July 2006, the Federal Reserve Board released a report on Bank Lending Practices.[217] The report is based on responses to questions posed to senior loan officers. When questioned about the practices of approving residential mortgage loans, about 10 percent of domestic institutions indicated that they had eased credit standards on residential mortgage loans over the past three

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[214] *See* Appendix A for detailed complaint analysis.
[215] Texas Attorney General's Office, *Attorney General Abbott Shuts Down Housing Scam That Targeted Dallas-Area Consumers*, June 29, 2006.
[216] *Id.*
[217] Federal Reserve Board, *Senior Loan Officer Opinion Survey on Bank Lending Practices*, July 2006. *See also* Department of Housing and Urban Development, *Curbing Predatory Home Mortgage Lending*, June 2000.

months.[218] However, many banks reported that demand for consumer loans weakened over the past three months.

The July survey included a set of special questions on domestic banks' holdings of *subprime* residential mortgages and *non-traditional* residential mortgage products, as well as on changes in the credit quality of such loans.[219] The subprime residential mortgages comprised a small part of the responding banks' holdings. Of the thirty domestic banks with subprime residential mortgages, most indicated that such mortgages accounted for less than 5 percent of their residential mortgages. Six institutions noted that subprime mortgages accounted between 5 percent and 15 percent of their total mortgage section. The remainder of banks reported a share that was more than 20 percent. Those institutions that reported a share between 5 percent and 15 percent account for 22 percent of all such mortgages.[220]

A modest net fraction of respondents indicated that the quality of their subprime residential real estate portfolios—as measured by delinquencies and charge-offs—had deteriorated somewhat over the past twelve months. Nonetheless, three institutions reported that the quality of their portfolios of such products had performed somewhat better than they had expected over that period, while only one bank noted that the quality of its portfolio had performed somewhat worse than anticipated. About 10 percent of institutions, on net, indicated that they had tightened price-related terms on such mortgages over the same period. Approximately one-third of respondents reported that they anticipate that the quality of the subprime residential mortgages currently on their books will deteriorate somewhat over the next twelve months, and the rest expect loan quality to likely stabilize around current levels.

The July survey also included a special question on changes in demand for residential real estate loans used to finance homes for investment purposes.[221] Almost 20 percent of domestic institutions reported stronger demand for such loans over the past 12 months, while 30 percent noted that demand had weakened over the same period.

Statistics of Subprime Lending

Subprime lending is a growing industry. Many mortgage lenders, who previously paid little attention to this market, have become quite active originators. MARI organized the chart below

[218] Federal Reserve Board, *Senior Loan Officer Opinion Survey on Bank Lending Practices*, July 2006, pg.22-35.
[219] The subprime category of residential mortgages includes loans made to borrowers that displayed one or more of the following characteristics at the time of loan origination: weakened credit histories stemming from payment delinquencies, charge-offs, judgments, or bankruptcies; reduced repayment capacity as measured by credit scores or debt-to-income ratios; and incomplete credit histories. Non-traditional residential mortgage products include—but are not limited to—adjustable-rate mortgages with multiple payment options, interest-only mortgages, and "Alt-A" products such as mortgages with limited income verification and mortgages secured by non-owner-occupied properties. In considering subprime residential mortgages, banks were instructed to include first-lien loans only.
[220] Federal Reserve Board, *Senior Loan Officer Opinion Survey on Bank Lending Practices*, July 2006, pg.22-35.
[221] The forty-four banks that responded to this special question accounted for 63 percent of all residential real estate loans on the books of domestic commercial banks as of March 31, 2006.

which ranks the top ten states over the past five years where fraud was found in subprime loans.[222]

MARI Fraud Index (MFI)
(2001-2005 Subprime Originations By State)

State	2005		2004		2003		2002		2001	
	Rank	MFI	Rank	MFI	Rank	MFI	Rank	MFI	Rank	MFI
Florida	1	301	1	323	2	245	3	175	9	153
Utah	2	281	3	160	3	182	6	151	3	212
Missouri	3	261	26	52	12	93	20	80	11	144
Illinois	4	179	15	86	14	89	9	127	6	173
Georgia	5	172	2	280	1	600	1	445	2	223
Colorado	6	161	4	142	6	137	16	94	18	114
Texas	7	145	9	109	11	104	12	105	27	62
Rhode Island	8	133	37	29	41	22	8	132	33	31
Arkansas	9	115	30	42	4	159	41	1	40	1
Ohio	10	109	16	74	19	66	15	98	8	154
***	***	***	***	***	***	***	***	***	***	***
So. Carolina	22	50	12	92	13	91	2	184	1	253

Another indication of possible predatory lending is Serious Early Defaults (SEDs) Loans. SEDs are loans that become delinquent by more than ninety days or go into foreclosure in the first 6 to 18 months. While SEDs are not automatically assumed to be fraudulent, many SED loans contain some form of misrepresentation and should not have been made. An analysis of prime payment histories prepared by LoanPerformance is presented in the following chart.[223] It shows prime loan SED scores for various metropolitan statistical areas (MSAs) around the country.

[222]The data in the following Tables are from the cooperative mortgage fraud database operated by the Mortgage Asset Research Institute, Inc. (MARI). MARI has designed and offered various mortgage industry databases for the past sixteen years. Its most recognized database system is the Mortgage Industry Data Exchange (MIDEX) that contains information about licensing, public sanctions and incidents of alleged fraud reported to MARI by MIDEX subscribers. The reports submitted to MARI include the following information about each incident:

- Location of the collateral (state, city and address, to the extent known)
- Names of the originating entity and the loan officer who took the application
- Date the misrepresentation took place
- The method used to verify the existence of the reported misrepresentation(s)
- A short narrative description of the misrepresentation(s) found during the MIDEX subscriber's investigation
- Names of any other professionals that appear to be in a position to influence the accuracy of the information found to be misrepresented, e.g. the name of the appraiser and appraisal firm in cases where the property value is found to be significantly inflated
- A certification from an authorized individual at the submitting mortgage entity that the report is, to the best of his/her knowledge, complete and accurate

Financial Crimes Enforcement Network, *SAR Activity Review - Issue 10 May 2006*, United States Department of the Treasury, May 10, 2006. *See also* Merle Sharick, Erin E. Omba, Nick Larson & D. James Croft, *Eighth Periodic Mortgage Fraud Case Report*, April 2006, Mortgage Asset Research Institute, Inc., Virginia.

