

**SUBJECT:** Authorizing the Legislature to define interest rates for commercial loans

**COMMITTEE:** Financial Institutions — favorable, without amendment

**VOTE:** 6 ayes — Solomons, McCall, Chavez, Flynn, Orr, Riddle  
0 nays  
1 absent — Guillen

**SENATE VOTE:** On final passage, April 14 — 31-0

**WITNESSES:** For — (*Registered but did not testify:* Val Perkins, Texas Business Law Foundation; Eric Sandberg, Texas Savings and Community Bankers Association; Steve Scurlock, Independent Bankers Association of Texas; Mark Vane, Gardere Wynne Sewell)  
Against — None

**BACKGROUND:** Texas Constitution Art. 16, sec. 11 allows the Legislature to define interest and fix maximum rates of interest. If no maximum rate of interest has been defined, any rate above 10 percent is deemed usurious.  
  
According to 12 U.S.C. § 85, banks domiciled in one state may export interest rates, including most fees in connection with credit extension or availability, to customers in another state. Other commercial lenders also use choice-of-law provisions to close loans in their home states with more favorable interest rate conditions. This means that Texas banks and commercial lenders operate under different restrictions than those to which many of the out-of-state entities must adhere.

**DIGEST:** SJR 21 would allow the Legislature to create exemptions from the maximum rates of interest on commercial loans. A commercial loan would be considered a loan made primarily for business, commercial, investment, agricultural, or similar purposes and not primarily for personal, family, or household purposes.

The proposal would be presented to the voters at an election on Tuesday, November 8, 2005. The ballot proposal would read: "The constitutional amendment allowing the legislature to define rates of interest for commercial loans."

**SUPPORTERS  
SAY:**

SJR 21 would allow the Legislature to exempt certain commercial loans from maximum interest rates. Texas' commercial lending laws place both Texas borrowers and lenders at a competitive disadvantage compared to the laws of 46 other states. In these states, sophisticated commercial lenders and borrowers are allowed greater freedom to structure the unique loan arrangements that commercial parties often require. Texas-chartered banks and other commercial lenders do not share this freedom.

Often, Texas banks and lenders cannot obtain a great enough yield to make high-dollar commercial lending worthwhile because of the greater risk involved in making large loans. Loosening the restrictions on certain commercial lending would further reduce costs because parties to large commercial loans with Texas banks often must obtain elaborate legal opinions to navigate the complex laws governing which fees and charges constitute interest.

The bill would grant sophisticated borrowers the freedom to structure loan deals with proper incentives to compensate banks with reasonable rewards for the risk they assumed. This would not remove the protections of rate ceilings for less sophisticated borrowers because the Legislature still would exercise judgment in determining eligibility criteria for which commercial loans would receive interest-ceiling exemptions. In addition, regardless of whether or not Texas institutes such exemptions, out-of-state banks and commercial lenders still would have the ability to contract with small, commercial borrowers according to the rate standards in accordance with laws from their home states.

Because of Texas' interest rate ceiling, the vast majority of commercial loan transactions are made by out-of-state entities in accordance with the lending laws of other states. Texas' existing commercial lending laws increase costs for Texas businesses, limit opportunities for Texas-chartered banks attempting to make commercial loans, and require Texas businesses to obtain loans from lenders whose decision makers are located out-of-state. This proposed amendment would allow the Legislature to level the playing field by permitting Texas' commercial borrowers and lenders to compete with financial institutions from across the country.

This also would provide opportunities for economic development, because it would increase incentives for large banks to locate their headquarters in Texas.

OPPONENTS  
SAY:

The interest-rate ceilings in the Texas Constitution and statutes create a protection from usurious lending practices. While some commercial borrowers have the sophistication to enter into complex loan agreements, not all commercial loans are obtained by sophisticated borrowers. Even if the Legislature this session included appropriate criteria to protect less sophisticated borrowers, this proposed amendment would open the door for these criteria to be lifted in the future. Texas should not follow the dangerous lead of other states that have exempted all commercial lending from interest-rate ceilings.

Small business owners may wish to obtain commercial loans in lesser amounts adequate to meet their business needs, and these borrowers may not be as sophisticated as larger commercial borrowers. Less sophisticated borrowers could be victimized by unscrupulous lenders who incorporated unfavorable terms into contracts without the knowledge of borrowers. Small borrowers may not recognize the implications of all the terms included in a loan contract and often do not possess adequate resources to subject the contract to legal review prior to signing.

NOTES:

The enabling legislation for SJR 51 is included in HB 955 by Solomons. HB 955 would provide that parties in an exempt commercial loan could agree to contract for, charge, and receive any rate or amount to which the parties had agreed. An exempt commercial loan would be any commercial loan of \$7 million or more that was not secured primarily by real property or any loan of \$500,000 or more that was secured primarily by real property. HB 955 is on today's General State Calendar.