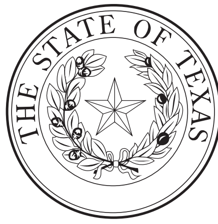


Interim Report
to the 86th Texas Legislature

House Committee on Investments and Financial Services

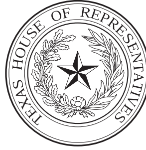
January 2019

HOUSE COMMITTEE ON INVESTMENTS AND FINANCIAL SERVICES
TEXAS HOUSE OF REPRESENTATIVES
INTERIM REPORT 2018

A REPORT TO THE
HOUSE OF REPRESENTATIVES
86TH TEXAS LEGISLATURE

TAN PARKER
CHAIRMAN

COMMITTEE CLERK
KORY CURTIS



Committee On
Investments and Financial Services

January 3, 2019

Tan Parker
Chairman

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

The Honorable Joe Straus
Speaker, Texas House of Representatives
Members of the Texas House of Representatives
Texas State Capitol, Rm. 2W.13
Austin, Texas 78701

Dear Mr. Speaker and Fellow Members:

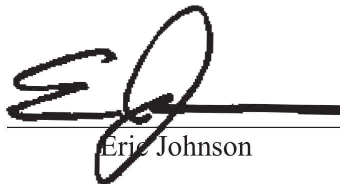
The Committee on Investments and Financial Services of the Eighty-fifth Legislature hereby submits its interim report including recommendations and drafted legislation for consideration by the Eighty-sixth Legislature.

Respectfully submitted,

Tan Parker

Phil Stephenson

Dustin Burrows


Eric Johnson

Jay Dean

Oscar Longoria

Justin Holland

Phil Stephenson
Vice-Chairman

Members: Eric Johnson, Oscar Longoria, Dustin Burrows, Jay Dean, Justin Holland

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INVESTMENTS AND FINANCIAL SERVICES

At the beginning of the 85th Legislative Session, the Honorable Joe Straus, Speaker of the Texas House of Representatives, appointed seven members to the House Committee on Investments and Financial Services (the Committee). The Committee membership included the following appointees: Tan Parker, Phil Stephenson, Eric Johnson, Oscar Longoria, Dustin Burrows, Jay Dean, and Justin Holland

During the interim, Speaker Straus assigned the Committee the following charges:

1. Review the impact of Hurricane Harvey on financial institutions in Texas and evaluate the response of the state's oversight agencies. Study how Harvey impacted consumers and lenders in the mortgage and home equity markets. Identify opportunities to improve the operational stability of financial institutions and to improve the state's responsiveness following a natural disaster.

2. Study the impact and risks that a large-scale security breach of a credit bureau has on Texans. Identify opportunities to protect Texas consumers and to mitigate the impact of such a breach.

3. Examine mortgage licensure requirements in Texas and identify opportunities to update statute to fit modern mortgage options.

4. Study policy challenges in the area of financial technology. Evaluate the concept of a "sandbox" as a regulatory approach for enabling innovation and the feasibility of implementing such in Texas. If appropriate, make recommendations for possible legislative action to foster innovation in the finance industry.

5. Monitor the agencies and programs under the Committee's jurisdiction and oversee the implementation of relevant legislation passed by the 85th Legislature.

HURRICANE HARVEY

Charge #1: " Review the impact of Hurricane Harvey on financial institutions in Texas and evaluate the response of the state's oversight agencies. Study how Harvey impacted consumers and lenders in the mortgage and home equity markets. Identify opportunities to improve the operational stability of financial institutions and to improve the state's responsiveness following a natural disaster."

Background

In August of 2017, one of the most devastating natural disasters to ever occur in the United States hit the Texas gulf coast in the form of Hurricane Harvey. Over 1 million homes in 49 counties were impacted.[1]

Within the financial services sector the impact of the hurricane was severe and varied. Some communities received more than 19 trillion gallons of rainwater[2] resulting in impassable roads and homes inundated with several feet of floodwater. The difficulty of getting to financial institutions and communicating with lien-holders, such as mortgage lenders, in this trying time had the potential to make this disaster even more stressful for the citizens of Texas.

The committee was tasked with examining how the agencies under their purview handled the storm and with making recommendations on how to improve the response from the financial services sector in anticipation of the next major storm. Access to safe deposit boxes, bank accounts, and the ability to communicate with lenders were among the primary concerns at the onset of the storm, and for the most part, there were no major disruptions of service due to the storm. Banks and credit unions as well as their significant vendors are required to have business continuity plans in place to shore up the institutions in case of a disasterand those plans helped to ensure a positive outcome within the financial services sector during this disaster.

FINRA Rule 4370. Business Continuity Plans and Emergency Contact Information[3]

(a) Each member must create and maintain a written business continuity plan identifying procedures relating to an emergency or significant business disruption. Such procedures must be reasonably designed to enable the member to meet its existing obligations to customers. In addition, such procedures must address the member's existing relationships with other broker-dealers and counter-parties. The business continuity plan must be made available promptly upon request to FINRA staff.

(b) Each member must update its plan in the event of any material change to the member's operations, structure, business or location. Each member must also conduct an annual review of its business continuity plan to determine whether any modifications are necessary in light of changes to the member's operations, structure, business, or location.

(c) The elements that comprise a business continuity plan are flexible and may be tailored to the size and needs of a member. Each plan, however, must at a minimum, address:

(1) Data back-up and recovery (hard copy and electronic);

(2) All mission critical systems;

(3) Financial and operational assessments;
(4) Alternate communications between customers and the member;
(5) Alternate communications between the member and its employees;
(6) Alternate physical location of employees;
(7) Critical business constituent, bank, and counter-party impact;
(8) Regulatory reporting;
(9) Communications with regulators; and
(10) How the member will assure customers' prompt access to their funds and securities in the event that the member determines that it is unable to continue its business.

Each member must address the above-listed categories to the extent applicable and necessary. If any of the above-listed categories is not applicable, the member's business continuity plan need not address the category. The member's business continuity plan, however, must document the rationale for not including such category in its plan. If a member relies on another entity for any one of the above-listed categories or any mission critical system, the member's business continuity plan must address this relationship.

(d) Members must designate a member of senior management to approve the plan and he or she shall be responsible for conducting the required annual review. The member of senior management must also be a registered principal.

(e) Each member must disclose to its customers how its business continuity plan addresses the possibility of a future significant business disruption and how the member plans to respond to events of varying scope. At a minimum, such disclosure must be made in writing to customers at account opening, posted on the member's Web site (if the member maintains a Web site), and mailed to customers upon request.

(f)(1) Each member shall report to FINRA, via such electronic or other means as FINRA may specify, prescribed emergency contact information for the member. The emergency contact information for the member includes designation of two associated persons as emergency contact persons. At least one emergency contact person shall be a member of senior management and a registered principal of the member. If a member designates a second emergency contact person who is not a registered principal, such person shall be a member of senior management who has knowledge of the member's business operations. A member with only one associated person shall designate as a second emergency contact person an individual, either registered with another firm or non-registered, who has knowledge of the member's business operations (e.g., the member's attorney, accountant, or clearing firm contact).

(2) Each member must promptly update its emergency contact information, via such electronic or other means as FINRA may specify, in the event of any material change. With respect to the designated emergency contact persons, each member must identify, review, and, if necessary, update such designations in the manner prescribed by Rule 4517.

(g) For purposes of this Rule, the following terms shall have the meanings specified below:

(1) "Mission critical system" means any system that is necessary, depending on the nature of a member's business, to ensure prompt and accurate processing of securities transactions, including, but not limited to, order taking, order entry, execution, comparison, allocation, clearance and settlement of securities transactions, the maintenance of customer accounts, access to customer accounts and the delivery of funds and securities.

(2) "Financial and operational assessment" means a set of written procedures that allow a member to identify changes in its operational, financial, and credit risk exposures.

Agency Testimony

The committee held a public hearing on January 31, 2018, at the State Capitol to discuss the impact that Hurricane Harvey had on the financial services sector in Texas.

The first panel to address the committee consisted of the CEO of the Texas Treasury Safekeeping Trust Company, Paul Ballard, the Executive Director of the Texas Bond Review Board, Rob Latsha, the Executive Director of the Texas Public Finance Authority, Lee Deviney, and the Commissioner of the Texas State Securities Board, Travis Iles.

Texas Treasury Safekeeping Trust Company

Paul Ballard, CEO of the Texas Treasury Safekeeping Trust, the investment arm of the State Comptroller's office, was the first to testify. Mr. Ballard explained that the Texas Treasury Safekeeping Trust oversees the two largest local government investment pools, TexPool and TexPool Prime, which are short term money fund type instruments where cities, counties, school districts, and various other municipalities park their operating dollars. The servicing office for these pools is located in Houston, and it is the client facing component of the trust. Mr. Ballard explained that on August 24th, 2017 they made the decision to implement their business continuity plan so that the hurricane would not threaten normal operations. On August 25th all calls were transferred to offices located in Boston, Massachusetts and Pittsburgh, Pennsylvania and those calls remained transferred to both offices until September 5th when the Houston office reopened. Other than the phones being answered by individuals that the clients were not familiar with, the contingency plan was effective and there were no gaps in service.