[223] LoanPerformance, Inc. collects monthly payment data on more than 40 million loans. These scores are based on the dollar volume of the problem loans, and an SED score of 100 indicates an area has an SED score that is average for the United States.

The 13 MSAs listed in the first column of the table are those that have SED rates at least 50 percent above the national average for prime business.

LoanPerformance, Inc. Data on Prime Loans Serious Early Defaults 2002-2005					
MSA	2005 Rank	2005	2004	2003	2002
New Orleans	1	9,347	225	194	155
Miami	2	347	100	147	155
Houston	3	311	192	188	164
Indianapolis	4	263	267	235	236
Newark	5	200	229	153	127
Dallas-Ft. Worth	6	195	263	271	233
Detroit	7 (tie)	174	158	135	124
West Palm Beach	7 (tie)	174	83	76	39
Atlanta	9 (tie)	163	300	271	239
Memphis	9 (tie)	163	217	224	170
Columbus	11 (tie)	158	271	194	176
San Antonio	11 (tie)	158	213	282	252
Orange	13	153	83	141	82

In some areas, unusually high real estate price appreciation may be masking fraud problems, even early in the life of a loan. New Orleans' SED is far above any reasonable range due to the effects of Hurricane Katrina. This chart expresses the concerns of industry professionals over the past two years. Many report seeing much of their fraud problems shifting from the larger metropolitan areas to cities of more moderate size. This is the case in San Antonio which has only recently shown up as a potential fraud hot spot.

Predatory Lending

The true cause of predatory lending is the same cause of any fraud: the scam. Commissioner Payne pointed out the three main scams his Department encounters. The following three examples are real estate scams, which usually involve people posing as real estate brokers.[224] This information was originally discussed in the mortgage broker section; however, its applicability resonates in the predatory lending arena.

The bailout, aka 'equity stripping' - In theory, a person or company could help a homeowner keep his house via a process in which the homeowner sells the house very cheaply to them while the homeowner gets his finances in order. The new owner pays the mortgage, and the old homeowner pays to live in the home in the meantime, buying back the home (with interest) in a

224 Testimony of Commissioner Danny Payne of the Texas Department of Savings & Mortgage Lending, before the Texas House Committee on Financial Institutions, June 20 2006. *See also* Christopher Solomon, *Don't hand your house to a thief: Three top choices of con artists and how to avoid them*, MSN: Real Estate, August 17, 2006.

fixed amount of time. If the financial setbacks are temporary, and the company is above-board, everybody can win: The homeowner keeps the house and the company earns a profit for its role as rescuer. But reconveyance is ripe for abuse and, ultimately, default and foreclosure often occur.[225]

Phantom help scam - This scheme is fairly simple: a homeowner is behind on mortgage payments and is facing foreclosure. An individual or group approaches and offers to help. The group charges the homeowner thousands of dollars for various administrative duties like filing forms and phone calls, or else keeps simply promising a big rescue later. The group instructs the homeowner to make home mortgage payments directly to them or to their company instead of the mortgage lender. In the end, the home is foreclosed and the homeowner did not know it until it is too late.

Bait-and-switch scam - In this scam, the homeowner is lured in by a promise and then given something else. Con artists actually trick homeowners into signing over their deeds to their homes without their knowledge. The con artist gets the home and the homeowner is left with nothing.

Committee Hearing

The Committee held a public hearing at the Texas State Capitol on June 20, 2006 to hear invited testimony on mortgage lending practices. The Committee invited Commissioner Leslie Pettijohn (Office of the Consumer Credit Commissioner), Stephen Schottman (Texas Department of Housing and Community Affairs), and Robert Doggett (Texas Low Income Housing Information Service) to discuss the "Predatory & Subprime Lending" issue.[226]

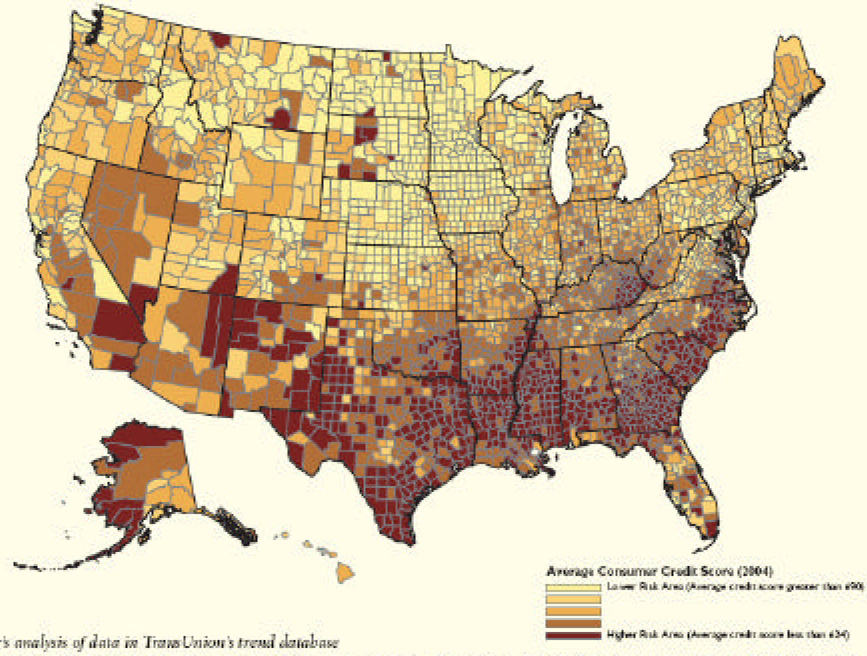
The Office of Consumer Credit Commissioner

