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CREDIT UNION DEPARTMENT

Harold E. Feeney
Commissioner

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Deputy Commissioner

January 27, 2011

RQ-0942-GA

The Honorable Greg Abbott
Attorney General of Texas
P.O. Box 12548
Austin, Texas 78711-2548

Dear General Abbott:

This letter requests an opinion on whether the "enlargement of powers" authority set out in Section 123.003(a) of the Finance Code trumps other state laws, specifically including the interest rate limitations of Section 124.002 of the Finance Code.

For example, Finance Code Section 124.002 (Limitations on Interest Rates) provides:

> The interest rate on a loan to a member may not exceed:
> (1) 1-1/2 percent per month on the unpaid balance; or
> (2) a higher rate authorized by law, including a rate authorized by Chapter 303.

Finance Code Section 123.003 (Enlargement of Powers) states:

> (a) A credit union may engage in any activity in which it could engage, exercise any power it could exercise, or make any loan or investment it could make, if it were operating as a federal credit union.
> (b) Notwithstanding any other law, and in addition to the powers and authorities conferred under Subsection (a), a credit union has the powers or authorities of a foreign credit union operating a branch in this state if the commissioner finds that exercise of those powers or authorities is convenient for and affords an advantage to the credit union's members and maintains the fairness of competition and parity between the credit union and any foreign credit union. A credit union does not have the field of membership powers or authorities of a foreign credit union operating a branch in this state.

Until recently, federal laws and regulations concerning credit unions were generally more restrictive than state laws and rules. On September 24, 2010, however, the National Credit Union Administration (NCUA) adopted a regulation permitting federal credit unions to offer certain loans to their members at a higher interest rate than the 18% currently permitted under NCUA's general lending regulation. Among other provisions, the new regulation permits a federal credit union to make a single, closed-end loan to a member with a maximum interest rate of 28% per year, inclusive of all finance charges. The regulation also has provisions more liberal than those in a similar rule that was adopted by the Credit Union Commission in June, 2010 (7 TAC Section 91.720). A copy of the both the Commission rule and the NCUA regulation are included with this letter.

Opinion No. MW-281 addressed a prior version of Section 123.003, and held that "the legislature may not delegate its power to establish maximum interest rates". This predecessor to Section 123.003 (Texas Credit Union Act, article 2461-7.01, V.T.C.S.), had permitted the commissioner to authorize credit unions to engage in activities authorized for federal credit unions. The opinion addressed only interest rates; it did not address other activities that might also conflict with state law.

Given the statutory history[i], and given the conflict between the Commission rule and the NCUA regulation, I seek your opinion on the following questions:

1. Does Opinion No. MW-281 continue to apply in light of the revised language of Section 123.003?

2. Does Section 123.003(a) permit state-chartered credit unions to charge a higher interest rate than Section 124.002 permits if federally-chartered credit unions are allowed to do so?

3. More generally, are the activities authorized by Section 123.003 limited by the laws of this state? If so, how?

4. If the activities authorized by Section 123.003 are not limited by the laws of this state, does the Commissioner have the authority to limit a specific credit union's exercise of these activities for regulatory or for safety and soundness reasons?

5. If the activities authorized by Section 123.003 are not limited by the laws of this state, may the Commission adopt rules that further regulate how a credit union exercises these activities?

6. If the activities authorized by Section 123.003 are not limited by the laws of this state, can the Commissioner enforce all restrictions associated with the activities? For example, if Section 123.003 permits a state-chartered credit union to make loans under the NCUA loan regulation, does the Commissioner have the ability to enforce the other provisions of that regulation?

7. Do the provisions of Section 123.003 automatically adopt current as well as future federal statutes and regulations as part of state law? In other words, does Section 123.003 apply only to federal statutes and regulations that existed at the time it was adopted, or does it apply to federal laws or regulations adopted after it became effective?

Your response to these questions would be appreciated.

Respectfully submitted,

Harold E. Feeney
Commissioner

HEF/iv

Enclosures

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[i] **This agency has not established an administrative construction of Section 123.003. In 2006, however, the Finance Commission and the Credit Union Commission prepared a joint legislative report entitled *Preemption of Financial Services Study* (Study). A copy of that study is included with this letter. In the study, this agency postulated that, in adopting Section 123.003, the legislature did not intend to trump other state laws or rules, and did not intend to automatically adopt future federal statutes and rules as part of state law. Rather, the legislature intended to cover federal powers and authorities in existence when Section 123.003 was adopted which are not otherwise addressed in state statutes or rules. (Study, pp 16-17)**

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Texas Administrative Code

TITLE 7	BANKING AND SECURITIES
PART 6	CREDIT UNION DEPARTMENT
CHAPTER 91	CHARTERING, OPERATIONS, MERGERS, LIQUIDATIONS
SUBCHAPTER G	LENDING POWERS
RULE §91.720	**Small-Dollar, Short-Term Credit**

(a) General. Credit unions are encouraged to offer small-dollar credit products that are affordable, yet safe and sound, and consistent with applicable laws. The goal in offering these small-dollar credit products should be to help members avoid, or transition away from, reliance on high-cost debt. To accomplish this goal, credit unions should offer products with reasonable interest rates, low fees, and payments that reduce the principal balance of the loan or extension of credit.