Texas Bond Review Board

After explaining how disaster bonds were allocated in the wake of Hurricane Ike in 2008, Mr. Latsha mentioned that Texas has not received any federal disaster bonds in the aftermath of Hurricane Harvey. Mr. Latsha explained that the Office of the Governor did remove a limitation for the private activity bond program. In statute, you are limited to $20 million for residential rental projects, but that limit was removed through the end of 2017, for the regions affected.

Texas Public Finance Authority

Lee Deviney, executive director of the Texas Public Finance Authority, was the next to testify. The Texas Public Finance Authority is the central debt issuer for some state agencies and institutions of higher education. They issue regularly for most state agencies and certain universities. The Texas Public Finance authority is a relatively small agency located in Austin, and as such, neither the agency nor their employees were directly impacted by Hurricane Harvey. Mr. Deviney stated that to date, the Texas Public Finance Authority has not received any requests for financing due to Hurricane Harvey, but that the agency is able to provide financing upon request.

Mr. Deviney commented that one concern of his that did not materialize during Hurricane Harvey would be a situation where the Texas Public Finance Authority had a bond debt service payment that could subsequently be interrupted by a storm. Mr. Deviney clarified that because

the Texas Public Finance Authority has payments that go out through the disaster prepared Texas Safekeeping Trust Company, he is comfortable knowing that there are systems in place to handle adverse situations.

Mr. Deviney suggested that the Texas Public Finance Authority could potentially see an impact from their client agencies that have facilities within an impacted area.
Mr. Deviney went on to say that the Texas Public Finance Authority is also the issuer of debt for the Texas Windstorm Insurance Association (TWIA) and of the $1.13 billion worth of TWIA claims that had been made to date, $348 million of the funding stack used to pay the claims came from a $500 million pre-event bond issued by TPFA in 2014. Mr. Deviney concluded that the market for the type of reinsurance that TWIA would potentially need to purchase is typically done before the hurricane season starts in June, meaning that if TWIA were to request financing from TPFA, it would likely happen before June of 2018.

As of October of 2018, TWIA has not requested a new bond issue, but they have depleted the proceeds of the bond that was issued in 2014. TWIA has taken out a $500 million line of credit with JP Morgan to handle liquidity issues after paying out their Harvey claims. If another catastrophic event were to happen that causes TWIA to have to draw from that line of credit then they would likely pursue new bond financing through TPFA

Texas Securities Commission

Texas Securities Commissioner Travis Iles rounded out the first panel. Commissioner Iles stated that the Securities Commission field offices that are located in Houston and Corpus Christi were temporarily closed in advance of the storm but were reopened shortly after the storm at or near full capacity. The agency reported no damage, loss of information, or major disruption of duties due to the storm.

The Commission worked with the Governor's office to coordinate the response to their licensees to ensure that they were able to make the necessary accommodations to those that were affected and to help avoid any increased financial burdens or administrative requirements in a time when these licensees were focused on repairing their homes and businesses. This included 350 investment advisory firms.

Commissioner Iles finished by stating that in the immediate aftermath of the storm, their enforcement program made a heightened surveillance effort to monitor for unregistered or fraudulent investment schemes trying to capitalize on the aftermath of the storm but they have yet to identify any such illicit promotion.

The next panel of speakers was comprised of Harold Feeney, commissioner of the Credit Union Department, Leslie Pettijohn, commissioner of the Office of Consumer Credit Commissioner, Caroline Jones, commissioner of the Department of Savings and Mortgage Lending, and Charles Cooper, commissioner of the Department of Banking.

The Credit Union Department

Harold Feeney, the Credit Union commissioner explained that during the hurricane, the longest that any one institution was not operational was 7 days because the flood waters were so

high that people could not get to the office. Once the waters receded after those 7 days, the institution was back up and running as normal.

Commissioner Feeney explained that the most significant operational issue that Credit Union Department members faced was that armored cash carrying vehicles did not have drivers to transport cash to and from the institutions, which resulted in a severe restriction of cash and in some cases almost resulted in institutions running out of cash. Other credit union branches had to provide cash to ensure that some institutions did not run out of cash completely.

In Commissioner Feeney's written testimony, he outlined 4 important topics for member institutions to consider in advance of the next potential disaster: how will the credit union access and provide cash if armored carriers are not accessible;, should the credit union have an alternate location for serving members if access to the institution is blocked or restricted; can the credit union activate alternative staffing; and how can the credit union communicate better with members during emergency situations.[4]

Office of Consumer Credit Commissioner

Commissioner Leslie Pettijohn of the Office of Consumer Credit Commissioner (OCCC) was next to discuss her agency. Commissioner Pettijohn explained that their office suspended compliance examinations within the affected area for a short period of time following the storm. They encouraged creditors to work with consumers regarding payment arrangements and any possible payment deferrals. Many companies offered free 30 or 60 day deferrals as well as other types of payment relief.

Commissioner Pettijohn explained that her agency issued an advisory bulletin to pawn shops explaining that they are obligated to protect pledged goods from loss or damage, what impact closing may have on pawn shop attempted redemptions, how to continue to safeguard business records, and latitude that may be available for temporary relocations.

Commissioner Pettijohn stated that the OCCC's highest volume of storm related complaints were related to pawn shops, which is not uncommon after storms because pledged merchandise is often in a store that has been damaged, or the consumers may just simply be trying to contact a store that has been closed for a few days and thus call OCCC instead. Commissioner Pettijohn clarified that if pledged goods of a consumer had been damaged at a pawn shop, then the pawn shop has an obligation to replace those with like kind merchandise.

ommissioner Pettijohn mentioned that many cars that were damaged during the hurricane will be entering the market soon. However, the OCCC is working to ensure that when these vehicles are put on the market, they are advertised appropriately and dealers are advised of the appropriate processing procedures for these vehicles.

Department of Savings and Mortgage Lending

Caroline Jones, commissioner of the Department of Savings and Mortgage Lending ("DSML") testified next. Commissioner Jones explained that 36 bank branches between nine savings banks had temporary closures for reasons such as branches being flooded, employees homes being flooded, roads to the branches being flooded, or water and power outages at a

branch occurring. Commissioner Jones stated that the longest a branch was closed was 7 days. Commissioner Jones described how DSML fast tracked approvals for those branches hit by the storm in order to allow these branches to make the decisions they needed to make and avoid being a further hindrance, with concern for employee and customer safety being paramount in these closure decisions.

Some of the most significant complications that arose from Hurricane Harvey in the mortgage lending space were from people who did not have flood insurance but had their houses flooded. Much of the mortgage lending industry is now requiring flood insurance on new properties that were impacted during Harvey even if they are not in the floodplain.

Initially, the Department anticipated seeing a spike in non-performing loans, but at the time of the hearing it was difficult to judge how many non-performing loans there were because there was a 90-day deferral period and after that another 90-day deferral. As of the hearing DSML was still in the process of determining how many non-performing loans were out there, but as of October of 2018, DSML has stated that they have not seen any drastic increase in non-performing loans as a result of Hurricane Harvey.

Department of Banking

Charles Cooper from the Texas Department of Banking ("DOB") was the final agency head to testify. Commissioner Cooper explained that after the governor issued his proclamation warning of the impending hurricane, Commissioner Cooper issued an order authorizing banks to close on an as-needed basis and then released a subsequent order allowing institutions to open temporary banks as-needed to provide assistance to customers in their time of need.

Commissioner Cooper testified that he communicated with bankers in the affected area as the storm approached to get first hand information on what was going on in those communities. Each morning, Commissioner Cooper had a call with the state operations center to hear what the issues were and what people on the ground were seeing. Commissioner Cooper went on to describe how he divided responsibilities with his federal counterparts to ensure that contact to banks was not overly duplicative and inefficient during the storm. Commissioner Cooper outlined the two conference calls he had each day with regulatory agencies that included the Federal Deposit Insurance Corporation ("FDIC"), Federal Reserve, Office of the Comptroller of the Currency, Savings and Mortgage Lending Department, Credit Union Department, and the Louisiana Banking Department as well as a daily call with the Financial and Banking Information Infrastructure Committee ("FBIIC") to coordinate financial sector activities.

Commissioner Cooper explained that his main focus was on ensuring that banks were able to be responsive to their customers and provide them with cards and access to their accounts when needed. Commissioner Cooper reiterated the comments made by Commissioner Feeney that the armored car services that provide cash to the banks in many instances did not do a good job, and in some cases did not even answer their phones. Commissioner Cooper described banks moving cash in an unprotected manner including in their personal vehicles due to the lack of reliable armored car service.

Commissioner Cooper stated that his agency would not be able to properly assess non-

performing loans until later in the year, but he projected that the past-dues and loan losses would go up slightly, but not in an overly burdensome way. As of October of 2018, there has been no major increase in non-performing loans nor serious impact on banks.

Below is a chart detailing the effects of Hurricane Harvey on state banks:

Counties Declared a Disaster Area by Governor Greg Abbott	60
State-chartered Banks in Affected Areas	66
State Bank Branches in Affected Areas	670
Number of Branches Closed at Peak of Storm	260
Number of Branches Closed One Week After Storm	43
Number of Branches Closed One Month After Storm	2

[5]

Non-Agency Testimony

The first panel of testimony from the non-agency sector included Karen Neeley from the Independent Bankers Association of Texas ("IBAT"), Wes Hoskins from the Texas Bankers Association ("TBA"), and Brian Engel testifying on his own behalf.