Commissioner Leslie Pettijohn of the Office of Consumer Credit Commissioner (OCCC) testified that there is still confusion between predatory lending and subprime lending. Subprime lending allows consumers with credit problems to purchases houses. On the other hand, predatory lending is fraudulent activity. The OCCC sees predatory lenders targeting two types of people: those who lack the credit worthiness to purchase a house and those who are unable to put up a down payment on a house.[227]

Credit ratings are the most important factor in qualifying for either a prime or subprime loan. Commissioner Pettijohn referenced the following chart that depicts the concentration of weak credit scores in the south.

[225] Testimony of Commissioner Danny Payne of the Texas Department of Savings & Mortgage Lending, before the Texas House Committee on Financial Institutions, June 20 2006.
[226] During the hearing, the Committee invited stakeholders and industry representatives to submit written testimony by July 15, 2006 to determine if Interim Charge #2 required additional public discussion.
[227] Testimony of Commissioner Leslie Pettijohn of the Office of Consumer Credit Commissioner, before the Texas House Committee on Financial Institutions, June 20 2006.

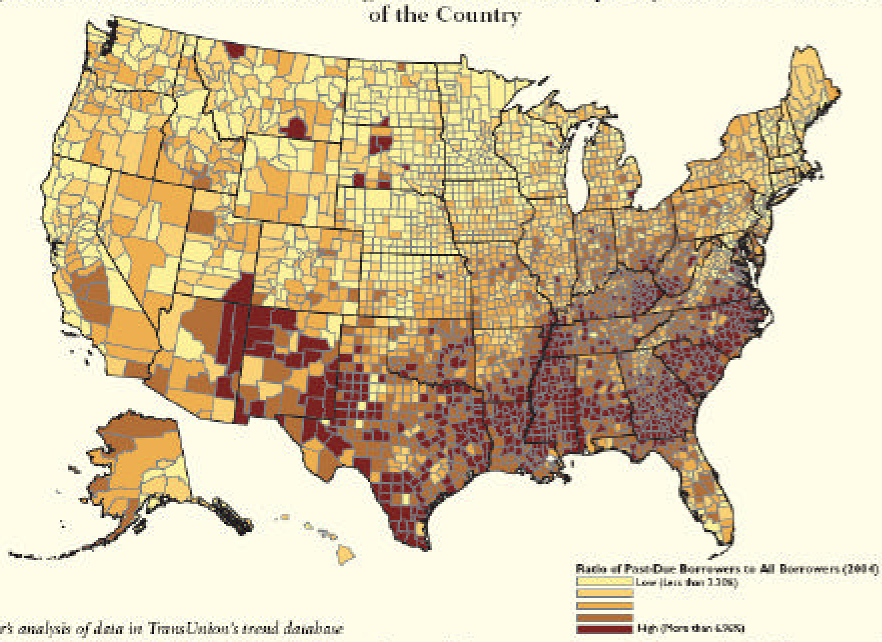
Figure 3. Credit Scores Widely Vary Across U.S. Counties



Source: Author's analysis of data in TransUnion's trend database

Note: All available data in the trend database were aggregated from depersonalized consumer credit reports. Data are displayed by country and in quintiles.

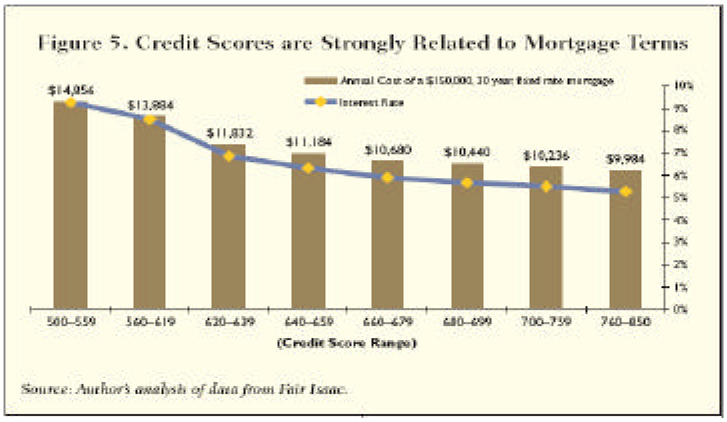
Figure 8. Southern Counties Have Higher Consumer Delinquency Rates Than Other Areas of the Country



Source: Author's analysis of data in TransUnion's trend database

Note: All available data in the trend database were aggregated from depersonalized consumer credit reports. Data are displayed by country and in quintiles; past-due borrowers are 60+ days past due.

In comparison, the preceding two maps demonstrate the correlation between weak credit scores and delinquency on mortgage loans.[228] To further clarify, the Brookings Institution conducted a study which further illustrates the connection.