(b) Definition. For purposes of this section, small-dollar, short term credit product is defined as a low denomination loan or extension of credit having a term of 6 months or less, where the amount financed does not exceed $1,100. Each credit union is responsible for establishing appropriate dollar limits and terms based upon its size and sophistication of operations, and its net worth.

(c) Limitation. Accessibility and expediency are important factors for many members with emergency or other short-term needs. Therefore, small-dollar credit products must balance the need for quick availability of funds with the fundamentals of responsible lending. Sound underwriting criteria should focus on a member's history with the credit union and ability to repay a loan within an acceptable timeframe. Given the small dollar amounts of each individual credit request, documenting the member's ability to repay can be streamlined and may need to include only basic information, such as proof of recurring income. The aggregate total of streamlined underwritten small-dollar credit products outstanding, however, shall not exceed 20% of the credit union's net worth.

(d) Fees. A credit union may require a member to pay reasonable expenses and fees incurred in connection with making or closing a loan. With respect to expenses and fees being assessed on small-dollar, short-term credit products, the expenses and fees are presumed to be reasonable if the aggregate total is $20 or less. In addition, if the credit union refinances a small-dollar, short-term credit product, it may charge such expenses and fees only once in a 180-day period. Credit unions may also charge a late fee as permitted by Finance Code §124.153.

(e) Payments. Credit unions should structure payment programs in a manner that reduces the principal owed. For closed-end products, loans should be structured to provide for affordable and amortizing payments. Lines of credit should require minimum payments that pay off principal. Excessive renewals or the prolonged failure to reduce the outstanding balance are signs that the product is not meeting the member's credit needs and will be considered an unsound practice.

(f) Required Savings. Credit unions may structure small-dollar credit programs to include a savings component. The funds in this account may also serve as a pledge against the loan or extension of credit.

Source Note: The provisions of this §91.720 adopted to be effective July 11, 2010, 35 TexReg 5807

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Rules and Regulations

Federal Register
Vol. 75, No. 185
Friday, September 24, 2010

NATIONAL CREDIT UNION ADMINISTRATION

12 CFR Part 701

RIN 3133–AD71

Short-Term, Small Amount Loans

AGENCY: National Credit Union Administration (NCUA).

ACTION: Final rule.

SUMMARY: NCUA is amending its general lending rule to enable Federal credit unions (FCUs) to offer short-term, small amount loans (STS loans) as a viable alternative to predatory payday loans. The amendment permits FCUs to charge a higher interest rate for an STS loan than is permitted under the general lending rule, but imposes limitations on the permissible term, amount, and fees associated with an STS loan. This final rule also requires an FCU to set a cap on the total dollar amount of STS loans it will make and to set a length of membership requirement of at least one month. Also, any loan under this rule must be fully amortized. The STS loan alternative will assist FCUs in meeting their mission to promote thrift and meet their members' credit needs, particularly the provident needs of members of modest means. Permitting a higher interest rate for STS loans will allow FCUs to make loans cost effective while the limitations will appropriately constrain the product to meeting its purpose as an alternative to predatory credit products. This final rule also includes guidance in the form of "best practices" FCUs should consider incorporating into their individual STS programs.

DATES: This rule will become effective on October 25, 2010.

FOR FURTHER INFORMATION CONTACT: Justin M. Anderson, Staff Attorney, Office of General Counsel, at the above address or telephone (703) 518–6540.

SUPPLEMENTARY INFORMATION:

A. Background

The Federal Credit Union Act (the Act) permits FCUs to make loans and extend lines of credit to members but prohibits FCUs from charging an annual percentage rate (APR), inclusive of all finance charges, above 15%. 12 U.S.C. 1757(5)(A)(vi). The Act, however, permits the NCUA Board (the Board), after considering certain statutory criteria, to establish a higher interest rate ceiling in 18-month cycles. *Id.* At its July 2009 meeting, the Board reapproved an APR ceiling of 18%, effective until March 10, 2011. NCUA Letter to Federal Credit Unions 09–FCU–06 (July 2009).

The Board reviewed NCUA's regulatory structure and recognized that under this current structure many FCUs could not provide their members with a reasonable alternative to traditional payday loans. The Board, therefore, considered amending its regulations to provide FCUs with a regulatory structure under which they could offer a responsible payday loan alternative to members in a safe and sound manner.