Karen Neeley was first to testify highlighting disaster planning as well as how banks and their vendors are required to have business continuity plans in the case of an emergency. Ms. Neeley described how IBAT provided information to answer frequently asked questions from their community banks such as how to do loan modifications and deferrals. Ms. Neeley explained that flood insurance requirements come from federal statute and stipulate that the lender is required to obtain a flood determination from specialized vendors before extending a loan. Ms. Neeley went on to say that if the determination begins with an "A" then you are required to purchase flood insurance prior to securing that loan. However, if the borrower does not keep that insurance up, then there is a requirement to force place it. Ms. Neeley then stated that if you don't have a loan, there is no requirement to get flood insurance or explicit information that may explain your risk.

Ms. Neeley further explained that the 80% loan to value ratio requirement on home equity loans[6] means that if there are severely flooded or damaged homes, then you wouldn't be able to get a home equity loan. The two exceptions to that rule being the 12 day cooling off period, or if you are doing a home improvement in the wake of a natural disaster due to the disaster affecting the integrity of the home enough to impact the potential health and safety of the tenants. Ms. Neeley stated that the best thing to do is a modification to alter a loan in the wake of a natural disaster.

Next to testify was Wes Hoskins, the president and CEO of First Community Bank in Corpus Christi and vice chair of Texas Bankers Association. Mr. Hoskins discussed that the required disaster plans that they had in place helped them and their major vendors to succeed when the hurricane hit. Mr. Hoskins shared insight on how his banks handled the hurricane before, during, and after the storm which included evacuating some of their accounting team to

Dallas to ensure that they had a safe location to be able to operate from. Mr. Hoskins also explained that his bank instituted their emergency communication system, and secured an abundance of cash to avoid running low if there were issues in securing cash in the aftermath of the storm, which there were. Mr. Hoskins bank also stocked their ATM machines with cash and upped their customer's debit card limits to ensure access to vital monetary reserves in the face of the storm.

Mr. Hoskins shut down his bank and worked with the Commissioner of Banking to notify him on which banks were open and closed, and the Commissioner did his best to stay out of the bank's way so that they were able to handle the disaster as necessary. Mr. Hoskins explained that this included not requiring daily reports. He also discussed to the committee that he had a spreadsheet which was updated daily showing which banks were opened and closed so that the DOB was up-to-date on what was going on. Finally, Mr. Hoskins described how his bank waived all fees and cashed checks for all customers even if they were not customers of their bank.

The next panel was composed of John Fleming from the Texas Mortgage Bankers Association, Burt Solomons from the Texas Association of Realtors, and Brent Morstad from the American Association of Retired People ("AARP").

John Fleming began the testimony by stating that one of the biggest challenges going forward is that of flood insurance. Limits on national flood insurance are set at a maximum of $250,00 per home and in Harvey, 4 out of 5 homes were not in an existing flood plain, meaning they weren't required to have flood insurance. Mr. Fleming then posed the questions: how do you entice the market to come back in and have competitive mortgage rates in areas that have been repeatedly flooded; and how many times do you issue insurance on properties where total losses have been paid due to floods three times already.

Burt Solomons from the Texas Association of Realtors was next to testify. He believes that most homes are going to have to be fixed with grant money, flood insurance money, or home improvement money. He also believes that lenders aren't going to offer many home equity loans. Mr. Solomons thinks that the home equity portion of loans in the wake of Harvey will be relatively small. He reinforced that it will take some time to sort out which loans are truly delinquent, and that he is very encouraged by what the lenders are doing to help homeowners.

Tim Morstad from AARP closed out the testimony on Harvey. Mr. Morstad discussed how reverse mortgages have muddied the water in terms of what remediation homeowners have in the wake of Harvey. Mr. Morstad stated that residents are confused as to what assistance they can and cannot accept because some residents believe that if they accept loans from the federal government then their reverse mortgage company may feel threatened and move to foreclose. This means that people are not taking loans that they need to improve their homes because of the uncertainty. Mr. Morstad believes that we need more education efforts so that people know what they can and cannot do, and that caseworkers need to be more informed so that they can assist with educating the public.

John Fleming then chimed in to clarify that to consummate a reverse mortgage loan through FHA you are required to undergo counselling with a HUD approved counselor to discuss

what the various minutiae of a reverse mortgage loan are. Mr. Fleming suggested a specific new expanded disclosure that has to go to a consumer relating to the obligations of a consumer 12 days prior to closing a reverse mortgage could help cover some of the gaps that may be in the counseling.

Conclusions

1. The legislature should continue to monitor finance agencies and member institutions to ensure adequacy of disaster recovery and business continuity plans.
2. The legislature should explore ways to provide information on flood insurance and explanation of risk to homeowners who do not have mortgage loans and thus are not required to purchase flood insurance.
3. The legislature should encourage financial institutions to ensure access to cash during a disaster event by:
    a. having a backup supplier of cash from an area that is unlikely to be impacted by a severe storm and;
    b. securing adequate cash reserves in advance of a disaster in case they cannot receive cash during and after a storm

CREDIT BUREAU SECURITY BREACH

Charge #2: " Study the impact and risks that a large-scale security breach of a credit bureau has on Texans. Identify opportunities to protect Texas consumers and to mitigate the impact of such a breach."

Background

On September 7, 2017, Equifax announced the discovery of a cybersecurity breach of their data systems.[7] This breach affected nearly 150 million Americans and 12 million Texans,[8] with their personally identifiable financial information being exposed to hackers and putting countless aspects of their live's and financial well-being at risk.

On April 24, 2018, the Committee held a hearing at the State Capitol. At that time, Texas Department of Banking Commissioner Charles Cooper described in detail to the Committee the multi-state examination of Equifax that followed the disclosure of the security breach.

Commissioner Cooper stated that on September 11, 2017, the Conference of State Bank Supervisors held an all states call to determine which states had the authority and expertise to conduct an examination of Equifax. The result of this call was the development of a multi-state examination team including the financial regulatory agencies from Alabama, California, Georgia, Maine, Massachusetts, New York, and North Carolina with the Texas Department of Banking (”DOB”) in the lead. This examination team commenced their investigation in November of 2017 with the goal of reviewing Equifax cyber security programs to determine what led to the breach and if consumer data held by Equifax was still at risk of further security breaches. Once these determinations were made, the goal was to outline a plan to repair broken systems and put protections in place to prevent further breaches of consumer data from happening.

The conclusion of this multi-state examination was reached on June 27, 2018, when the state financial regulatory agencies that were involved in the examination entered into a Consent Order with Equifax.[9] This Consent Order outlined the corrective actions that Equifax must undertake including increased security and regular audits among other measures.

On May 24, 2018, President Trump signed into law the "Economic Growth, Regulatory Relief, and Consumer Protection Act". This act amends the Fair Credit Reporting Act to increase the length of time a consumer reporting agency must include a fraud alert in a consumer's file from 90 days to 1 year. It also requires consumer reporting agencies to provide a consumer with free credit freezes and to notify a consumer of the availability of free credit freezes, establishes provisions related to the placement and removal of these freezes, and creates requirements related to the protection of the credit records of minors.[10]

The Texas Finance code authorizes the DOB to examine third-party service providers. This is usually used to examine data processors, but credit reporting agencies also fall under this statute. This statute was the basis for the authority that gave the DOB the power to lead the multi-state examination team.

Chapter 31.107 of the Texas Finance Code outlines the authority that the DOB has to regulate and examine the services and activities of third-party service providers:[11]

REGULATION AND EXAMINATION OF RELATED ENTITIES.

(a) The banking commissioner may regulate and examine, to the same extent as if the services or activities were performed by a state bank on its own premises:

(1) the activities of a state bank affiliate; and

(2) the services or activities of a third-party service provider that a state bank or state bank affiliate has contracted for or otherwise arranged to be performed on behalf of the state bank or state bank affiliate.

(b) The banking commissioner may collect a fee from an examined third-party service provider or affiliate in connection with each examination to cover the cost of the examination or may collect that fee from the state banks that use the examined third-party service provider.

(c) For purposes of this section, a state bank affiliate does not include a company in which ownership or membership is limited to individuals and conditioned by law on the existence and maintenance of professional licensing.

(d) To promote regulatory efficiency, if, in the preceding 24 months, a third-party service provider or affiliate has been examined by a federal or state financial services regulatory agency or by a member agency of the Federal Financial Institutions Examination Council, or its successor agency, the banking commissioner may accept the results of that examination instead of conducting the banking commissioner's own examination of the third-party service provider or affiliate. Nothing in this subsection shall be construed as limiting or restricting the banking commissioner from participating in an examination of a third-party service provider or affiliate conducted by a federal or state financial services regulatory agency or by a member agency of the Federal Financial Institutions Examination Council, or its successor agency.

