Charles G. Cooper
Commissioner

TEXAS DEPARTMENT OF BANKING

2601 North Lamar Blvd., Austin, Texas 78705
512-475-1300 /877-276-5554
www.dob.texas.gov

To: The Honorable John Corona
Chairman of the Senate Committee on Business and Commerce

***From*:** Charles G. Cooper, Banking Commissioner

***Date*:** January 29, 2013

Subject: Quarterly Update on Texas Department of Banking

I. Status of the implementation of last session's key legislation.

SB 1165 – related to enforcement powers of the banking commissioner
SB 1166 and HB 3004– related to prepaid funeral benefits contracts and the prepaid funeral contract guaranty fund
SB 1167 and HB 2495– related to cemeteries and perpetual care cemetery corporations

All actions to enforce these statutes have been fully implemented, including:

- Notices regarding statutory changes have been sent to the industry; and,
- Examination procedures, related forms and contracts, internal memorandums, and rules have been updated.

II. Texas state-chartered bank information.

	June 30, 2011	September 30, 2011	September 30, 2012
Number of Insured Depository Institutions	309	305	295
Assets *(billions)**	$164.6	$168.3	$198.5
Net Loan Volume *(billions)**	$96.2	$96.0	$110.3
Problem Banks**	54	50	38

**FDIC financial data for insured institutions.*
***The Department defines problem banks as any financial institution with a composite rating of "3", "4" or "5".*

- Troubled Asset Relief Program (TARP) – Eighty of our banks applied to participate in the Capital Purchase Program under TARP. However, after significant withdrawals, only 21 banks received funds totaling $2.8 billion, with one bank receiving about 80% of this total. As of January 22, 2013, nine banks have not repaid any of their TARP funds. The total outstanding amount is approximately $311 million.
- Small Business Lending Fund (SBLF) – Twenty-three Texas state-chartered banks applied for funds under this program. Twelve banks received funds totaling $255.7 million. One approved bank decided not to accept the funds ($40 million). The remaining banks either withdrew their applications or their applications were denied. As of January 22, 2013, one bank has paid back its funds, leaving $255.1 million outstanding.
- There have been no state-chartered bank failures since September 30, 2011, when First International Bank, Plano, Texas failed.

- The Department of Treasury released final regulations on April 17, 2012, which require reporting deposit interest paid to nonresident individuals. The new reporting rules apply to interest paid on or after January 1, 2013.
- The Transaction Account Guarantee (TAG) program was not extended and no adverse effect has been reported by any state-chartered bank. Under this program, customers of participating insured depository institutions were provided full coverage on qualifying transaction accounts.
- The agency's initiative on Corporate Account Takeovers (CATO) is supported by the Texas Bankers Electronic Crimes Task Force in cooperation with the U.S. Secret Service. The initiative is to promote awareness and provide information on cyber related crimes and risk management practices to bankers and consumers. The developed practices are being prepared for national distribution through the Conference of State Bank Supervisors (CSBS) and the Financial Services – Information Sharing and Analysis Center (FSISAC).

III. Federal Implementation of Dodd-Frank.

The Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank) significantly changed the financial landscape and the regulation of domestic and foreign financial institutions, but Dodd-Frank relies heavily on rulemaking and interpretation by federal regulatory agencies for implementing many of its provisions regarding regulatory improvements.

The Davis Polk law firm tracks and reports monthly progress in these rulemaking requirements, and recently released its January Dodd-Frank Progress Report.[1] As of January 2, 2013, 136 (34.2%) of the 398 total rulemaking requirements of Dodd-Frank had been met with finalized rules, and rules have been proposed that would meet an additional 133 (33.4%) more. Rules have not yet been proposed to meet 129 (32.4%) of the rulemaking requirements.

Despite the intensive effort of the federal regulatory agencies charged with implementing Dodd-Frank, almost 60% of the completed rulemaking projects missed the statutory deadlines, primarily due to complexity of the subject matter. However, because of the very substantial work that has been done over the past two years, the agencies are reaching the finish line for several massive Dodd-Frank reform rules. For example:

a. The Consumer Financial Protection Bureau (CFPB) recently finalized several rules implementing important mortgage-related reforms that will affect many aspects of the mortgage lending business, including:

i. The ability-to-repay rule along with its "qualified mortgage" standard and related safe harbor provisions, to be effective January 10, 2014.[2]

1. The final rule describes certain minimum requirements for creditors making ability-to-repay determinations, but does not dictate that they follow particular underwriting models. At a minimum, creditors generally must consider eight underwriting factors: (1) current or reasonably expected income or assets; (2) current employment status; (3) the monthly payment on the covered transaction; (4) the monthly payment on any simultaneous loan; (5) the monthly payment for mortgage-related obligations; (6) current debt obligations, alimony, and child support; (7) the monthly debt-to-income ratio or residual income; and (8) credit

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[1] The monthly Dodd-Frank Progress Report can be found at**:** http://www.davispolk.com/Dodd-Frank-Rulemaking-Progress-Report/.
[2] The CFPB summary of the ability-to-repay and qualified mortgage rule can be found at: http://files.consumerfinance.gov/f/201301_cfpb_ability-to-repay-summary.pdf.

history. Creditors must generally use reasonably reliable third-party records to verify the information they use to evaluate the factors.