B. Proposed Rule

On April 29, 2010, the Board issued a proposed rule amending § 701.21 to increase the interest rate ceiling for STS loans, provided FCUs made the loans within the requirements of the rule. 75 FR 2447 (May 5, 2010). The Board also specifically asked for comments on the issues of amortization, utilizing a 36% APR inclusive of all fees, and requiring members to participate in direct deposit or payroll deduct. The comment period closed on July 6, 2010. The Board received 33 comments from: Two credit union trade associations; one bank trade association; two private citizens; sixteen credit unions; seven State credit union leagues; three consumer advocacy groups; one credit union service organization; and one philanthropic foundation. Commenters addressed a wide range of issues including the different requirements of the rule, those areas where the Board specifically requested comment, and other aspects of payday lending that were not related to this rule.

C. Summary of Comments

1. General

While most commenters supported the idea and framework of the rule, many commenters offered a suggestion on one or more aspects of the proposal. There were, however, three commenters that supported the proposed rule as drafted, four that did not support the rule, and one that only provided details about its payday alternative program. The commenters that supported the rule as written believe the rule would be a valuable tool FCUs could use to assist their members, is in line with the mission and purpose of the FCU charter, and would provide members with a way to safely break the payday loan cycle.

Of the commenters that did not support the rule, one commenter generally opposed the idea of payday lending and believed NCUA should monitor and regulate existing programs, rather than help foster an alternative. Two other commenters did not believe the terms of the rule would be attractive to FCUs or borrowers. Finally, one commenter believed credit unions should be permitted to develop their own programs instead of NCUA creating one. With respect to the last comment, the Board notes this final rule does not prohibit an FCU from continuing or participating in a closed or open-end payday loan program that operates successfully and legally under NCUA's Regulations and the Federal Reserve Board's Regulation Z (Reg Z). 12 CFR Part 226.

2. Specific Comments and NCUA's Response

The remaining 25 commenters generally supported the rule, but offered suggestions on specific aspects of the rule or provided comments on the sections where the Board specifically requested comments. The Board considered all of the comments and modified the final rule where appropriate. The specific comments and NCUA's responses are discussed in the following section-by-section analysis.

a. Permissible Interest Rate

A majority of the commenters believed an interest rate ceiling of 1000 basis points above the established general interest rate ceiling, as set by the Board, was sufficient for FCUs offering an STS product. As noted above, the Board set interest rate ceiling is currently at 18%. A few other commenters, however, provided alternative suggestions for the Board's consideration. Two commenters believed the interest rate ceiling for STS loans should be higher to account for the higher degree of risk associated with this type of lending, but did not provide a specific interest rate they favored. Two other commenters believed a 36% all inclusive APR was appropriate, citing a relation to the Department of Defense (DOD) regulations and the need to keep costs as low as possible for borrowers.

Two commenters advocated maximum flexibility and believed FCUs should be permitted to choose between a 36% all inclusive APR and the proposed rate and fee structure. One commenter believed the APR for STS loans should be 36% plus a $20 application fee. Other individual commenters suggested approaches, such as an 18% APR with a broader definition of finance charges, allowing a 28% APR for all legally permissible payday programs, and not increasing the APR at all.

The Board has considered these comments and, based on the reasons set forth in the preamble to the proposed rule, has decided to proceed with the proposed structure of an APR 1000 basis points above the Board approved interest rate ceiling, which currently would be 28%, and a $20 application fee.

With respect to the comments on FCUs being able to offer this product to members of the military, the Board notes that the definition of a payday loan in the DOD regulations would not include most loans made under this final rule. The DOD regulations provide the following definition of a payday loan:

(i) *Payday loans*. Closed-end credit with a term of 91 days or fewer in which the amount financed does not exceed $2,000 and the covered borrower:

(A) Receives funds from and incurs interest and/or is charged a fee by a creditor, and contemporaneously with the receipt of funds, provides a check or other payment instrument to the creditor who agrees with the covered borrower not to deposit or present the check or payment instrument for more than one day, or;

(B) Receives funds from and incurs interest and/or is charged a fee by a creditor, and contemporaneously with the receipt of funds, authorizes the creditor to initiate a debit or debits to the covered borrower's deposit account (by electronic fund transfer or remotely created check) after one or more days. This provision does not apply to any right of a depository institution under statute or common law to offset indebtedness against funds on deposit in the event of the covered borrower's delinquency or default.

32 CFR 232.2. Under the terms of this final rule, all STS loans will be for less than $2,000 and many will have maturities less than 91 days. The terms of this final rule, however, do not require an FCU to obtain a check or payment instrument or authorization to debit a member's account contemporaneously with an extension of credit. Further, NCUA does not generally expect FCUs to need to require a check or payment instrument and, as discussed below, FCUs are prohibited from conditioning the extension of credit on a member's consent for electronic debit. An FCU, therefore, will typically be able to offer loans under the terms of this rule to members of the military without violating the DOD regulations.

b. Loan Term

Approximately one-third of the commenters submitted comments on the proposed permissible loan term. Of those commenters, most believed the minimum loan term should be greater than 30 days, with commenters citing a range between 90–120 days as an acceptable minimum term. Some commenters also believed the maximum loan terms should also be longer, citing 12 to 18 months as an acceptable range for the maximum loan term. The commenters who advocated for a longer term believed that a longer term was necessary to enable borrowers to pay back a loan in small, more manageable payments.