Texas Business and Commerce Code Chapter 20.04 outlines the current state provisions regarding ability of consumer reporting services to charge for credit freezes:[12]

SUBCHAPTER C. RESTRICTIONS ON AND AUTHORITY OF CONSUMERS AND CONSUMER REPORTING AGENCIES

Sec. 20.04. CHARGES FOR CERTAIN DISCLOSURES OR SERVICES. (a) Except as provided by Subsection (b), a consumer reporting agency may impose a reasonable charge on a consumer for the disclosure of information pertaining to the consumer or for placing a security freeze on a consumer file, temporarily lifting a security freeze for a designated period or for an identified requester, or removing a security freeze in accordance with this chapter. The amount of the charge for the disclosure of information pertaining to the consumer may not exceed $8. The amount of the charge for placing a security freeze on a consumer file, temporarily lifting a security freeze for a designated period, or removing a security freeze may not exceed $10 per request. The amount of the charge for temporarily lifting a security freeze for an identified requester may not exceed $12 per request. On January 1 of each year, a consumer reporting agency may increase the charge for disclosure to a consumer or for placing, temporarily lifting,

or removing a security freeze. The increase, if any, must be based proportionally on changes to the Consumer Price Index for All Urban Consumers as determined by the United States Department of Labor with fractional changes rounded to the nearest 50 cents.

(b) A consumer reporting agency may not charge a fee for:

(1) a request by a consumer for a copy of the consumer's file:

(A) made not later than the 60th day after the date on which adverse action is taken against the consumer; or

(B) made on the expiration of a 45-day security alert;

(2) notification of the deletion of information that is found to be inaccurate or can no longer be verified sent to a person designated by the consumer, as prescribed by Section 611 of the Fair Credit Reporting Act (15 U.S.C. Section 1681i), as amended;

(3) a set of instructions for understanding the information presented on the consumer report;

(4) a toll-free telephone number that consumers may call to obtain additional assistance concerning the consumer report or to request a security alert;

(5) a request for a security alert made by a consumer; or

(6) the placement, temporary lifting, or removal of a security freeze at the request of a consumer who has submitted to the consumer reporting agency a copy of a valid police report, investigative report, or complaint involving the alleged commission of an offense under Section 32.51, Penal Code.

The Economic Growth, Regulatory Relief, and Consumer Protection Act put in place new consumer protections by amending the Fair Credit Reporting Act:[13]

S.2155- ECONOMIC GROWTH, REGULATORY RELIEF, AND CONSUMER PROTECTION ACT
TITLE III—PROTECTIONS FOR VETERANS, CONSUMERS, AND HOMEOWNERS

SEC. 301. PROTECTING CONSUMERS' CREDIT.

(a) IN GENERAL.—Section 605A of the Fair Credit Reporting Act (15 U.S.C. 1681c–1) is amended—

(1) in subsection (a)(1)(A), by striking "90 days" and inserting "1 year"; and

(2) by adding at the end the following:

"(i) NATIONAL SECURITY FREEZE.—

"(1) DEFINITIONS.—For purposes of this subsection:

“(A) The term ‘consumer reporting agency’ means a consumer reporting agency described in section 603(p).

“(B) The term ‘proper identification’ has the meaning of such term as used under section 610.

“(C) The term ‘security freeze’ means a restriction that prohibits a consumer reporting agency from disclosing the contents of a consumer report that is subject to such security freeze to any person requesting the consumer report.

“(2) PLACEMENT OF SECURITY FREEZE.—

“(A) IN GENERAL.—Upon receiving a direct request from a consumer that a consumer reporting agency place a security freeze, and upon receiving proper identification from the consumer, the consumer reporting agency shall, free of charge, place the security freeze not later than—

“(i) in the case of a request that is by toll-free telephone or secure electronic means, 1 business day after receiving the request directly from the consumer; or

“(ii) in the case of a request that is by mail, 3 business days after receiving the request directly from the consumer.

“(B) CONFIRMATION AND ADDITIONAL INFORMATION.—Not later than 5 business days after placing a security freeze under subparagraph (A), a consumer reporting agency shall—

“(i) send confirmation of the placement to the consumer; and

“(ii) inform the consumer of—

“(I) the process by which the consumer may remove the security freeze, including a mechanism to authenticate the consumer; and

“(II) the consumer’s right described in section 615(d)(1)(D).

“(C) NOTICE TO THIRD PARTIES.—A consumer reporting agency may advise a third party that a security freeze has been placed with respect to a consumer under subparagraph (A).

“(3) REMOVAL OF SECURITY FREEZE.—

“(A) IN GENERAL.—A consumer reporting agency shall remove a security freeze placed on the consumer report of a consumer only in the following cases:

“(i) Upon the direct request of the consumer.

“(ii) The security freeze was placed due to a material misrepresentation of fact by the consumer.

“(B) NOTICE IF REMOVAL NOT BY REQUEST.—If a consumer reporting agency removes a security freeze under subparagraph (A)(ii), the consumer reporting agency shall notify the consumer in writing prior to removing the security freeze.

“(C) REMOVAL OF SECURITY FREEZE BY CONSUMER REQUEST.—Except as provided in subparagraph (A)(ii), a security freeze shall remain in place until the consumer directly requests that the security freeze be removed. Upon receiving a direct request from a consumer that a consumer reporting agency remove a security freeze, and upon receiving proper identification from the consumer, the consumer reporting agency shall, free of charge, remove the security freeze not later than—

“(i) in the case of a request that is by toll-free telephone or secure electronic means, 1 hour after receiving the request for removal; or

“(ii) in the case of a request that is by mail, 3 business days after receiving the request for removal.

“(D) THIRD-PARTY REQUESTS.—If a third party requests access to a consumer report of a consumer with respect to which a security freeze is in effect, where such request is in connection with an application for credit, and the consumer does not allow such consumer report to be accessed, the third party may treat the application as incomplete.

“(E) TEMPORARY REMOVAL OF SECURITY FREEZE.—Upon receiving a direct request from a consumer under subparagraph (A)(i), if the consumer requests a temporary removal of a security freeze, the consumer reporting agency shall, in accordance with subparagraph (C), remove the security freeze for the period of time specified by the consumer.

“(4) EXCEPTIONS.—A security freeze shall not apply to the making of a consumer report for use of the following:

“(A) A person or entity, or a subsidiary, affiliate, or agent of that person or entity, or an assignee of a financial obligation owed by the consumer to that person or entity, or a prospective assignee of a financial obligation owed by the consumer to that person or entity in conjunction with the proposed purchase of the financial obligation, with which the consumer has or had prior to assignment an account or contract including a demand deposit account, or to whom the consumer issued a negotiable instrument, for the purposes of reviewing the account or collecting the financial obligation owed for the account, contract, or negotiable instrument. For purposes of this subparagraph, ‘reviewing the account’ includes activities related to account maintenance, monitoring, credit line increases, and account upgrades and enhancements.

“(B) Any Federal, State, or local agency, law enforcement agency, trial court, or private collection agency acting pursuant to a court order, warrant, or subpoena.

“(C) A child support agency acting pursuant to part D of title IV of the Social Security Act (42 U.S.C. 651 et seq.).

“(D) A Federal agency or a State or its agents or assigns acting to investigate fraud or acting to investigate or collect delinquent taxes or unpaid court orders or to fulfill any of its other statutory responsibilities, provided such responsibilities are consistent with a permissible purpose under section 604.

“(E) By a person using credit information for the purposes described under section 604(c).

“(F) Any person or entity administering a credit file monitoring subscription or similar service to which the consumer has subscribed.

“(G) Any person or entity for the purpose of providing a consumer with a copy of the consumer’s consumer report or credit score, upon the request of the consumer.

“(H) Any person using the information in connection with the underwriting of insurance.

“(I) Any person using the information for employment, tenant, or background screening purposes.

“(J) Any person using the information for assessing, verifying, or authenticating a consumer’s identity for purposes other than the granting of credit, or for investigating or preventing actual or potential fraud.

“(5) NOTICE OF RIGHTS.—At any time a consumer is required to receive a summary of rights required under section 609, the following notice shall be included:

CONSUMERS HAVE THE RIGHT TO OBTAIN A SECURITY FREEZE

“ ‘ You have a right to place a ‘security freeze’ on your credit report, which will prohibit a consumer reporting agency from releasing information in your credit report without your express authorization. The security freeze is designed to prevent credit, loans, and services from being approved in your name without your consent. However, you should be aware that using a security freeze to take control over who gets access to the personal and financial information in your credit report may delay, interfere with, or prohibit the timely approval of any subsequent request or application you make regarding a new loan, credit, mortgage, or any other account involving the extension of credit.

“ ‘ As an alternative to a security freeze, you have the right to place an initial or extended fraud alert on your credit file at no cost. An initial fraud alert is a 1-year alert that is placed on a consumer’s credit file. Upon seeing a fraud alert display on a consumer’s credit file, a business is required to take steps to verify the consumer’s identity before extending new credit. If you are a victim of identity theft, you are entitled to an extended fraud alert, which is a fraud alert lasting 7 years.

“ ‘ A security freeze does not apply to a person or entity, or its affiliates, or collection agencies acting on behalf of the person or entity, with which you have an existing account that requests information in your credit report for the purposes of reviewing or collecting the account. Reviewing the account includes activities related to account maintenance, monitoring, credit line increases, and account upgrades and enhancements.’ .

“(6) WEBPAGE.—

“(A) CONSUMER REPORTING AGENCIES.—A consumer reporting agency shall establish a webpage that—

“(i) allows a consumer to request a security freeze;

“(ii) allows a consumer to request an initial fraud alert;

“(iii) allows a consumer to request an extended fraud alert;

“(iv) allows a consumer to request an active duty fraud alert;

“(v) allows a consumer to opt-out of the use of information in a consumer report to send the consumer a solicitation of credit or insurance, in accordance with section 615(d); and

“(vi) shall not be the only mechanism by which a consumer may request a security freeze.