2. Dodd-Frank provides that "qualified mortgages" are entitled to a presumption that the creditor making the loan satisfied the ability-to-repay requirements. Loans that are not considered qualified mortgages (QMs) under the rule are those with negative amortization, interest-only payments, balloon payments, or terms exceeding 30 years. So-called "no-doc" loans also cannot be QMs. The final rule also implements a special Dodd-Frank provision that treats certain balloon-payment loans as QMs if they are originated and held in portfolio by small banks in predominantly rural or underserved areas.

ii. The high-cost mortgage and homeownership counseling rule, to be effective January 10, 2014.[3] The final rule expands the types of mortgage loans that are subject to the protections of the Home Ownership and Equity Protections Act of 1994 (HOEPA) and imposes additional restrictions on mortgages that are covered by HOEPA, including a pre-loan counseling requirement. The final rule also imposes certain other requirements related to homeownership counseling, including a requirement that consumers receive information about homeownership counseling providers. Under the rule, a high-cost mortgage, among other things, is a loan with an annual percentage rate that is more than 6.5 percentage points higher than the average prime offer rate for first mortgages, and more than 8.5 percentage points higher than the average prime offer rate for second or junior mortgages. For mortgages that qualify as high-cost, the rule generally bans balloon payments and prohibits prepayment penalties. The rule also bans fees for modifying loans, caps late fees at 4%, prohibits closing costs from being rolled into the loan amount, and restricts fees lenders charge when consumers ask for a payoff statement.

iii. The loan originator compensation rule, to be effective January 10, 2014.[4] Under the rule, originators cannot be paid by both the consumer and the creditor, and they must meet new qualification and screening standards—including character and financial responsibility reviews, criminal background checks and training requirements. The final rule also implements Dodd-Frank provisions applicable to mortgage and home equity loans that generally prohibit mandatory arbitration of disputes related to mortgage loans and the practice of increasing loan amounts to cover credit insurance premiums.

iv. The escrow accounts rule, to be effective June 1, 2013.[5] The rule implements statutory changes made by Dodd-Frank that lengthen the time for which a mandatory escrow account established for a higher-priced mortgage loan must be maintained. The rule also exempts certain transactions from the statute's escrow requirement. The primary exemption applies to mortgage transactions extended by creditors that operate predominantly in rural or underserved areas, originate a limited number of first-lien covered transactions, have assets below a certain threshold, and do not maintain escrow accounts on mortgage obligations they currently service.

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[3] The detailed CFPB summary of the final high-cost mortgage and homeownership counseling rule can be found at: http://files.consumerfinance.gov/f/201301_cfpb_high-cost-mortgage-rule_summary.pdf. The CFPB summary for consumers can be found at: http://files.consumerfinance.gov/f/201301_cfpb_high-cost-mortgage-rule_what-it-means-for-consumers.pdf.
[4] The CFPB summary of the final loan originator compensation rule can be found at: http://files.consumerfinance.gov/f/201301_cfpb_loan-originator-compensation-rule_summary.pdf.
[5] The detailed CFPB summary of the final escrow accounts rule can be found at: http://files.consumerfinance.gov/f/201301_cfpb_escrow-requirements-rule_summary.pdf. The CFPB summary for consumers can be found at: http://files.consumerfinance.gov/f/201301_cfpb_escrow-requirements-rule_what-it-means-for-consumers.pdf.

v. New mortgage servicing rules, to be effective January 10, 2014.[6] In general, the rules impose new requirements in nine major areas, including interest-rate adjustment notices; prompt payment crediting and payoff statements; error resolution and information requests; periodic billing statements; lender-placed insurance; early intervention with delinquent borrowers; and loss mitigation procedures. Mortgage servicers that handle 5,000 mortgage loans or less that they or an affiliate own or originate are exempt from some of the new rules, a provision that should benefit community banks.

b. The federal financial regulatory agencies, including the Office of the Comptroller of the Currency (OCC), the Board of Governors of the Federal Reserve System (FRB), and the Federal Deposit Insurance Corporation (FDIC), are in the home stretch of crafting several more major rules required by Dodd-Frank, including rules banning banks' proprietary trading (the so-called Volcker Rule), requiring lenders to keep pieces of securitized loans (the risk retention rules), and imposing some variant of the proposed Basel III capital standards. Hope has been expressed that these rules will be in place by the second half of 2013.