After considering the comments and for the reasons articulated in the preamble to the proposed rule, the Board has decided to keep the proposed terms of a minimum maturity of one month and a maximum maturity of six months. The Board believes this final rule should provide a high level of protection for borrowers, and is concerned that longer term loans may actually have unintended negative consequences. The Board is specifically concerned that borrowers with longer term STS loans may continue to use payday lenders to cover expenses that arise during repayment. While it is possible that this scenario may also occur under the maturity structure in this rule, the Board believes loans with maturities between one and six months will provide borrowers with frequent enough access to credit to minimize the need for additional loans from payday lenders. To effectuate the beneficial nature of a one to six month maturity and ensure maximum borrower protection, the Board is reaffirming its statement in the preamble to the proposed rule that FCUs should structure the terms of an STS loan in a way that allows a borrower to repay the loan in the given term. NCUA will scrutinize an FCU's program to ensure loans are being made in a way that provides a member with the best chance to successfully repay a loan made under this rule.

c. Number of Loans and Roll-Overs

Approximately one-third of the commenters addressed the issues of roll-overs and the permissible number of loans. While most commenters agreed the final rule should prohibit roll-overs, there were three commenters that believed roll-overs could be appropriate in limited circumstances. The commenters cited that without roll-overs a borrower who cannot pay off the loan within the loan term will incur late fees and, possibly, a negative entry on his or her credit report. Also, one commenter asked for further clarification of the term "roll-over" in the final rule.

After considering these comments, the Board has determined to keep the prohibition against roll-overs, but will provide some flexibility in the final rule so borrowers can meet their payment obligations without incurring additional fees. While the Board continues to disagree that roll-overs are ever appropriate, it believes permitting FCUs to extend the term of a loan, without any additional fees, may be beneficial to both FCUs and borrowers. The prohibition against roll-overs in this rule applies to situations in which a borrower is charged additional fees for extending or "re-borrowing" funds to avoid delinquency. Under this rule, an FCU may, however, extend the term of the loan, within the maximum loan term set by this rule, provided the FCU does not charge any additional fees, except interest, or extend any additional funds. For example, if a borrower takes out a $300 loan for three months and, at some point within those three months, is unable to continue making payments, the FCU can extend the loan term for another one to three months, but cannot extend any new credit or charge additional fees in connection with this extension. The Board believes allowing for an extension without any additional fees will provide borrowers with the best opportunity to repay the loan and avoid delinquencies. NCUA generally expects FCUs, however, to set the term and amount of the loan in a way that allows borrowers to repay it within the term and avoid the need to extend a loan.

With respect to the number of loans, most commenters believed there should be a higher limit on the number of loans a borrower may have in a 12-month period or no cap at all. Commenters believed that the number imposed in the proposed rule was too limiting and could drive borrowers back to payday lenders.

After considering these comments the Board has determined to proceed with the terms in the proposed rule, which limit FCUs to making only one loan at a time to a member and no more than three in any rolling six-month period. In response to the commenters advocating for a higher number of loans, the Board disagrees that a limited number of loans will push borrowers back to payday lenders. As noted above, the Board intends this rule to provide borrowers with enough access to credit to preclude the need for a borrower to also borrow from a payday lender. The Board also intends this rule to help borrowers curtail the repetitive use of payday loans and transition them to more mainstream financial products and more responsible borrowing. A cap of three loans in any rolling six-month period coupled with the minimum and maximum maturities, set out above, achieves this balance of providing borrowers with sufficient access to credit while helping borrowers transition from a reliance on repetitive borrowings.

d. Application Fee and Amount of the Loan

Approximately one-half of the commenters addressed the appropriate amount of an application fee. Two commenters believed $20 was an appropriate amount but two other commenters felt an application fee should be capped at $25. Of the remaining commenters, four believed the application fee should be higher, but did not provide a specific amount and several commenters believed FCUs should be permitted to set their own application fees in accordance with Regulation Z or the application fee should be tied to the amount of the loan. All commenters who sought a higher application fee cited an increased risk in this type of lending. Two commenters believed FCUs should charge a borrower only one $20 application fee every six months and two commenters believed the Board should not permit FCUs to charge any fees for these loans, including application and late fees. All commenters who favored a lower fee or no fee cited a minimal underwriting process that does not justify a fee.