High homeownership rates and county per capita income are strongly associated with high consumer credit scores. The average county with a low, mean credit score had a per capita income of $26,636 and a homeownership rate of 63 percent in 2000. Meanwhile, the typical county with high average credit scores had higher per capita incomes ($40,941) and higher shares of homeowners (73 percent). Out of a possible range between 350 and over 850 (where higher numbers indicate lower risks for underwriting) the average consumer credit score was 656 in 2004. In general, consumers in the typical Southern county have much lower credit scores than elsewhere in the country. While the typical consumer in the Western, Midwest, and Northeast counties had credit scores that ranged between 660 and 675, the average among Southern counties was 635 in 2004. Because this scale is constant across the country, this indicates that the average consumer in a Southern areas of the country. This carries important implications for the cost of credit across different areas of the country. To see this, Figure 5 illustrates the relationship between consumer credit scores, interest rates, and the annual cost of a $150,000 mortgage. These consumer credit scores are average FICO scores, based on the three FICO-branded scores estimated by each of the three major bureaus. According to the company, FICO scores are the "credit scores most lenders use to estimate risk. The company illustrates on its web page the relationship between interest rates and credit score categories—a practice also used by creditors. Here, interest rates range from a low of 5.3 percent charged to consumers with scores between 760–850 to a high of 9.3 percent charged to consumers with scores between 500 and 559. That difference adds up to nearly $5,000 every year in extra payments that are charged to consumers with scores in the lower range.[229]

As previously noted, a correlation exists between subprime lending and areas with less education and weak credit ratings. However, like the Department of Saving and Mortgage Lending, the

[228] *Id*; *See* Fellowes, Matt, *Credit Scores, Reports, and Getting Ahead in America*, Metropolitan Policy Group, The Brookings Institutions, May 2006, p.6-12.
[229] Fellowes, Matt, *Credit Scores, Reports, and Getting Ahead in America*, Metropolitan Policy Group, The Brookings Institutions, May 2006, p.6-8.

OCCC does not find a concentration of predatory lending in certain geographical or ethnic communities.[230] The major metropolitan areas seem to attract fraudulent activity because it is easier for violators to "run and hide" from investigators and prosecutors. The OCCC did not find a correlation between fraud and areas with less access education or lower income.[231]

On the federal level, some regulatory officials are considering issuing proposed guidelines for non-traditional products.[232] State regulators are looking at issuing parallel guidance for state chartered credit providers. Commissioner Pettijohn testified that she is working with other states on task force on this issue. Other states have passed legislation to combat predatory lending such as Ohio and Georgia. While these laws have been helpful, Commissioner Pettijohn testified that these laws could result in more harm than good if passed in Texas.[233] Congress is considering legislation and some fear it could preempt states' attempts to regulate the issue.

Discussion and Opinions from Industry Stakeholders

Stephen Schottman of the Texas Department of Housing and Community Affairs (TDHCA) testified that TDHCA is conducting a study on mortgage foreclosures. House Bill 1582 required TDHCA to study the foreclosure activity in Bexar, Cameron, Dallas, El Paso, Harris and Travis Counties.[234]

Nationally, there is one foreclosure for every 358 households.[235] Comparatively, in Dallas, there is one foreclosure per every 99 households (as of June 20, 2006, there were 20,749 foreclosures in 2006). In San Antonio, there is one foreclosure per every 133 households (as of June 20, 2006, there were 4,119 foreclosures in 2006). The study will be completed by early October 2006.

Robert Doggett representing the Texas Low Income Housing Information Services testified that mortgage fraud affects all aspects of the industry, including consumers. Borrowers need to be in loans they can afford. Mr. Doggett argued that borrowers believe mortgage brokers are "hired shoppers" and, as a result, borrowers rely on their broker's advice.[236] If no fiduciary relationship

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[230] Testimony of Commissioner Leslie Pettijohn of the Office of Consumer Credit Commissioner, before the Texas House Committee on Financial Institutions, June 20 2006.
[231] *Id.*
[232] In September 2006, the Federal Reserve released a report under the Home Mortgage Disclosure Act reviewing the lending practices of 8,850 lenders that account for an estimated 80 percent of home lending nationwide. The report that found that minority borrowers may pay higher interest rates on mortgage products. However, the report does not address other key factors (including " loan-to-value rations, debt-to-income ratios, and measures of borrower credit history) used by lenders to underwrite loans. Robert B. Avery, Kenneth P. Brevoort, and Glenn B.Canner, *Higher-Priced Home Lending and the 2005 HMDA Data*, Federal Reserve Bulletin, September 8, 2006.
[233] Like any choice, a consumer should heed the old advice of "caveat emptor." The buyer needs to understand the consequences of his actions and fully understand the ramifications of entering into a mortgage loan. If a lender offers a consumer a $500,000 mortgage for $600 per month, common sense would dictate that "if it looks to good to be true, it probably is."
[234] House Bill 1582 (79th Regular Legislative Session) by Rep. Norma Chavez.
[235] Testimony of Stephen Schottman, Texas Department of Housing and Community Affairs, before the Texas House Committee on Financial Institutions, June 20 2006.
[236] Testimony of Robert Doggett representing the Texas Low Income Housing Information Services, before the Texas House Committee on Financial Institutions, June 20 2006.

exists in fact, then Mr. Doggett stressed the nature of the relationship should be fully disclosed in the initial discussion between broker and borrower; the borrow must understand the ramifications of a non-fiduciary relationship.[237]

If no fiduciary relationship exists, Mr. Doggett testified that borrowers need the right of a private course of action against a broker.[238] Regardless of predatory or subprime lending, mortgage brokers need to be accountable to the consumers. Consumers need more counseling when entering into mortgage loans. The Legislature needs to define mortgage fraud and make it a criminal offense.

[237] *Id.*
[238] *Id.*

FINDINGS

1. Texas ranks sixth in the nation in foreclosures. The major metropolitan areas have the highest concentration of foreclosures and mortgage fraud.

2. Consumers need more protections, including accountability from mortgage brokers that engage in fraudulent activities.

3. After Congress allowed consumers a choice in non-traditional mortgage loans, Texas also gave consumers the choice in their mortgage package. Previously, mortgage products required a down-payment (usually 20 percent) as collateral for the loan the consumers needed to purchase the home. Due to federal and state laws, consumers now have a choice when financing a home and some new mortgage products do not require a down payment. However, in any choice, a consumer should heed the old advice of "buyer beware."