“(B) FTC.—The Federal Trade Commission shall establish a single webpage that includes a link to each webpage established under subparagraph (A) within the Federal Trade Commission’s website www.Identitytheft.gov, or a successor website.

“(j) NATIONAL PROTECTION FOR FILES AND CREDIT RECORDS OF PROTECTED CONSUMERS.—

“(1) DEFINITIONS.—As used in this subsection:

“(A) The term ‘consumer reporting agency’ means a consumer reporting agency described in section 603(p).

“(B) The term ‘protected consumer’ means an individual who is—

“(i) under the age of 16 years at the time a request for the placement of a security freeze is made; or

“(ii) an incapacitated person or a protected person for whom a guardian or conservator has been appointed.

“(C) The term ‘protected consumer's representative’ means a person who provides to a consumer reporting agency sufficient proof of authority to act on behalf of a protected consumer.

“(D) The term ‘record’ means a compilation of information that—

“(i) identifies a protected consumer;

“(ii) is created by a consumer reporting agency solely for the purpose of complying with this subsection; and

“(iii) may not be created or used to consider the protected consumer’s credit worthiness, credit standing, credit capacity, character, general reputation, personal characteristics, or mode of living.

“(E) The term ‘security freeze’ means a restriction that prohibits a consumer reporting agency from disclosing the contents of a consumer report that is the subject of such security freeze or, in the case of a protected consumer for whom the consumer reporting agency does not have a file, a record that is subject to such security freeze to any person requesting the consumer report for the purpose of opening a new account involving the extension of credit.

“(F) The term ‘sufficient proof of authority’ means documentation that shows a protected consumer’s representative has authority to act on behalf of a protected consumer and includes—

“(i) an order issued by a court of law;

“(ii) a lawfully executed and valid power of attorney;

“(iii) a document issued by a Federal, State, or local government agency in the United States showing proof of parentage, including a birth certificate; or

“(iv) with respect to a protected consumer who has been placed in a foster care setting, a written communication from a county welfare department or its agent or designee, or a county probation department or its agent or designee, certifying that the protected consumer is in a foster care setting under its jurisdiction.

“(G) The term ‘sufficient proof of identification’ means information or documentation that identifies a protected consumer and a protected consumer’s representative and includes—

“(i) a social security number or a copy of a social security card issued by the Social Security Administration;

“(ii) a certified or official copy of a birth certificate issued by the entity authorized to issue the birth certificate; or

“(iii) a copy of a driver’s license, an identification card issued by the motor vehicle administration, or any other government issued identification.

“(2) PLACEMENT OF SECURITY FREEZE FOR A PROTECTED CONSUMER.—

“(A) IN GENERAL.—Upon receiving a direct request from a protected consumer’s representative that a consumer reporting agency place a security freeze, and upon receiving sufficient proof of identification and sufficient proof of authority, the consumer reporting agency shall, free of charge, place the security freeze not later than—

“(i) in the case of a request that is by toll-free telephone or secure electronic means, 1 business day after receiving the request directly from the protected consumer’s representative; or

“(ii) in the case of a request that is by mail, 3 business days after receiving the request directly from the protected consumer’s representative.

“(B) CONFIRMATION AND ADDITIONAL INFORMATION.—Not later than 5 business days after placing a security freeze under subparagraph (A), a consumer reporting agency shall—

“(i) send confirmation of the placement to the protected consumer’s representative; and

“(ii) inform the protected consumer’s representative of the process by which the protected consumer may remove the security freeze, including a mechanism to authenticate the protected consumer’s representative.

“(C) CREATION OF FILE.—If a consumer reporting agency does not have a file pertaining to a protected consumer when the consumer reporting agency receives a direct request under subparagraph (A), the consumer reporting agency shall create a record for the protected consumer.

“(3) PROHIBITION ON RELEASE OF RECORD OR FILE OF PROTECTED CONSUMER.—After a security freeze has been placed under paragraph (2)(A), and unless the security freeze is removed in accordance with this subsection, a consumer reporting agency may not release the protected consumer’s consumer report, any information derived from the protected consumer’s consumer report, or any record created for the protected consumer.

“(4) REMOVAL OF A PROTECTED CONSUMER SECURITY FREEZE.—

“(A) IN GENERAL.—A consumer reporting agency shall remove a security freeze placed on the consumer report of a protected consumer only in the following cases:

“(i) Upon the direct request of the protected consumer’s representative.

“(ii) Upon the direct request of the protected consumer, if the protected consumer is not under the age of 16 years at the time of the request.

“(iii) The security freeze was placed due to a material misrepresentation of fact by the protected consumer’s representative.

"(B) NOTICE IF REMOVAL NOT BY REQUEST.—If a consumer reporting agency removes a security freeze under subparagraph (A)(iii), the consumer reporting agency shall notify the protected consumer's representative in writing prior to removing the security freeze.

"(C) REMOVAL OF FREEZE BY REQUEST.—Except as provided in subparagraph (A)(iii), a security freeze shall remain in place until a protected consumer's representative or protected consumer described in subparagraph (A)(ii) directly requests that the security freeze be removed. Upon receiving a direct request from the protected consumer's representative or protected consumer described in subparagraph (A)(ii) that a consumer reporting agency remove a security freeze, and upon receiving sufficient proof of identification and sufficient proof of authority, the consumer reporting agency shall, free of charge, remove the security freeze not later than—

"(i) in the case of a request that is by toll-free telephone or secure electronic means, 1 hour after receiving the request for removal; or

"(ii) in the case of a request that is by mail, 3 business days after receiving the request for removal.

"(D) TEMPORARY REMOVAL OF SECURITY FREEZE.—Upon receiving a direct request from a protected consumer or a protected consumer's representative under subparagraph (A)(i), if the protected consumer or protected consumer's representative requests a temporary removal of a security freeze, the consumer reporting agency shall, in accordance with subparagraph (C), remove the security freeze for the period of time specified by the protected consumer or protected consumer's representative.".

(b) CONFORMING AMENDMENT.—Section 625(b)(1) of the Fair Credit Reporting Act (15 U.S.C. 1681t(b)(1)) is amended—

(1) in subparagraph (H), by striking "or" at the end; and

(2) by adding at the end the following:

"(J) subsections (i) and (j) of section 605A relating to security freezes; or".

(c) EFFECTIVE DATE.—The amendments made by this section shall take effect on the date that is 120 days after the date of enactment of this Act.

Analysis

When news of the Equifax breach first came to light, there were several key concerns that needed to be addressed to ensure the protection of Texans. Among those were how many Texans had their data compromised, what specific data was compromised, if personal data was compromised what recourse do individual consumers have and how do we make sure that consumers are aware that their data has been compromised, and what can be done in the future to protect against these breaches.

Five days after news of the breach went public, Texas Attorney General Ken Paxton issued a consumer alert to inform the citizens of Texas on how severe and widespread this breach was, as well as potential options for protection.[14] In this consumer alert, Attorney General Paxton stated that the breach affected nearly 12 million Texans and hackers accessed names, Social Security numbers, birth dates, addresses and driver's license numbers. He went on to encourage consumers to place a credit freeze on their files so that it is more difficult for accounts to be opened under their name without authorization. At the time, Texas and federal statute allowed for credit reporting agencies to charge a fee for these freezes. This was of great concern to the committee due to the fact that the necessity of placing a freeze on an account was due to the lack of cyber security protection by Equifax. Not only was Equifax responsible for consumer data falling into the wrong hands, but they were charging consumers to take action to mitigate the risks associated with that mistake. The company quickly decided that charging customers fees to fix the mistake that was caused by Equifax's own security negligence was not the appropriate action and instead offered free credit freezes and also offered to refund fees to anyone who had paid for a freeze after September 7, 2017, the date that the breach was announced.[15]

Most of the major concerns that Texas would have been able to address at the state level were handled when Congress passed the Economic Growth, Regulatory Relief, and Consumer Protection Act. This act provides numerous consumer protections and ensures that consumers can freeze and unfreeze their credit file for free and provides year long fraud alerts. These fraud alerts tell businesses to verify with consumers before opening new accounts in their name.

Conclusions

1. The legislature should update statutes to align with the Economic Growth, Regulatory Relief, and Consumer Protection Act as necessary.
2. The legislature should continue to monitor the cyber security protocols of state governmental entities to ensure protection of consumer data.

MORTGAGE LICENSURE

Charge #3: " Examine mortgage licensure requirements in Texas and identify opportunities to update the statute to fit modern mortgage options."

Background

The committee held a public hearing on January 31, 2018, at the Texas State Capitol to discuss mortgage licensure in the state as well as the impact that Hurricane Harvey had on the financial services sector in Texas, including the mortgage lending sector.

Ambiguity in the current statute left many lenders uncertain about what types of relief they could offer to their borrowers in the aftermath of Hurricane Harvey specifically with regard to forbearance. Many lenders offered 3, 6, or 9 month payment hiatuses; however, there were many that were unsure if they could legally offer forbearance because they were uncertain if that is considered a modification, which is permissible, or a refinancing, which is not permissible within a year of closing.