After considering the comments, the Board has decided to keep the proposed maximum application fee of $20. While the Board agrees that this type of lending is inherently riskier than many other types of lending, it is interest income and not the application fee that allows FCUs to offset the higher degree of risk. The Board notes, Reg Z limits application fees to the recovery of costs associated with processing applications for credit that are charged to all consumers who apply, regardless if credit is actually extended. 12 CFR 226.4(c)(1). For the reasons articulated in the preamble to the proposed rule, the Board believes a maximum application fee of $20 is sufficient to allow FCUs to recoup the costs associated with processing an application for an STS loan. With regard to those commenters who argued for a lower application fee or a restriction that application fees be charged only once in a six-month period, the Board points out that $20 under this rule is the maximum amount FCUs can charge for an application fee and that FCUs are still bound by the definition of application fee in Reg Z. As such, an FCU's application fee can only be the amount needed to recoup the actual costs associated with processing an application. If an FCU undertakes a more limited application process with repeat borrowers, there would be no justification for charging the same application fee each time the borrower applied. NCUA will scrutinize application fees to ensure FCUs are using the fee to recoup costs associated with processing an application and not to account for the riskier nature of this type of lending.

On the issue of the permissible amount of a loan, slightly less than one-half of the commenters provided suggestions. A majority of the commenters believed the minimum loan amount should be less than $200, citing a high demand for loans between $50 and $100. One commenter believed the minimum loan amount was acceptable, but the maximum loan amount should be $2,500. Finally, one commenter believed that the maximum amount should be lowered because most payday borrowers cannot pay back $1,000, even over a six-month period.

The Board believes the proposed minimum loan amount of $200 and the proposed maximum amount of $1000 are appropriate and has included these amounts in the final rule. With respect to those commenters who advocated for a lower minimum amount, the Board notes, as discussed above, that this rule does not prohibit FCUs from making smaller loans that are legal under NCUA's regulations and Reg Z. Also, as noted in the preamble to the proposed rule, a minimum loan amount of $200 is in-line with the typical loan extended to payday loan borrowers.

In response to the commenter who argued that the maximum loan amount should be $2,500, the Board does not believe it would be prudent to allow FCUs to lend amounts over $1,000 to borrowers at terms of six months or less. As noted in the preamble to the proposed rule, the Board chose a maximum loan amount of $1,000 because it may allow borrowers to repay loans from payday lenders and transition to more traditional FCU products while still being a manageable short-term loan.

Finally, in response to the comment that most borrowers could not pay back $1,000 in six months and, therefore, the maximum amount should be lower, the Board notes the discussion above regarding the impetus for a maximum loan of $1,000. In addition, as discussed earlier in this preamble, the Board expects FCUs to extend loans to borrowers in amounts and under terms in which the borrower can manage repayment of the loan, within the confines of this rule.

e. Amortization and Length of Membership Requirements

In response to the Board's specific request for comment on the issue of amortization, approximately one-third of the commenters provided a response. The majority of those commenters believed that the final rule should require FCUs to fully amortize STS loans. There were two commenters, however, that believed FCUs should have the option to use balloon payments, citing that, in limited circumstances, balloon payments may actually benefit members.

The Board agrees with the majority of the commenters that FCUs should fully amortize loans made under this rule, and is including a specific requirement in the final rule. The Board notes that balloon payments often create additional difficulty for borrowers trying to repay their loans, and requiring FCUs to fully amortize the loans will allow borrowers to make manageable payments over the term of the loan, rather than trying to make one large payment. Under the requirement to amortize a loan, FCUs must structure the payments so that the borrower is paying a portion of the principal and interest in equal or near-equal installments on a periodic basis over the course of the loan. While the Board is not prescribing specific payment schedules, *i.e.*, monthly or bi-weekly, FCUs should offer payment schedules that allow borrowers to easily repay the loan within the given term.

Approximately one-quarter of the commenters addressed the issue of a length of membership requirement. Of those commenters, all but one believed FCUs should have the option to impose a length of membership requirement, but that it should not be a regulatory requirement. The Board disagrees that FCUs should have the option of setting a length of membership requirement and has included a requirement in the final rule that FCUs set a length of minimum membership requirement of at least one month. The Board wants to provide FCUs with as much flexibility as possible in developing an STS loan program, but it must consider the riskier nature of this type of loan and the safety and soundness of the FCUs offering them. The Board believes a minimum membership requirement of one month will build a meaningful relationship between the borrower and the FCU and help reduce the chance of a borrower defaulting on an STS loan. While the final rule imposes a minimum requirement of one month, individual FCUs should evaluate their risk tolerance and set a membership requirement accordingly.

f. Lending Cap and Payroll Deduct/ Direct Deposit

Less than a quarter of the commenters addressed the issue of a lending cap. Of those commenters, there was an even split between the number of commenters that believed NCUA should impose a cap and those that believed the Board should permit FCUs to set their own cap. The Board received three suggestions on how to establish a cap: Setting a cap at 20% of net worth; 5–10% of assets; and a cap only on the dollar amount of total loans made as a percentage of net worth.