4. The underwriting of mortgage lending need stricter guidelines and report fraudulent practices. Borrowers need to be placed in mortgage loans they understand and can afford to repay.

5. Texas district attorneys need to prosecute fraudulent, mortgage-related activities. The state needs to encourage district attorneys to enforce the criminal code on fraud.

APPENDIX A

FINANCIAL INSTITUTION CHARTER COMPARISON[239]

POWERS & REGULATORY ENVIRONMENT

Characteristic	Texas State Bank	National Bank	Texas Savings Bank	Texas S&L	Federal S&L
POWERS (General)	+General Banking-Broader than National Bank (Automatic parity provision) +TX Business Law Expands Corporate Authorities	Similar to State Banks (No automatic parity provision)	Same as Federal Savings Association, State S&L, and State or National Bank (Automatic parity provision)	Same as Federal Savings Association (Automatic parity provision) + Real estate development through subsidiary (with FDIC approval) or Holding Co.	Same as State S&L (No automatic parity p rovision) + Real estate development through subsidiary or Holding Co.
DISTINCTION (positive)	+ Locally Oriented + Access to Regulator + Less Costly	+ National Regulation + Single Regulator	+ Locally Oriented + Accessible Regulator + Less Costly + SSB = "Bank" under fed. law	+ Locally Oriented + Accessible Regulator + Less Costly	+ Nationwide Regulation + Single Regulator
DISTINCTION (negative)	- Multiple Regulators (State & Primary FRB, FDIC or FRB) - Varied Interstate Regulation	- National Orientation - Regulator Less Accessible - More Costly	- Multiple Regulators (State & Primary Federal - FDIC) - Varied Regulation Interstate	- Multiple Regulators (State & Federal - OTS & FDIC) - Varied Regulation Interstate	- National Orientation - Regulator Less Accessible - More Costly
REGULATOR	Banking Commissioner & FDIC or FRB	OCC	S&L Commissioner & FDIC or FRB	S&L Commissioner, OTS & FDIC	OTS Primary & FDIC Backup
MUTUAL FORM PERMITTED	No	No	Yes	Yes	Yes
FDIC INSURANCE SAIF v. BIF	Bank Insurance Fund (BIF)	Bank Insurance Fund (BIF)	BIF - New Charter SAIF - If Converting SAIF Institution	Savings Association Insurance Fund (SAIF)	Savings Association Insurance Fund (SAIF)
FRB MEMBERSHIP	Optional	Required	Optional	Not Eligible	Not Eligible
FHLB MEMBERSHIP	Optional	Optional	Optional	Optional	Required
ACTIVITIES	State Law May Exceed National Banks with Approval of FDIC	Federal Banking Law	State Law May Exceed National Banks with Approval of FDIC + Parity With Federal Savings Associations	State Law May Exceed National Banks with Approval of FDIC + Parity With Federal Savings Assoc.	Federal Thrift Law

[239] Dept. of Savings & Mortgage Lending with Dept. of Banking, available at: http://www.sml.state.tx.us/Charter%20Comparisons2005_10-MutHC%20(5).htm

INVESTMENTS[240]

Characteristic	Texas State Bank	National Bank	Texas Savings Bank	Texas S&L	Federal S&L
Commercial Concentration Lending Guideline [concentration of credit would be a concern]	100% of Tier 1 Capital in Loans to an Industry Group	100% of Tier 1 Capital in any Commercial Loan	40% of Assets in Non-Real Estate Commercial Loans; 100% RE Commercial Loans	10% of Assets in Non-Real Estate Commercial Loans; 100% RE Commercial Loans	20% of Assets in Non-Real Estate Commercial Loans (half in Small Business Loans); 100% RE Commercial Loans
Loans to One Borrower Limit	25% or 40%* of Capital & Certified Surplus (excluding ALLL + Undivided Profits) [*If statutory and regulatory exceptions apply.]	15% or 25%* of Capital & Surplus (including ALLL) [*If statutory and regulatory exceptions apply.]	Same as National Banks, parity with State Banks + Greater Federal Savings Association limits [At least $500,000]	Same as Federal Savings Association through parity provision	Greater of National Bank authority, or $500,000 + 30% of Capital and Surplus for loans to develop domestic residential housing units, with Director approval
Investment in Subsidiary Corporation (Service Corporation) and Financial Subsidiaries.	+ 10% of Capital and Certified Surplus in a Service Corporation, and no more than the Bank's total equity capital in all Service Corporations. + Operating subsidiaries that engage in activities the Bank could engage in directly are not subject to this investment limitation.	+ 10% of Capital and Surplus in a Service Corporation, and no more than 5% of the Bank's total assets in all Service Corps. + Operating subsidiaries that engage in activities the Bank could engage in directly are not subject to this investment limitation.	+ 10% of total assets. + Operating subsidiaries that engage in activities the savings bank could engage in directly are not subject to this investment limitation.	+ 10% of total assets. + Operating subsidiaries that engage in activities the savings association could engage in directly are not subject to this investment limitation.	+ 2% of total assets, or 3% if the additional percent serves primarily community development, etc. + Operating subsidiaries that engage in activities the savings association could engage in directly are not subject to this investment limitation.
Service and Financial Subsidiary Corporation Activities & Investments Permitted	+ May engage in any activity that can be engaged in directly by a Bank or Bank Holding Company including securities underwriting.	+ May engage in any activity that can be engaged in directly by a Bank or Bank Holding Company including securities underwriting.	+ May engage in loan origination and servicing, real estate acquisition, development and investment, real estate brokerage, securities brokerage services on a riskless principal basis, and insurance brokerage. + Also, parity with federal savings associations, state and national banks.	+ May engage in loan origination and servicing, real estate acquisition, development and investment, real estate brokerage, securities brokerage services on a riskless principal basis, and insurance brokerage. + Also, parity with federal savings associations.	+ May engage in loan origination and servicing, services to financial institutions, real estate services, acquisition, improvement and maintenance of real estate, securities brokerage services on a riskless principal basis, and insurance brokerage.