Chapter 153.45 of the Texas Administrative Code restricts home equity loans from being refinanced within a year of closing:[16]

A refinance of debt secured by the homestead, any portion of which is an extension of credit described by Subsection (a)(6) of Section 50, may not be secured by a valid lien against the homestead unless either the refinance of the debt is an extension of credit described by Subsection (a)(6) or (a)(7) of Section 50, or all of the conditions in Section 50(f)(2) are met.

(1) One Year Prohibition. To meet the condition in Section 50(f)(2)(A), the refinance may not be closed before the first anniversary of the closing date of the equity loan. For purposes of this section, the closing date of the refinance is the date on which the owner signs the loan agreement for the refinance.

Chapter 153.14 of the Texas Administrative Code specifies that a home equity loan may be modified within a year of closing, so long as the note is not satisfied and replaced, and additional funds are not advanced to the borrower:[17]

An equity loan may not be closed before the first anniversary of the closing date of any other equity loan secured by the same homestead property.

(1) Section 50(a)(6)(M)(iii) prohibits an owner who has obtained an equity loan from:
(A) refinancing the equity loan before one year has elapsed since the loan's closing date; or
(B) obtaining a new equity loan on the same homestead property before one year has elapsed since the previous equity loan's closing date, regardless of whether the previous equity loan has been paid in full.
(2) Section 50(a)(6)(M)(iii) does not prohibit modification of an equity loan before one year has elapsed since the loan's closing date. A modification of a home equity loan occurs when one or

more terms of an existing equity loan is modified, but the note is not satisfied and replaced. A home equity loan and a subsequent modification will be considered a single transaction. The home equity requirements of Section 50(a)(6) will be applied to the original loan and the subsequent modification as a single transaction.

(A) A modification of an equity loan must be agreed to in writing by the borrower and lender, unless otherwise required by law. An example of a modification that is not required to be in writing is the modification required under the Service Members Civil Relief Act, 50 U.S.C. app. §§501-597b.

(B) The advance of additional funds to a borrower is not permitted by modification of an equity loan.

(C) A modification of an equity loan may not provide for new terms that would not have been permitted by applicable law at the date of closing of the extension of credit.

(D) The two percent limitation required by Section 50(a)(6)(E) applies to the original home equity loan and any subsequent modification as a single transaction.

Article 16, Section 50 of the Texas Constitution outlines the protections that prevent forced sale of a homestead:[18]

Sec. 50. PROTECTION OF HOMESTEAD FROM FORCED OR UNAUTHORIZED SALE; EXCEPTIONS; REQUIREMENTS FOR MORTGAGE LOANS AND OTHER OBLIGATIONS SECURED BY HOMESTEAD. (a) The homestead of a family, or of a single adult person, shall be, and is hereby protected from forced sale, for the payment of all debts except for:

(6) an extension of credit that:

(A) is secured by a voluntary lien on the homestead created under a written agreement with the consent of each owner and each owner's spouse;

(B) is of a principal amount that when added to the aggregate total of the outstanding principal balances of all other indebtedness secured by valid encumbrances of record against the homestead does not exceed 80 percent of the fair market value of the homestead on the date the extension of credit is made;

(C) is without recourse for personal liability against each owner and the spouse of each owner, unless the owner or spouse obtained the extension of credit by actual fraud;

(D) is secured by a lien that may be foreclosed upon only by a court order;

(E) does not require the owner or the owner's spouse to pay, in addition to any interest or any bona fide discount points used to buy down the interest rate, any fees to any person that are necessary to originate, evaluate, maintain, record, insure, or service the extension of credit that exceed, in the aggregate, two percent of the original principal amount of the extension of credit, excluding fees for:

(i) an appraisal performed by a third party appraiser;

(ii) a property survey performed by a state registered or licensed surveyor;

(iii) a state base premium for a mortgagee policy of title insurance with endorsements established in accordance with state law; or

(iv) a title examination report if its cost is less than the state base premium for a mortgagee policy of title insurance without endorsements established in accordance with state law;

(F) is not a form of open-end account that may be debited from time to time or under which credit may be extended from time to time unless the open-end account is a home equity line of credit;

(G) is payable in advance without penalty or other charge;

(H) is not secured by any additional real or personal property other than the homestead;

(I) (repealed);

(J) may not be accelerated because of a decrease in the market value of the homestead or because of the owner's default under other indebtedness not secured by a prior valid encumbrance against the homestead;

(K) is the only debt secured by the homestead at the time the extension of credit is made unless the other debt was made for a purpose described by Subsections (a)(1)-(a)(5) or Subsection (a)(8) of this section;

(L) is scheduled to be repaid:

(i) in substantially equal successive periodic installments, not more often than every 14 days and not less often than monthly, beginning no later than two months from the date the extension of credit is made, each of which equals or exceeds the amount of accrued interest as of the date of the scheduled installment; or

(ii) if the extension of credit is a home equity line of credit, in periodic payments described under Subsection (t)(8) of this section;

(M) is closed not before:

(i) the 12th day after the later of the date that the owner of the homestead submits a loan application to the lender for the extension of credit or the date that the lender provides the owner a copy of the notice prescribed by Subsection (g) of this section;

(ii) one business day after the date that the owner of the homestead receives a copy of the loan application if not previously provided and a final itemized disclosure of the actual fees, points, interest, costs, and charges that will be charged at closing. If a bona fide emergency or another good cause exists and the lender obtains the written consent of the owner, the lender may provide the documentation to the owner or the lender may modify previously provided documentation on the date of closing; and

(iii) the first anniversary of the closing date of any other extension of credit described by Subsection (a)(6) of this section secured by the same homestead property, except a refinance described by Paragraph (Q)(x)(f) of this subdivision, unless the owner on oath requests an earlier closing due to a state of emergency that:

(a) has been declared by the president of the United States or the governor as provided by law; and

(b) applies to the area where the homestead is located;

(N) is closed only at the office of the lender, an attorney at law, or a title company;

(O) permits a lender to contract for and receive any fixed or variable rate of interest authorized under statute;

(P) is made by one of the following that has not been found by a federal regulatory agency to have engaged in the practice of refusing to make loans because the

applicants for the loans reside or the property proposed to secure the loans is located in a certain area:

(i) a bank, savings and loan association, savings bank, or credit union doing business under the laws of this state or the United States, including a subsidiary of a bank, savings and loan association, savings bank, or credit union described by this subparagraph;

(ii) a federally chartered lending instrumentality or a person approved as a mortgagee by the United States government to make federally insured loans;

(iii) a person licensed to make regulated loans, as provided by statute of this state;

(iv) a person who sold the homestead property to the current owner and who provided all or part of the financing for the purchase;

(v) a person who is related to the homestead property owner within the second degree of affinity or consanguinity; or

(vi) a person regulated by this state as a mortgage banker or mortgage company; and

(Q) is made on the condition that:

(i) the owner of the homestead is not required to apply the proceeds of the extension of credit to repay another debt except debt secured by the homestead or debt to another lender;

(ii) the owner of the homestead not assign wages as security for the extension of credit;

(iii) the owner of the homestead not sign any instrument in which blanks relating to substantive terms of agreement are left to be filled in;

(iv) the owner of the homestead not sign a confession of judgment or power of attorney to the lender or to a third person to confess judgment or to appear for the owner in a judicial proceeding;

(v) at the time the extension of credit is made, the owner of the homestead shall receive a copy of the final loan application and all executed documents signed by the owner at closing related to the extension of credit;

(vi) the security instruments securing the extension of credit contain a disclosure that the extension of credit is the type of credit defined by Subsection (a)(6) of this section;

(vii) within a reasonable time after termination and full payment of the extension of credit, the lender cancel and return the promissory note to the owner of the homestead and give the owner, in recordable form, a release of the lien securing the extension of credit or a copy of an endorsement and assignment of the lien to a lender that is refinancing the extension of credit;

(viii) the owner of the homestead and any spouse of the owner may, within three days after the extension of credit is made, rescind the extension of credit without penalty or charge;

(ix) the owner of the homestead and the lender sign a written acknowledgment as to the fair market value of the homestead property on the date the extension of credit is made;

(x) except as provided by Subparagraph (xi) of this paragraph, the lender or any holder of the note for the extension of credit shall forfeit all principal and interest of the extension of credit if the lender or holder fails to comply with the lender's or

holder's obligations under the extension of credit and fails to correct the failure to comply not later than the 60th day after the date the lender or holder is notified by the borrower of the lender's failure to comply by:

(a) paying to the owner an amount equal to any overcharge paid by the owner under or related to the extension of credit if the owner has paid an amount that exceeds an amount stated in the applicable Paragraph (E), (G), or (O) of this subdivision;

(b) sending the owner a written acknowledgement that the lien is valid only in the amount that the extension of credit does not exceed the percentage described by Paragraph (B) of this subdivision, if applicable, or is not secured by property described under Paragraph (H) of this subdivision, if applicable;

(c) sending the owner a written notice modifying any other amount, percentage, term, or other provision prohibited by this section to a permitted amount, percentage, term, or other provision and adjusting the account of the borrower to ensure that the borrower is not required to pay more than an amount permitted by this section and is not subject to any other term or provision prohibited by this section;

(d) delivering the required documents to the borrower if the lender fails to comply with Subparagraph (v) of this paragraph or obtaining the appropriate signatures if the lender fails to comply with Subparagraph (ix) of this paragraph;