After considering these comments, the Board has decided to require FCUs to set a cap in their written lending policies on the aggregate dollar amount of loans outstanding not to exceed 20% of total net worth. While the Board believes it is preferential to allow an FCU to evaluate its own risk tolerance and resources in setting a cap, the Board also wants to provide FCUs with a ceiling to ensure any cap set by an FCU is sufficient from a safety and soundness perspective. The Board believes a cap on the aggregate dollar amount with a ceiling of 20% net worth will be sufficient to ensure FCUs are not exposed to unnecessary risks and their resources are not stretched. Depending on the success of these programs, the Board can consider raising the cap ceiling at a later date.

Over half of the commenters addressed the issue of requiring credit unions to provide STS loans only to members that had direct deposit or authorized payroll deduction. Of those commenters, nearly three-quarters believed FCUs should have the option to require direct deposit or payroll deduct as part of their program, but it should not be a regulatory requirement. One commenter believed it should be a regulatory requirement and three believed the rule should specifically prohibit the practices. One of the commenters that believed the rule should prohibit the practices stated that requiring payroll deduct to obtain a loan was prohibited by the Federal Reserve Board's Regulation E.

The Board agrees with a majority of the commenters that direct deposit and payroll deduct for members should not be regulatory requirements. While the Board believes direct deposit is a useful tool for limiting risk, it recognizes that a regulatory requirement may restrict FCUs from offering STS loans to members who may not have access to direct deposit. Rather, the Board believes an FCU should be able to evaluate its risk tolerance and members' needs in determining whether or not to require members to participate in direct deposit in order to borrow an STS loan.

On the issue of payroll deduct, the Board notes that Regulation E prohibits financial institutions, including FCUs, from conditioning an extension of credit to a consumer on the consumer's repayment by preauthorized electronic fund transfers. 12 CFR 205.10(e)(1). However, under Regulation E, FCUs can offer members a lower rate or other incentives if they participate in payroll deduct. 12 CFR Part 205, Supplement I, 205.10(e)(1). The Board believes that payroll deduction is an important tool for FCUs to utilize in lowering the risk associated with these loans. Based on these considerations, the Board will let individual FCUs decide if they wish to provide an incentive to or encourage members to utilize payroll deduct or other pre-authorized electronic fund transfers, but will not include any regulatory requirement. The Board is also modifying the best practices section in the final rule to reflect these legal considerations regarding payroll deduction.

g. Underwriting and Best Practices

In addition to comments on the specific requirements of the rule, the Board also received a few comments requesting that it not require specific underwriting criteria in the regulation and also not change the best practices section into regulatory requirements. With regard to underwriting, the Board will proceed with the approach in the proposed rule that an FCU is required to establish underwriting standards in its written lending policies, but the Board will not require specific standards. The Board believes an FCU is in the best position to evaluate the needs of its members and its risk tolerance and set appropriate underwriting standards. The Board will also keep the underwriting in the best practices section to provide FCUs with guidance on how to structure underwriting for STS loans. With respect to the best practice section, the Board will keep the approach in the proposed rule and offer this section as guidance and not as a regulatory requirement. While the Board believes the suggestions in the best practices section may be beneficial to FCUs and members, the Board also believes an FCU should have flexibility to determine the features of its own program.

h. Other Comments

In addition to the comments addressed above, the Board received several comments that did not address specific features of the rule, but warrant a discussion in this preamble. Several commenters asked NCUA to collect data about STS loans under this rule and reevaluate the requirements in a year. The Board agrees with these commenters and will modify the 5300 call report by January 2011 to include new sections to evaluate loan programs under this rule. One year from the effective date of this final rule the Board will evaluate the data collected on the 5300 call report and reevaluate the requirements in the final rule.

There were also several commenters that urged NCUA to take enforcement actions against FCUs that are offering predatory payday lending products. The Board notes that NCUA staff will continue to investigate programs that may be predatory in nature and take action where appropriate.

D. Dodd-Frank Wall Street Reform and Consumer Protection Act (The Dodd-Frank Act)

The Dodd-Frank Act, signed into law by President Obama on July 21, 2010, includes, as Title XII, the Improving Access to Mainstream Financial Institutions Act of 2010 (Title XII). Title XII includes, among other things, Federal assistance to Federally-insured financial institutions that are providing small-dollar value loans. Specifically, § 1205 of Title XII authorizes the

Secretary of the Treasury to establish multi-year demonstration programs by means of grants, cooperative agreements, financial agency agreements, and similar contracts or undertakings with eligible entities to provide low-cost, small loans to consumers that will provide alternatives to more costly small dollar loans. The Dodd–Frank Wall Street Reform and Consumer Protection Act, Public Law 111–203, § 1205 (2010). Institutions participating in programs under this section are required to promote and provide financial education and literacy to small-dollar loan borrowers.