[240] Dept. of Savings & Mortgage Lending with Dept. of Banking, available at: http://www.sml.state.tx.us/Charter%20Comparisons2005_10-MutHC%20(5).htm

Characteristic	Texas State Bank	National Bank	Texas Savings Bank	Texas S&L	Federal S&L
Thriftness Test: HOLA(Home Owners Loan Act) - QTL (Qualified Thrift Lender) test **or** IRS test for domestic building and loan	Not Applicable	Not Applicable	Yes - **50% if no OTS Holding Company** **or** **65%** of Assets as pursuant to 12 U.S.C. §1467a(m) (defined as Cash, U.S. Government or Agency Securities, or Real Estate Related Lending, **plus** Consumer, Credit Card, and Small Business Lending); **or** IRS Rule as defined under Federal S&L column. NOTE: Most community banks qualify without any change to their lending or investment portfolio.	Yes - Same as Federal Savings Association	Yes - **65%** of Assets as pursuant to 12 U.S.C. §1467a(m) (defined as Cash, U.S. Government or Agency Securities, or Real Estate Related Lending, plus Consumer, Credit Card, and Small Business Lending) or **60%** of Assets in IRS defined Qualified Assets of Cash, U.S. Government or Agency Securities, Premises or Real Estate Related Lending and Investments [26 U.S.C., (Chapter 79)§7701(a)(19) 1986 Internal Revenue Code]

BRANCHING[241]

Characteristic	Texas State Bank	National Bank	Texas Savings Bank	Texas S&L	Federal S&L
Intrastate Authority	State Wide	State Wide	State Wide	State Wide	State Wide
Interstate Authority	Yes - Parity Provision of Texas Constitution and Texas Finance Code Permit State Banks to Operate Interstate Branches	Yes - Interstate Branching	Yes - + Statutory Parity With Federal Savings Associations, State and National Banks + Texas Finance Code Permits State Savings Banks to Operate Interstate Branches	Yes - + Statutory Parity With Federal Savings Associations + Interstate Merger and Out-of-State Branches Authorized + Retention of Interstate Branches Upon Conversion to State Charter Authorized	Yes - Interstate Branching

REGULATORY COST[242]

Characteristic	Texas State Bank	National Bank	Texas Savings Bank	Texas S&L	Federal S&L
Assessments	Lower than National Banks	Higher than State Thrifts	50% Lower than Federal Thrifts	50% Lower than Federal Thrifts	Higher than State Thrifts
Application Fees	About the Same as National Banks	About the Same as State Thrifts	Lower than Federal Thrifts	Lower than Federal Thrifts	Higher than State Thrifts

241 Dept. of Savings & Mortgage Lending with Dept. of Banking, available at: http://www.sml.state.tx.us/Charter%20Comparisons2005_10-MutHC%20(5).htm

242 *Id.*

HOLDING COMPANY REGULATION[243]

Characteristic	Texas State Bank	National Bank	Texas Savings Bank	Texas S&L	Federal S&L
Holding Companies, in General	Bank Holding Company (FRB)- Limited to Banks and activities directly related to Banking, Unless Company is a Financial Holding Company	Bank Holding Company (FRB)- Limited to Banks and activities directly related to Banking, Unless Company is a Financial Holding Company	Bank Holding Company (FRB) <u>or</u> May elect to Be S&L Holding Company (OTS) [HOLA - Sec 10(l)]	S & L Holding Company (OTS) - Same as Federal Savings Association Unless Company is a Financial Holding Company	S & L Holding Company (OTS) - Limited to Activities of a Federal Savings Association, Unless Company is a Financial Holding Company
Mutual Holding Companies	NONE	NONE	The Mutual Holding Company Must Hold More Than 50 percent of the Stock of the Subsidiary Savings Bank and receive all approvals required under federal law for the creation of a bank or thrift holding company.	Not Expressly Allowed	The Mutual Holding Company Must Hold More Than 50 percent of the Stock of the Subsidiary Savings Bank, must be an OTS Mutual Holding Company.
Diversified Activities of Unitary S&L Holding Company (Controls Only One Savings Association)	Not Applicable	Not Applicable	Yes, Same as Federal Savings Association.	Yes, Same as Federal Savings Association.	Yes, Unitary S&L Holding Company may engage in any legal business activity.

[243] Dept. of Savings & Mortgage Lending with Dept. of Banking, available at: http://www.sml.state.tx.us/Charter%20Comparisons2005_10-MutHC%20(5).htm

APPENDIX B

SUMMARY ANALYSIS - EXAMINATION

	Aug 2006	Jul 2006	Jun 2006	May 2006	Apr 2006	Mar 2006	Feb 2006	Jan 2006	Dec 2005	Nov 2005	Oct 2005	Sep 2005	**YTD2006 $ Refunds**
Second Lien HE, H/I, & P/M**				$0.00	$0.00	$0.00	$802.38	$0.00	$0.00	$0.00	$29.73	$0.00	**$832.11**
Home Equity 1st Lien				$438.43	$8.00	$0.00	$0.00	$0.00	$0.00	$814.98	$13,240.72	$140.83	**$14,642.96**
Manufactured Housing				$0.00	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00	**$0.00**
Total Refunds Year to Date 2006				$438.43	$8.00	$0.00	$802.38	$0.00	$0.00	$814.98	$13,270.45	$140.83	**$15,475.07**
	Aug 2005	Jul 2005	Jun 2005	May 2005	Apr 2005	Mar 2005	Feb 2005	Jan 2005	Dec 2004	Nov 2004	Oct 2004	Sep 2004	**FY2005 $ Refunds**
Second Lien HE, H/I, & P/M**	$0.00	$5,062.07	$0.00	$0.00	$0.00	$839.96	$0.00	$1,640.74	$0.00	$0.00	$0.00	$0.00	**$7,542.77**
Home Equity 1st Lien	$1,276.92	$5,840.48	$2,100.72	$0.00	$0.00	$0.00	$0.00	$111.19	$0.00	$0.00	$11,769.57	$300.60	**$21,399.48**
Manufactured Housing	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00	**$0.00**
Total Refunds Fiscal Year 2005	$1,276.92	$10,902.55	$2,100.72	$0.00	$0.00	$839.96	$0.00	$1,751.93	$0.00	$0.00	$11,769.57	$300.60	**$28,942.25**

**** HE- Home Equity**
H/I - Home Improvement
P/M Purchase Money

The above figures represent restitution given to consumers as a result of examinations conducted.