(e) sending the owner a written acknowledgement, if the failure to comply is prohibited by Paragraph (K) of this subdivision, that the accrual of interest and all of the owner's obligations under the extension of credit are abated while any prior lien prohibited under Paragraph (K) remains secured by the homestead; or

(f) if the failure to comply cannot be cured under Subparagraphs (x)(a)-(e) of this paragraph, curing the failure to comply by a refund or credit to the owner of $1,000 and offering the owner the right to refinance the extension of credit with the lender or holder for the remaining term of the loan at no cost to the owner on the same terms, including interest, as the original extension of credit with any modifications necessary to comply with this section or on terms on which the owner and the lender or holder otherwise agree that comply with this section; and

(xi) the lender or any holder of the note for the extension of credit shall forfeit all principal and interest of the extension of credit if the extension of credit is made by a person other than a person described under Paragraph (P) of this subdivision or if the lien was not created under a written agreement with the consent of each owner and each owner's spouse, unless each owner and each owner's spouse who did not initially consent subsequently consents;

In Sims v. Carrington Mortgage Services, LLC, 440 SW3d 10 (Tex. Sup. 2014) the Texas Supreme Court concluded that modifications of home equity loans can be made without triggering the lien requirements of a refinancing transaction:[19]

> "After oral argument, the Fifth Circuit certified the following four questions to us [Supreme Court of Texas]:
>
> 1. After an initial extension of credit, if a home equity lender enters into a new agreement with the borrower that capitalizes past-due interest, fees, property taxes, or insurance

premiums into the principal of the loan but neither satisfies nor replaces the original note, is the transaction a modification or a refinance for purposes of Section 50 of Article XVI of the Texas Constitution?

If the transaction is a modification rather than a refinance, the following questions also arise:

2. Does the capitalization of past-due interest, fees, property taxes, or insurance premiums constitute an impermissible “advance of additional funds” under Section 153.14(2)(B) of the Texas Administrative Code?

3. Must such a modification comply with the requirements of Section 50(a)(6), including subsection (B), which mandates that a home equity loan have a maximum loan-to-value ratio of 80%?

4. Do repeated modifications like those in this case convert a home equity loan into an open-end account that must comply with Section 50(t)?

To the first certified question, we answer: the restructuring of a home equity loan that, as in the context from which the question arises, involves capitalization of past-due amounts owed under the terms of the initial loan and a lowering of the interest rate and the amount of installment payments, but does not involve the satisfaction or replacement of the original note, an advancement of new funds, or an increase in the obligations created by the original note, is not a new extension of credit that must meet the requirements of Section 50.

Is the capitalization of past-due interest, taxes, insurance premiums, and fees an “advance of additional funds” under the Commissions' interpretations of Section 50? No, if those amounts were among the obligations assumed by the borrower under the terms of the original loan. And more importantly, such capitalization is not a new extension of credit under Section 50(a)(6).

Must a restructuring like the Simses' comply with Section 50(a)(6)? No, because it does not involve a new extension of credit, for the reasons we have explained. The Simses argue that any restructuring must satisfy Section 50(a)(6)(B), which requires a home equity loan to be
of a principal amount that when added to the aggregate total of the outstanding principal balances of all other indebtedness secured by valid encumbrances of record against the homestead does not exceed 80 percent of the fair market value of the homestead on the date the extension of credit is made.

The Simses' argument incorrectly assumes that the restructuring is a new extension of credit.
Finally, would repeated restructuring convert a home equity loan into an open-end account subject to Section 50(t)? Section 50(t) applies to a home equity line of credit—“a

form of an open-end account that may be debited from time to time, under which credit may be extended from time to time and under which the owner requests advances, repays money, and reborrows money". The repeat transactions are clearly contemplated from the outset. This description does not remotely resemble a loan with a stated principal that is to be repaid as scheduled from the outset but must be restructured to avoid foreclosure.

Fundamentally, the requirements of Article XIV, Section 50 of the Texas Constitution for extensions of credit secured by the homestead are designed to protect the homestead, not endanger it. The Constitution does not prohibit the restructuring of a home equity loan that already meets its requirements in order to avoid foreclosure while maintaining the terms of the original extension of credit. We answer the certified questions accordingly."

In addition to forbearance on a home equity loan, much discussion regarding mortgage licensure centered around wrap lending. Wrap loans or wrap-around loans are somewhat variable in their make-up and the number of parties involved, but the defining features of one of these loans is that a consumer has a predefined, outstanding loan, usually to a major mortgage lender, and then they take out a second loan that does not pay off the original loan. The consumer makes their monthly loan payment to the wrap-around loan holder and that person is expected to pay the monthly obligation to the original loan holder and keep the rest to satisfy their own portion of the loan. A common issue that arises out of this arrangement is that the middle-man will accept the payment from the consumer, but not proceed to pay the loan obligation to the original lien-holder. With the loan becoming delinquent it is only a matter of time until the primary lien-holder moves to foreclose based on past due payments. This happens all while the consumer believes that they are making their monthly payments, and then they are blindsided by an eviction notice.

In the residential lending space, these loans can happen without much oversight and create a lot of uncertainty. There aren't many deterrents against bad actors, and it is common for the middle-men who accept the payments for these loans to never go forward and pay the primary lien-holder once the payments are made by the borrower, causing loans to default without the knowledge of the borrower. There are also situations where even if the middle-man is not intentionally malicious, there are unintentional mistakes in paperwork that cause the consumer unforeseen problems.

Often times upon entering into a wrap-around agreement, a consumer has unknowingly violated the terms of the primary mortgage agreement. This means that the mortgage company is within their right to void the mortgage and foreclose immediately.

Testimony

At the hearing on January 31, 2018, Karen Neeley, General Counsel for the Independent Bankers Association of Texas ("IBAT"), testified that it is her belief that forbearance is permissible for a home equity loan and does not constitute a refinancing. She stated that this belief is supported by Texas Supreme Court decisions.

In concluding her written testimony, Ms. Neeley stated that "[t]he many, rigid protections of the Texas Constitution as to home equity lending prevent some potential abuses. However, they do so at the expense of the homeowners' ability to use this asset at critical points-such as after a natural disaster."[20]

John Fleming with the Texas Mortgage Bankers Association agreed with Ms. Neeley that forbearance is permissible under current home equity rules. Mr. Fleming went on to explain that a forbearance is simply the lender not initiating foreclosure. The loan remains in default and none of the loan terms are modified, making forbearance different than modification. Mr. Fleming believes that the Finance Commission and Credit Union Commission should issue interpretations on what can be done in a home equity modification.

Mr. Fleming went on to explain that Texas Supreme Court rulings can be a guide for the lending space in that a modification does not constitute a new extension of credit, it is merely altering an existing agreement. Texas Supreme Court case Sim v. Carrington[21] explained what constitutes a modification without extending a new line of credit. This opinion can be the basis for interpretations that will provide safe harbors for lenders to offer forbearance. Most lenders will look to the Finance Commission and Credit Union Commission for their cue on how to handle modifications and refinance as opposed to the legal ruling made by the Texas Supreme Court. This makes the interpretations by these state agencies vital to bringing clarity to the industry.

Brian Engel, a private sector attorney whose practice is focused heavily on foreclosure, stated that he believes we should revisit the home equity forbearance issue as well because the rules on home equity forbearance are currently unclear.

The next topic of discussion in the mortgage licensure space was wrap loans. Molly Rogers, an attorney with Texas Rio Grande Legal Aid, discussed the spike in wrap-around loans that she has seen over the past 5 years. She also provided written testimony that outlined many of the issues that have arisen out of the spike in wrap loans.[22] Of the issues mentioned by Ms. Rogers, some of the more concerning issues were that the homeowner can no longer access account information on the first loan meaning that if the middle-man defaults then the homeowner has no right to information, the homeowner is typically not named on the property insurance policy which allows for a damage claim to be processed without notifying the homeowner, and many times the homeowner cannot refinance, sell, or get a homestead exemption due to gaps in the chain of title and sloppy documentation.

One of the most significant issues with these wrap loans is that they directly violate the terms of the first mortgage which allows the original lender to move to foreclose the moment the wrap contract is signed. Another issue that arises from this is that homeowners do not realize that even if they have a tax deferral in place that the wrap contract can supersede their agreement with their taxing entity and foreclosure can be initiated.

Trish McAllister with the Texas Access to Justice Commission echoed the concerns that the lack of transparency created by these agreements causes a significant amount of problems for the homeowner. The lack of transparency creates uncertainty regarding the standing of the

homeowner's loans.

John Fleming spoke last on wrap lending and stated that wrap loans, which were once fairly common in commercial transactions, are not nearly as common as they used to be. He stated that the reason for this, and the reason for much of the problems created in the residential space by wrap lending, is that in modern mortgage agreements there is usually a "due on sale" clause. This means that if the owner sells the property, then the mortgage lender can call the note due. Therefore, the moment the wrap contract is signed, the homeowner is in default and the original mortgage holder can foreclose.

Wrap lending creates many problems within residential lending and impacts banks as well as consumers. While these types of loans may have value in certain commercial transactions, they have been shown to be dangerous and cause great uncertainty in residential transactions.

Conclusions

1. The legislature should encourage the Texas Finance Commission and the Credit Union Commission to promptly respond to any requests received for formal interpretations regarding home equity loans clarifying whether certain forbearances and modifications constitute a new extension of credit under Article XVI Sec. 50 (a)(6) of the Texas Constitution
2. The legislature should enact more restrictive residential mortgage wrap lending laws to ensure the protection of consumers and lenders.