i. Section 619 of Dodd–Frank, known as the Volcker rule, prohibits banks from engaging in short-term proprietary trading of securities and derivatives for the banks' own account. It also prohibits banks from owning or having certain relationships with hedge funds or private equity funds. Implementing the Volcker Rule provisions is a very complex undertaking, even though the general objective of the statute—barring banks from engaging in proprietary trading or investing in or sponsoring "hedge funds" and "private equity" funds—initially seems straightforward. The proposed rulemaking was released for public comment on October 11, 2011.[7] Running to almost 300 pages, the proposal included nearly 400 questions on issues still to be resolved, and attracted over 19,000 comment letters. The agencies continue to discuss the issues raised by commenters and are drafting revisions to the proposal. Financial institutions will have two years, or until July 21, 2014, at the latest, to conform their activities to the statutory prohibitions imposed by Dodd-Frank and any final rule that is issued, unless an extension is granted by the FRB. The final rule is anticipated to include some exemptions for market-making or hedging activities, but the rule should still function to significantly limit the riskier trading activities seen in the past.

ii. Dodd-Frank generally requires the securitizer of asset-backed securities to retain at least 5% of the credit risk of the assets collateralizing the asset-backed securities. The term "securitizer" with respect to an issuance of asset-backed securities includes both "(A) an issuer of an asset-backed security; or (B) a person who organizes and initiates an asset-backed securities transaction by selling or transferring assets, either directly or indirectly, including through an affiliate, to the issuer."[8] Because residential mortgages are assets used to collateralize asset-backed securities, a mortgage lender such as a community bank must retain at least 5% of the credit risk of loans it sells into the secondary market for such purposes. However, Dodd-Frank authorizes an exemption for asset-backed securities that are collateralized exclusively by residential mortgages that qualify as "qualified residential mortgages," as such term is defined by rule. The federal agencies issued proposed risk retention rules almost two years ago[9] but have not adopted final regulations. Finalizing the risk retention rule has been held up pending adoption of the CFPB's similar qualified mortgage rule, completed on January 10, 2013.

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[6] The CFPB summary of the final mortgage servicing rules can be found at: http://files.consumerfinance.gov/f/201301_cfpb_servicing-rules_summary.pdf.
[7] 76 FR 68846 (November 7, 2011).
[8] 15 U.S.C. 78o–11(a)(3), as added by Dodd-Frank Section 941(b).
[9] 76 FR 24090 (April 29, 2011).

iii. In June 2012, the FRB, OCC and the FDIC approved three related notices of proposed rulemaking that would revise and replace the current regulatory capital rules, popularly referred to as the Basel III proposals.[10] The proposals would fundamentally change how all banks calculate their regulatory capital requirements by increasing the minimum levels of required capital, narrowing the definition of capital and increasing the risk weights for various asset classes. The comment period closed October 22, 2012. The proposals had suggested an effective date of January 1, 2013. However, on November 9, 2012, the agencies announced that none of the proposed rules would become effective on January 1, 2013. Debate around BASEL III and capital levels continues with community banks requesting a simplified and less costly approach.

IV. Implementation of Dodd-Frank by the Department of Banking.

As previously reported, legislation is not required to implement Dodd-Frank as it applies to state-chartered banks. For clarity and consistency, the Department of Banking has suggested proposed legislation to conform state law on interstate banking and branching to federal law that has twice been amended since state law on this topic was last revised. Regarding Dodd-Frank requirements for state lending limits, implementation has been accomplished through rulemaking.

a. Dodd-Frank Section 611 requires state legal lending limits to take into consideration credit exposure under derivative transactions by January 21, 2013, in order for state banks to retain authority to invest in derivatives (typically done for hedging purposes). Pursuant to similar requirements imposed on national banks, the OCC issued its interim final rules addressing the application of legal lending limits to credit exposures arising from derivative and securities financing transactions.[11] This rule served as a model for state rulemaking to address the requirement and, on August 17, 2012, the Finance Commission proposed a rule to take these transactions into account. A final rule was adopted by the Finance Commission on December 14, 2012, with an effective date of January 3, 2013.[12] The Department anticipates that the OCC will issue its final revised rule on this topic during the first quarter of 2013, and the Department will propose amending its rules on the topic to conform with the rule applicable to national banks.

b. Through the Conference of State Bank Supervisors (CSBS), the department is currently participating in the negotiation and development of a CFPB-State Supervisory Agreement to coordinate supervision and examination of covered depository institutions, and to coordinate and consult on the identification and supervision of nondepository businesses (e.g. money services businesses) that are subject to the jurisdiction of both the CFPB and the states. The purpose of the Agreement is to minimize regulatory burden through examination efficiencies and the avoidance of duplicative use of time and resources, to the extent permissible under applicable state law.

V. Legislation in 83rd Legislative Session.

The Department has provided draft language to the Senator's office that would clarify and update current statutes, as well as provide consistency with federal law, in the areas of banking, money services businesses, perpetual care cemeteries, and prepaid funeral contracts.

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[10] The core Basel III proposal was published at 77 FR 52792 (August 30, 2012).
[11] 77 FR 37265 (June 21, 2012)
[12] 37 TexReg 10195 (December 28, 2012).