In addition, section 1206 amends the Community Development Banking and Financial Institutions Act of 1994 by requiring the Community Development Fund (the Fund) to make grants to community development financial institutions (CDFIs) and to any other Federally insured depository institution with a primary mission to serve targeted investment areas to enable such institutions to establish a loan-loss reserve fund to defray the costs of a small dollar loan program established or maintained by such institution. *Id.* at section 1206(a)(1). Institutions accepting grants under this section are required to provide non-Federal matching funds in an amount equal to 50% of the grant. This section also requires the Fund to make technical assistance grants to be used for technology, staff support, and other costs associated with establishing a small-dollar loan program. To receive a grant or technical assistance grant under this section, a financial institution must have or establish a program with loans under $2,500 that are paid in installments with no pre-payment penalties, and the institution must report payments of the loan to at least one consumer reporting agency and meet any other affordability requirements established by the Administrator of the Fund. *Id.* at section 1206(b). Title XII also grants the Secretary of the Treasury the authority to issue regulations implementing and administering the grants and programs discussed in Title XII. *Id.* at section 1209.

The Board would like to clarify that the requirements of this final rule will not prohibit an FCU, which is otherwise eligible, from receiving a grant or participating in a program under Title XII. The requirements and best practices guidance in the final rule are in line with the requirements imposed by Title XII on participating financial institutions. FCUs will be able to comply with the requirements of the final rule to take advantage of the higher interest rate and still be within the limitations of Title XII.

As discussed above, the Secretary of the Treasury has the authority to issue regulations implementing Title XII and the Administrator of the Fund can impose other affordability requirements for grants. The Board will review any regulations or requirements related to the Title XII grants and programs and compare them to the requirements in the final rule to ensure FCUs with STS loan programs can continue to take advantage of the benefits included in Title XII.

Regulatory Procedures

Regulatory Flexibility Act

The Regulatory Flexibility Act requires NCUA to prepare an analysis to describe any significant economic impact a proposed rule may have on a substantial number of small credit unions (those under $10 million in assets). This final rule increases the interest rate ceiling for STS loans and sets out several STS loan program requirements an FCU must meet to take advantage of the higher interest rates. The final rule will not have a significant economic impact on a substantial number of small credit unions, and, therefore, a regulatory flexibility analysis is not required.

Small Business Regulatory Enforcement Fairness Act

The Small Business Regulatory Enforcement Fairness Act (SBREFA) of 1996, Public Law 104–121, provides generally for congressional review of agency rules. A reporting requirement is triggered in instances where NCUA issues a final rule as defined by Section 551 of the Administrative Procedures Act. 5 U.S.C. 551. The Office of Information and Regulatory Affairs, an office within OMB, is currently reviewing this rule, and NCUA anticipates it will determine that, for purposes of SBREFA, this is not a major rule.

Paperwork Reduction Act

This rule adds a requirement that Federal credit unions establish a cap on short-term, small-dollar loans in their general written lending policies, which Federal credit unions are already required to maintain and is currently approved under the Paperwork Reduction Act control number 3133–0139. NCUA has determined that the requirements of this rule are additions to an FCU's customary business records and do not increase the paperwork requirements under the Paperwork Reduction Act of 1995 and regulations of the Office of Management and Budget.

Executive Order 13132

Executive Order 13132 encourages independent regulatory agencies to consider the impact of their actions on State and local interests. In adherence to fundamental federalism principles, NCUA, an independent regulatory agency as defined in 44 U.S.C. 3502(5), voluntarily complies with the executive order. The final rule will not have substantial direct effects on the States, on the connection between the national government and the States, or on the distribution of power and responsibilities among the various levels of government. NCUA has determined that this final rule does not constitute a policy that has federalism implications for purposes of the executive order.

The Treasury and General Government Appropriations Act, 1999—Assessment of Federal Regulations and Policies on Families

NCUA has determined that this final rule would not affect family well-being within the meaning of section 654 of the Treasury and General Government Appropriations Act, 1999, Public Law 105–277, 112 Stat. 2681 (1998).

List of Subjects in 12 CFR Part 701.

Credit unions, Federal credit unions.

By the National Credit Union Administration Board on September 16, 2010.

Mary Rupp,

Secretary of the Board.

■ For the reasons discussed above, the National Credit Union Administration is amending 12 CFR chapter VI as set forth below:

PART 701—ORGANIZATION AND OPERATIONS OF FEDERAL CREDIT UNIONS

■ 1. The authority citation for part 701 continues to read as follows:

Authority: 12 U.S.C. 1752(5), 1755, 1756, 1757, 1759, 1761a, 1761b, 766, 1767, 1782, 1784, 1787, 1789. Section 701.6 is also authorized by 15 U.S.C. 3717. Section 701.31 is also authorized by 15 U.S.C. 1601 *et seq.*; 42 U.S.C. 1981 and 3601–3610. Section 701.35 is also authorized by 42 U.S.C. 4311–4312.

■ 2. In § 701.21 add paragraph (c)(7)(iii) to read as follows:

§ 701.21 Loans to members and lines of credit to members.