FINANCIAL TECHNOLOGY

Charge #4: " Study policy challenges in the area of financial technology. Evaluate the concept of a "sandbox" as a regulatory approach for enabling innovation and the feasibility of implementing such in Texas. If appropriate, make recommendations for possible legislative action to foster innovation in the finance industry."

Background

Sandbox is a regulatory approach that allows companies to conduct testing of products on real consumers in a controlled environment prior to wide-scale public release. This approach removes many of the normal regulatory and supervisory hurdles that businesses in the financial services sector typically face, which allows for increases in innovation and diversity of companies in the marketplace. This innovation can be used to further financial inclusion and meet financial needs that may not have been recognized previously.

Blockchain, also known as distributed ledger technology, is a foundational technology whereby each transaction is publically viewable and unchangeable unless agreed upon by a majority of those within the network[23]. This technology has many practical applications across the spectrum including the banking sector, confidential information storage, legal transactions and many more. The most widely publicized application of blockchain technology has been cryptocurrency, with much of that discussion focusing specifically on the cryptocurrency Bitcoin.

Cryptocurrency is an unbacked, decentralized, electronic "token" that is able to be used for various transactions. Many experts compare blockchain to the early internet with cryptocurrency being similar to email. Blockchain is the underlying technology that enables cryptocurrency to function, and cryptocurrency is the peer to peer interactive exchange application that utilizes the underlying technology.

Testimony

The committee held a public hearing on April 24, 2018, at the Texas State Capitol to discuss the opportunities and risks for Texas in the financial technology sector, including "sandbox" regulation, cryptocurrency, and blockchain technology.

First to testify was Daniel Wood, a private sector attorney and former assistant general counsel with the Texas Department of Banking, who described potential regulatory innovations as falling into two categories: sandbox and on-ramps. Sandbox is a live test environment where companies can explore new products on a limited number of real-world customers. The on-ramp concept is similar, but is more accurately described as allowing new companies to go from inception to market over the various regulatory barriers in a more efficient manner by lowering some of the regulatory requirements for a specified period of time. Traditionally in the world of start-ups, being first to market is a tremendous advantage, but in the financial services sector there are many more regulatory barriers to contend with before you can get your product to

market, which is what makes the idea of a sandbox or on-ramp appealing..

Mr. Wood proceeded to describe the United Kingdom's regulatory sandbox, which was created by their Financial Conduct Authority ("FCA") in 2015 and officially launched in 2016.[24] There were a wide variety of applicants from big banks to start-ups, and the applications involved an assortment of financial service products. Out of the 24 companies that were selected, 90% of the participants that completed testing in the first round of the sandbox continued on toward a larger market launch following their time in the sandbox. After participation in the sandbox these companies reported it easier to secure funding since they had the opportunity to prove the efficacy of their product within the sandbox.

Next to speak was Ann Baddour with Texas Appleseed. Ms. Baddour described Project Catalyst, which is a sandbox-like framework that was established by the Consumer Financial Protection Bureau ("CFPB") in 2012 with the goal of encouraging consumer-friendly innovations in the financial services sector.[25] This project is not the exact definition of a sandbox, but in many practical ways it functions like one. The CFPB created a policy whereby the Bureau will issue a no-action letter that serves as an acknowledgement that the CFPB has no present intention to recommend an enforcement or supervisory action against a firm with respect to a specified product or service, effectively greenlighting the project.[26] A no-action letter under the CFPB is subject to modification or revocation at any time and is not binding on the CFPB. In return, fintech companies that receive no-action letters must share certain information with the CFPB, which it will use to further its understanding of how different practices and models impact access to consumer financial products.[27]

Ms. Baddour also cautioned the committee that not all innovation is good, and that because of this the sandbox should be closely monitored and routinely inspected for deficiencies.

Next to speak was Texas Department of Banking Commissioner ("DOB") Charles Cooper and Deputy Commissioner Stephanie Newberg. Commissioner Cooper expressed his concern for allowing bad actors to prey on citizens regardless of the amount of consumers that bad actor is authorized to do business with. In Commissioner Coopers estimation it does not make sense to have an arbitrary number define how many people can be subject to bad business as is the case under a traditional sandbox framework.

Deputy Commissioner Newberg outlined a start-up license concept that the DOB has formed that would allow for companies with innovative financial services or products in the money service business arena to do business for up to three years with a lesser regulatory burden including a lower net-worth requirement and a waiver of the requirement to have an audited financial statement. The start-up would be required to have a sponsor that is a financial institution or licensed money service business that would oversee the operations of the company and would be responsible for the customer obligations if the start-up was unable to fulfill them.

The first panel to address cryptocurrency and blockchain technology consisted of Marshall Long, CEO of Final Hash and several other blockchain companies, Daniel Wood, former Assistant General Counsel at the Texas Department of Banking and current cryptocurrency and blockchain attorney at Pillsbury Winthrop Shaw Pittman, Justin Newton,

CEO of Netki, a blockchain and cryptocurrency service company, and Lana Reeve with Maco.La Capital, an investment fund focused on blockchain startups.

Marshall Long, an early adopter of blockchain technology and cryptocurrency as well as the CEO of multiple blockchain companies, testified first. Mr. Long explained to the committee that a blockchain is a secure database that cannot be updated unless all stakeholders are in agreement. He informed the committee that blockchain is an extremely versatile technology and can be utilized in many different sectors. To emphasize this point, Mr. Long explained that major accounting firms like Deloitte and PWC already have blockchain initiatives in place to streamline auditing systems.

He continued by describing blockchain's use in the legal environment as a way to automate arbitration in contracts as well as automate the movement of money based on conditional clauses in a contract. Mr. Long further emphasized the uses for blockchain by explaining that the world's largest real estate holder is currently implementing a blockchain to track properties to help ease accounting responsibilities and validate changes in their real estate holdings.

Mr. Long discussed the current rash of security breaches of major retailers that use traditional security models and how the use of blockchain can help to increase security in retail transactions. The use of blockchain allows consumers to "own" their data and to transmit that data securely whenever they make a purchase without the need to store that data on the part of the retailer. This decentralizes sensitive consumer information and makes this information more difficult to access by outside parties. Therefore, instead of hacking one database that contains all of the consumer data available to a company or agency, outside parties would have to hack each individual piece of data. This is much more labor intensive and offers an added layer of protection for consumer information.

Mr. Long mentioned the Bank Secrecy Act and money laundering as two of the primary concerns surrounding blockchain and cryptocurrency, but dispelled those concerns by saying that cryptocurrencies could comply with regulation and be easily tracked if tied to the dollar.

Mr. Long discussed Wyoming's recent legislation that loosened regulation to allow for more experimentation within the financial services sector. Wyoming has put forth instructions for businesses that want to launch a cryptocurrency or blockchain related start up.

Next to speak was Daniel Wood who continued to expound upon the distributed ledger technology known as blockchain and why it can have many benefits from an information security perspective. He explained that the distributed ledger is publically viewable and all exchanges on that ledger are also viewable, so no single person could make a change to the blockchain without getting the consent from a majority of those involved in the ledger. Mr. Wood also outlined the usability of a distributed ledger in land records and chain of title which could potentially ensure more accurate records of ownership.

Mr. Wood also introduced a few potential problems involved in using distributed ledger technology. One is the current inability of blockchain to be able to scale to meet the needs that

current systems can. However, he believes we are in the early stages of distributed ledger technology, and as the technology is more widely adopted, we will see further scalability. The other issue is that of competitive advantage. If all transactions are done on a distributed ledger then each transaction is viewable by the public. While this creates full transparency, which has many benefits, it also has drawbacks. For example, banks could view the exchanges of their competitors and use that information to become more competitive with them.

The next panel to testify included Texas Securities Commissioner Travis Iles and Banking Commissioner Charles Cooper. Commissioner Cooper spoke first and mentioned that the DOB regulates money transmission services which includes companies like PayPal, Western Union, Google and more. Commissioner Cooper stated that the department has concluded that cryptocurrency is not regulated by the department because cryptocurrency, under current Texas statute, is not money. Money is fiat currency supported by government sponsored entities and cryptocurrency does not meet this definition, and therefore, does not fall under the money transmission act. Commissioner Cooper also stated that historically they regulate products and industries, and that he believes cryptocurrency is neither and should instead be considered a technology.

Next to speak was Commissioner Travis Iles of the Texas Securities Commission. Commissioner Iles clarified his agencies regulatory authority over cryptocurrency stating that they do not regulate the underlying distributed ledger technology, but instead are more concerned with securitized cryptocurrency. He defined this as when promoters utilize cryptocurrencies in passive investments and offer them to retail investors. Commissioner Iles explained that many promoters are engaging in fraudulent investment schemes involving cryptocurrency that prey on mainstream investors. His agency has over 60 cases open involving potentially fraudulent cryptocurrency investment schemes.

Conclusions

1. The legislature should continue to monitor data from regulatory sandboxes and on-ramp programs around the country and the world to determine if there are potentially sound uses within the financial services industry in Texas.
2. The legislature should continue to monitor the technological landscape to determine what opportunities blockchain and cryptocurrency could provide in the financial services sector in Texas as well as what challenges these new technologies may present.

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