SUMMARY ANALYSIS - COMPLAINTS

	Jun 2006	May 2006	Apr 2006	Mar 2006	Feb 2006	Jan 2006	Dec 2005	Nov 2005	Oct 2005	Sep 2005	2006 Total	$ Refunds	2005 Total	$ Refunds
Home Equity 2nd Lien	0	0	1	1	1	3	2	0	3	1	12	$0.00	7	$0.00
Home Improvement 2nd Lien	0	1	0	0	0	0	1	2	0	1	5	$0.00	20	$0.00
Purchase Money 2nd Lien	0	0	0	2	2	0	0	0	1	1	6	$0.00	4	$0.00
Manufactured Housing	4	4	4	2	5	4	6	8	5	3	45	$637.85	68	$130.60
Home Equity 1st Lien	4	3	1	3	3	4	5	4	3	4	34	$7,715.27	124	########
Purchase/Refinance 1st Lien	18	5	5	16	10	8	4	7	6	14	93	$7,689.00	49	$3,146.16
Total - Mortgage Related Complaints	26	13	11	24	21	19	18	21	18	24	195	#########	272	########

DETAIL ANALYSIS COMPLAINT Regulated/Complaint Type	Jun 2006	May 2006	Apr 2006	Mar 2006	Feb 2006	Jan 2006	Dec 2005	Nov 2005	Oct 2005	Sep 2005	2006 Total	$ Refunds	2005 Total	$ Refunds
Home Equity 2nd Lien														
Interest Rate							1				1			
Charges/Fees						1	1		2		4		3	
Document/Contract			1	1	1	2			1		6		2	
Questionable Lending Practices										1	1		2	
Sub Totals	0	0	1	1	1	3	2	0	3	1	12	$0.00	7	$0.00
Home Improvement 2nd Lien														
Charges/Fees								2			2		5	
Document/Contract		1								1	2		5	
Mech. Breakdown; Product/Svc							1				1			
Sub Totals	0	1	0	0	0	0	1	2	0	1	5	$0.00	20	$0.00
Purchase Money 2nd Lien														
Charges/Fees					1						1		2	
Repos & Ligitgation										1	1			
Document/Contract									1		1		1	
Deceptive Trade (DTPA)				1							1			
Questionable Lending Practices					1						1			
Fair Credit Reporting Act				1							1			
Sub Totals	0	0	0	2	2	0	0	0	1	1	6	$0.00	4	$0.00
Manufactured Housing														
Interest Rate						1		1			2		3	
Charges/Fees					2	1		1	4	1	9		17	
Repos & Ligitgation			1	1	1		1	1			5		2	
Collections					2			1			3		5	
Document/Contract	2	4	1			2	3	3		1	16		32	
72 Hour Return Policy											0			
License/Registration											0			
Mech. Breakdown; Product/Svc			2								2			
Title Problems										1	1			
Warranty								1			1			
Fair Debt Collections - 3rd Party							2				2		3	
Other	2										2		3	
Questionable Lending Practices									1		1		1	
Fair Credit Reporting Act				1							1			
Sub Totals	4	4	4	2	5	4	6	8	5	3	45	$637.85	68	$130.60

DETAIL ANALYSIS - COMPLAINTS

Regulated Chapter/Complaint Type	Jun 2006	May 2006	Apr 2006	Mar 2006	Feb 2006	Jan 2006	Dec 2005	Nov 2005	Oct 2005	Sep 2005	2006 Total	$ Refunds	2005 Total	$ Refunds
Home Equity 1st Lien														
Interest Rate											0		5	
Charges/Fees		1	1	2	1	2	3		1	2	13		31	
Repos & Ligitgation										1	1		2	
Collections	1			1				1			3		6	
Document/Contract	1	1			1			3	1		7		36	
Mech. Breakdown; Product/Svc									1		1		2	
Credit Report (FACTA)					1	1	1				3			
Other	2	1				1	1				5		20	
Questionable Lending Practices										1	1		5	
Sub Totals	4	3	1	3	3	4	5	4	3	4	34	$7,715.27	124	$20,729.55
Purchase/Refinance 1st Lien														
Interest Rate								1			1			
Charges/Fees	6	1		6	3		2	4	2	5	29		11	
Repos & Ligitgation	2								1		3		2	
Collections	1	1	1	1	1	1				2	8		6	
Document/Contract	2		1	3	3	2		1	1	3	16		12	
72 Hour Return Policy											0			
License/Registration	1					1					2			
Mech. Breakdown; Product/Svc	1			4	2				1		8		1	
Deceptive Trade (DTPA)	1									1	2		2	
Credit Report (FACTA)							1			1	2		2	
Title Problems		1									1			
Warranty											0			
Fair Debt Collections - 3rd Party	1		1								2			
High Cost Mortgage											0			
Privacy Information/ID Theft				1				1			2			
Other	2	1	1		1	3	1			1	10		7	
Questionable Lending Practices	1		1								2		3	
Fair Credit Reporting Act		1		1		1			1	1	5		3	
Sub Totals	18	5	5	16	10	8	4	7	6	14	93	$7,689.00	49	$3,146.16
Total Mortgage Related Complaints	**26**	**13**	**11**	**24**	**21**	**19**	**18**	**21**	**18**	**24**	**195**	**$16,042.12**	**272**	**$24,006.31**

