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To the Sunset Advisory Commission:

I submit this testimony on behalf of the Texas Organization of Financial Service Centers ("TOFSC"). TOFSC is an association of dozens of owners of small and independent businesses engaged in the consumer-credit industry in towns and neighborhoods across Texas as "credit access businesses," or "CABs." TOFSC researches and promotes best practices for ensuring compliance with Texas's rapidly evolving patchwork of regulatory governance over CABs, as well as providing a forum for its members to exchange ideas for improving management, operations, and profitability of their businesses. Representing owners of more than 175 stores, TOFSC has members from McAllen to Lubbock, from Pasadena to El Paso, and everywhere in between. Many of TOFSC's constituents operate only a single storefront, while some have expanded to three, four, or even five branches. TOFSC's members are highly entrepreneurial and diverse, including women and minority business owners and many who have boldly ventured into business for themselves just in the last few years.

TOFSC submits this limited testimony in opposition to only two recommendations by the Sunset Staff. Specifically, TOFSC has serious concerns about recommendation 5.6 (removing the "knowingly and willfulness" standard for administration actions) and recommendation 5.9 (altering the standard for the regulatory remedy of restitution). Beyond these two limited objections, TOFSC has no objection to the Staff Report.

1. Elimination of "knowingly and willfulness" standard

The Sunset Staff criticizes the "knowingly and willfulness" standard as an "unnecessary barrier[] to enforcement" of violations within the industry. They opine that the current enforcement process "make[s] it overly difficult to bring disciplinary action" and does not allow the OCCC to "move quickly to deal with unlicensed activity."[1]

[1] To support these charges, Staff references a SOAH opinion that purportedly "acknowledge[s] OCCC's difficulty" in meeting this standard, *see* State Office of Admin. Hearings, *Office of Consumer Credit Commissioner v. Max Money Enterprises*, Docket No. 466-16-1450 (Mar. 9, 2016) (proposal for decision). But the Staff's characterization of that SOAH opinion is not at all objective. The ALJ in that proceeding did acknowledge that OCCC had failed to prove mens rea, but it did not suggest that this bar was "high" or impossible to meet. Rather, the ALJ simply followed the law and rejected OCCC's contention that it had met the legal standard. *Id.* at *5 ("The only argument Staff offered to support its position that the Legislature did not intend to require proof of a mens rea before a violation could be found is that it would make it easier for Staff to prove its case."). In other words, an administrative judge determined that OCCC failed in it's burden, but the judge espoused no view about whether the burden set by the Legislature was wise or unwise. The judge rightfully applied, without interpretation, the law set by the Legislature.

Staff's recommendations are based on a false premise. The Finance Code does *not* require a "knowing or willing" violation to bring a disciplinary action. Instead, the Code establishes a graduated scheme for enforcement. The Code grants the OCCC authority to *immediately* enforce remedies against a regulated entity upon a showing of knowing and willful violation. But that is not the normal course for enforcement. Most violations are done without flagrant disregard for the Code. The Code acknowledges this and predicates any enforcement action on the OCCC providing notice to the lending entity of the violation. Once the OCCC provides notice of a violation, any remedy needed to cure the violation is available to the OCCC to cure the infraction.

This graduated approach is consistent with the regulations of other financial institutions. For example, Chapter 35 (Subchapter C) of the Finance Code provides enforcement powers for unauthorized banking activity. The banking commissioner's authority starts with cease and desist orders and only authorizes administrative penalties and restitution for violations of the cease and desist order. *See* TEX. FIN. CODE §35.202 et seq. Similarly, Chapter 122 of the Finance Code, which regulates credit unions, provides that violations are first addressed by cease and desist orders, which can be enforced by administrative penalty and injunction. TEX. FIN. CODE §122.255 et seq.

All of these schemes exhibit an entirely reasonable approach to regulating what is a somewhat vague Finance Code, under which the allowances and prohibitions are necessarily vague. The "knowing and willfulness" predicate to immediate sanctions anchors both the regulated and the regulatory entity. It provides the regulatory agency the ability to stop potential harm to the public, but also protects the regulated entity from facing enforcement action for unintentional violations. The alternative proposed by Staff is essentially strict liability—a concept completely foreign to Texas law under modern tort reform.

2. Elimination of an "injury" standard for restitution

The Staff's recommendation to eliminate the "injury" standard for the remedy of restitution is both illogical and does not comport with the legal standard for restitution. As a starting point, the Staff's report still hinges restitution upon a showing of a "quantifiable cost to consumers." This recommendation seems to substitute one standard for harm for another: *i.e.*, a "cost" to consumers that is "quantifiable" can only mean a financial "injury", as is required by the current Code. Staff makes no compelling reason to change, and thereby confuse, the industry for the base standard the OCCC must prove before evoking the remedy of restitution. As my mother taught me, "if it ain't broke, don't fix it."