SUMMARY - COMPLAINTS
By Geographical Location

	2006									2005								
	Texas									Texas								
	DAL	HOU	SA	AUS	EP	S TX	All Other	OOS	Total	DAL	HOU	SA	AUS	EP	S TX	All Other	OOS	Total
Home Equity 2nd Lien	1	1	0	0	1	0	7	2	**12**	0	1	1	0	0	0	2	3	**7**
Home Improvement 2nd Lien	0	1	1	0	0	0	2	1	**5**	1	0	0	2	0	0	13	4	**20**
Purchase Money 2nd Lien	1	0	0	0	0	0	3	2	**6**	0	0	0	0	0	0	3	1	**4**
Manufactured Housing	2	0	1	2	0	0	38	2	**45**	1	0	1	1	1	0	62	2	**68**
Home Equity 1st Lien	3	2	3	1	0	0	22	3	**34**	9	12	4	5	1	4	65	24	**124**
Purchase/Refinance 1st Lien	6	5	4	2	1	0	45	30	**93**	3	4	3	2	3	0	21	13	**49**
Total Complaints	**13**	**9**	**9**	**5**	**2**	**0**	**117**	**40**	**195**	**14**	**17**	**9**	**10**	**5**	**4**	**166**	**47**	**272**

DISSENTING LETTER FROM MEMBER

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Norma Chávez

October 16, 2006

The Honorable Burt R. Solomons, Chairman
House Committee on Financial Institutions
Capitol Extension, Room E2.104
Austin, TX 78701

RE: Minority Report on Interim Charge 2

Dear Chairman Solomons:

Thanks to you and your staff for the hard work and time dedicated to drafting the House Committee on Financial Institutions interim report. I would also like to thank Speaker Tom Craddick for adding predatory lending in the border region as an interim study charge for the committee. However, I find it necessary to express some concerns regarding the report. I believe a hearing dedicated exclusively to this issue would have provided comprehensive information of vital importance to the report.

According to the interim report, the Office of the Consumer Credit Commissioner (OCCC) did not find "...a concentration of predatory lending in certain geographical or ethnic communities". However, in a recent report published by the Federal Reserve Board, *Higher-Priced Home Lending and the 2005 HMDA Data*, the HMDA data reviewed demonstrated "...the incidence of higher-priced lending varied substantially across racial and ethnic lines: Blacks and Hispanic whites were more likely, and Asians less likely, to have received higher-priced loans than non-Hispanic whites." The high priced lending market consists of two market segments - "subprime" or "near prime". Borrowers with subprime loans pay the highest prices. The report further states that "differences in loan-pricing outcomes, such as those revealed in the HMDA data have increased concern about the fairness of the lending process." One area of concern, as the report's conclusion suggests, is possible discrimination in the higher-priced lending market based on the race or ethnicity of the borrower.

DISTRICT 76

COMMITTEES ✯ Border & International Affairs, Chair ✯ Financial Institutions
International Committee of the Council of State Governments

By as early as 2025, 50 percent of Texans will be Hispanic. Considering the conclusion of the aforementioned study, income earned by Texans that could be used to pay for health care or college tuition instead will be used to pay for interest and fees on higher-priced loans. Enacting anti-predatory lending legislation may address this disparity.

Comments made by the commissioner of the OCCC suggest anti-predatory lending legislation may cause more harm than good in Texas. Similar arguments have been made in other states where such measures have been passed. In North Carolina, the first state to pass anti-predatory lending legislation in 1999, industry officials claimed this legislation would reduce the availability and drive up the cost of loans, however, no evidence exists to substantiate this claim. In fact, this year the North Carolina Attorney General stated, "It's clear from studies that our predatory-lending law is protecting consumers, while at the same time loans are still widely available." This summer, legislators in Ohio, the state with the highest foreclosure rate, passed anti-predatory lending legislation. Texas should consider similar measures to address our foreclosure rate, the sixth highest in the nation.

Industry officials and regulators have discussed federal preemption and its potential effect on state anti-predatory lending laws. Other states, including New York and New Mexico, have passed anti-predatory legislation despite the possibility of preemption. The possibility of preemption should not deter Texas from enacting its own laws. Legislation filed in Congress, H.R. 1182, is modeled after the North Carolina law and could give states a stronger role in regulating the lending market.

During the committee's interim hearing, the relationship of the broker and the borrower was discussed. A representative from the Texas Association of Mortgage Brokers testified that the association "...views the broker as neither the agent of the buyer or the lender." One aspect of the Ohio law requires mortgage brokers to make a best effort to secure a deal that is advantageous to the borrower. The committee report states, "Legislation may be necessary to clarify the relationship between residential borrower and mortgage broker," however, the report should go further and recommend that a relationship between a residential borrower and mortgage broker be established that requires brokers to act in the borrower's best interest.

Last session, I passed legislation requiring local workforce development boards to incorporate financial literacy in workforce training programs, and joint-authored legislation that will require high schools to offer a course in financial literacy. Financial literacy, though, is only one component of a strategy to combat predatory lending. Considering the state's growing Hispanic population, residential foreclosure rate, trends in lending practices, as well as successes in other states establishing laws to protect consumers against predatory lending, the committee should recommend a regulatory component to address predatory lending.

Again, thank you for your hard work and for the opportunity to share my concerns. I look forward to working with you and the committee on these and other issues during the 80th Legislature. Please feel free to contact me with any questions or concerns.

Kindest regards,

Norma Chávez, Chair
House Committee on Border and International Affairs

NC/aer: fimr