To the extent Staff is suggesting some *lower* standard for the OCCC to order restitution, the Staff recommendation is ill-advised. Indeed, the entire foundation of the remedy of restitution is an injury (or quantifiable harm) that can be cured through some financial recourse.[2] For example, if a lender overcharges a customer by $5, that is a quantifiable harm that can be remedied through restitution. If the overcharge can be established, restitution may be appropriate to make whole each individual consumer that was harmed by that overcharge.

But to the extent Staff is recommending that the OCCC have the authority to order "restitution" without proving the factual predicate of harm, the Staff's recommendation completely misunderstands the remedy of restitution. For example, if a lender fails to comply with some *technical* requirement of the Code, but no showing of harm is made, what is the remedy? A refund of the contract? Perhaps, under the Staff's new standard. But that's not restitution. That's *recession.* And, worse, that's *unilateral* or one-way recession, unacknowledged under Texas law: the lender forgoes the benefit of its contract, yet the borrower retains the benefit of the loaned funds – at no cost.[3] That result is entirely incongruent with the remedy of restitution. The Commission should reject this view of the legal concept of recession.

3. Policy concerns

Embedded in these legal arguments, of course, is a significant amount of policy concerns that need to be brought to the Commission's attention. The first is that the current Finance Code provides a rational and measured approach to regulation, as articulated above. Staff's concerns about the "overly restrictive" or "unnecessarily high" standards currently in play with the OCCC are not statistically based. The danger of changes to an industry without any kind of statistical analysis—or really any kind of normative justification—is that one can suspect the proposed changes are purely subjective, based on one or maybe two cases that do no reflect the investigation or enforcement actions against the industry as a whole. Worse, absent a normative study, the recommendations may even suggest a Staff bias to the industry, though certainly TOFSC is not suggesting one exists. The point here is to simply emphasize a need for careful, statistical-based studies. To the extent the Commission is concerned about enforcement of the industry in general, a

[2] Black's Law Dictionary defines "restitution" as "an equitable remedy under which a person is restored to his or her original position *before the loss or injury*; act of restoring; restoration of anything to its rightful owner; the act of making good or giving equivalent for any loss, damage, or injury; and indemnification." *See also Matter of J.R.*, 907 S.W.2d 107, 109 (Tex. App.—Austin 1995, no writ).

[3] *See Siddiqui v. Fancy Bites, LLC*, 504 S.W.3d 349, 374 n.11 (Tex. App.—Houston [14th Dist.] 2016, pet. denied) ("Like restitution, rescission is calculated based on the amount paid minus the benefits received." (citing *Cruz v. Andrews Restoration, Inc.*, 364 S.W.3d 817, 825 (Tex. 2012) for the proposition that "rescission is not a one-way street" and "requires a mutual restoration and accounting, in which each party restores property received from the other.")); *Denver City Indep. Sch. Dist. v. Moses*, 51 S.W.3d 386, 391 (Tex. App.—Amarillo 2001, no pet.) ("Award of restitution is an award of 'damages.'").

more thorough study should be directed to have *objective* information that might inform the Commission on any changes to the Code that might be needed.

The second policy concern is a bit more nebulous, but actually more alarming. Our organization is legitimately concerned that lowering the standard for enforcement, as Staff recommends, could mean the end of this industry, at least for some of our organization's membership. To give a concrete example: in 2013, under the Obama administration, the Department of Justice instituted an initiative against the industry. The purported investigation proved fruitful only in its ability to pressure traditional banks against doing business with credit access businesses, like those our organization represents. That is, without any significant regulatory changes, the Obama administration was able to pressure certain banks to cease doing business with the entities that our organization represents. The resulting change is not just politics. Instead, the Obama initiative resulted in a direct and tangible effect for many industry players. Traditional lenders became skeptical of the industry. As a result, even *one* infraction from the OCCC (whether based on a willful violation or an unknowing one) could result in those lenders cutting off one of our members. The *legal* result becomes immaterial because the *market* result is a death penalty—the end of a business for infractions that, absent the reasonable standards currently in the Finance Code, amount to the equivalent of a traffic ticket. That result makes no sense and is not good policy.

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The Staff may not have appreciated these legal and policy concerns as it reviewed the operations of the OCCC. But I hope my testimony alerts the Commission to the dangers of recommendations 5.6 and 5.9. On behalf of TOFSC, I implore the Commission to reject these recommendations for the sake of a fair and just enforcement process, and for the viability of the industry as a whole.

Respectfully Submitted,

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By: ______________________

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