* * * * *

(c) * * *

(7) * * *

(iii) *Short-term, small amount Loans (STS loans).* (A) Notwithstanding the provisions in § 701.21(c)(7)(ii), a Federal credit union may charge an interest rate of 1000 basis points above the maximum interest rate as established by the Board, provided the Federal credit union is making a closed-end loan in accordance with the following conditions:

(*1*) The principal of the loan is not less than $200 or more than $1000;

(*2*) The loan has a minimum maturity term of one month and a maximum maturity term of six months;

(*3*) The Federal credit union does not make more than three STS loans in any rolling six-month period to any one borrower and makes no more than one short-term, small amount loan at a time to a borrower;

(*4*) The Federal credit union must not roll-over any STS loan;

(A) The prohibition against roll-overs does not apply to an extension of the loan term within the maximum loan terms in paragraph (c)(7)(iii)(*3*) provided the Federal credit union does not charge any additional fees or extend any new credit.

(B) [Reserved]

(*5*) The Federal credit union fully amortizes the loan;

(*6*) The Federal credit union sets a minimum length of membership requirement of at least one month;

(*7*) The Federal credit union charges an application fee to all members applying for a new loan that reflects the actual costs associated with processing the application, but in no case may the application fee exceed $20; and

(*8*) The Federal credit union includes, in its written lending policies, a limit on the aggregate dollar amount of loans made under this section of a maximum of 20% of net worth and implements appropriate underwriting guidelines to minimize risk; for example, requiring a borrower to verify employment by producing at least two recent pay stubs.

(B) *STS Loan Program Guidance and Best Practices.* In developing a successful STS loan program, a Federal credit union should consider how the program will help benefit a member's financial well-being while considering the higher degree of risk associated with this type of lending. The guidance and best practices are intended to help Federal credit unions minimize risk and develop a successful program, but are not an exhaustive checklist and do not guarantee a successful program with a low degree of risk.

(*1*) *Program Features.* Several features that may increase the success of an STS loan program and enhance member benefit include adding a savings component, financial education, reporting of members' payment of STS loans to credit bureaus, or electronic loan transactions as part of an STS program. In addition, although a Federal credit union cannot require members to authorize a payroll deduction, a Federal credit union should encourage or incentivize members to utilize payroll deduction.

(*2*) *Underwriting.* Federal credit unions need to develop minimum underwriting standards that account for a member's need for quickly available funds, while adhering to principles of responsible lending. Underwriting standards should address required documentation for proof of employment or income, including at least two recent paycheck stubs. FCUs should be able to use a borrower's proof of recurring income as the key criterion in developing standards for maturity lengths and loan amounts so a borrower can manage repayment of the loan. For members with established accounts, FCUs should only need to review a member's account records and proof of recurring income or employment.

(*3*) *Risk Avoidance.* Federal credit unions need to consider risk avoidance strategies, including: requiring members to participate in direct deposit and conducting a thorough evaluation of the Federal credit union's resources and ability to engage in an STS loan program.

* * * * *

[FR Doc. 2010–23610 Filed 9–23–10; 8:45 am]
BILLING CODE 7535–01–P

DEPARTMENT OF TRANSPORTATION

Federal Aviation Administration

14 CFR Part 39

[Docket No. FAA–2010–0364; Directorate Identifier 2009–NE–27–AD; Amendment 39–16446; AD 2010–20–11]

RIN 2120–AA64

Airworthiness Directives; Rolls-Royce plc RB211 Trent 700 and Trent 800 Series Turbofan Engines

AGENCY: Federal Aviation Administration (FAA), DOT.

ACTION: Final rule.

SUMMARY: We are adopting a new airworthiness directive (AD) for the products listed above. This AD results from mandatory continuing airworthiness information (MCAI) issued by an aviation authority of another country to identify and correct an unsafe condition on an aviation product. The MCAI describes the unsafe condition as:

> In completing a review of Engine Manual repair/acceptance limits for titanium compressor shafts, Rolls-Royce has found the specified limits to be incorrect such that the shot peened surface layer at life critical features (the axial dovetail slots) may have been inadvertently removed in-service. Removal of the shot peened layer results in increased vulnerability of the part to tensile stresses, which could reduce the life of the shaft to below the published life limits.

We are issuing this AD to prevent failure of the intermediate-pressure (IP) and high-pressure (HP) shaft, which could result in an overspeed condition, possible uncontained disc failure and damage to the airplane.

DATES: This AD becomes effective October 29, 2010.

ADDRESSES: The Docket Operations office is located at Docket Management Facility, U.S. Department of Transportation, 1200 New Jersey Avenue, SE., West Building Ground Floor, Room W12–140, Washington, DC 20590–0001.

FOR FURTHER INFORMATION CONTACT: James Lawrence, Aerospace Engineer, Engine Certification Office, FAA, Engine and Propeller Directorate, 12 New England Executive Park, Burlington, MA 01803; *e-mail: james.lawrence@faa.gov;* telephone (781) 238–7176; fax (781) 238–7199.

SUPPLEMENTARY INFORMATION:

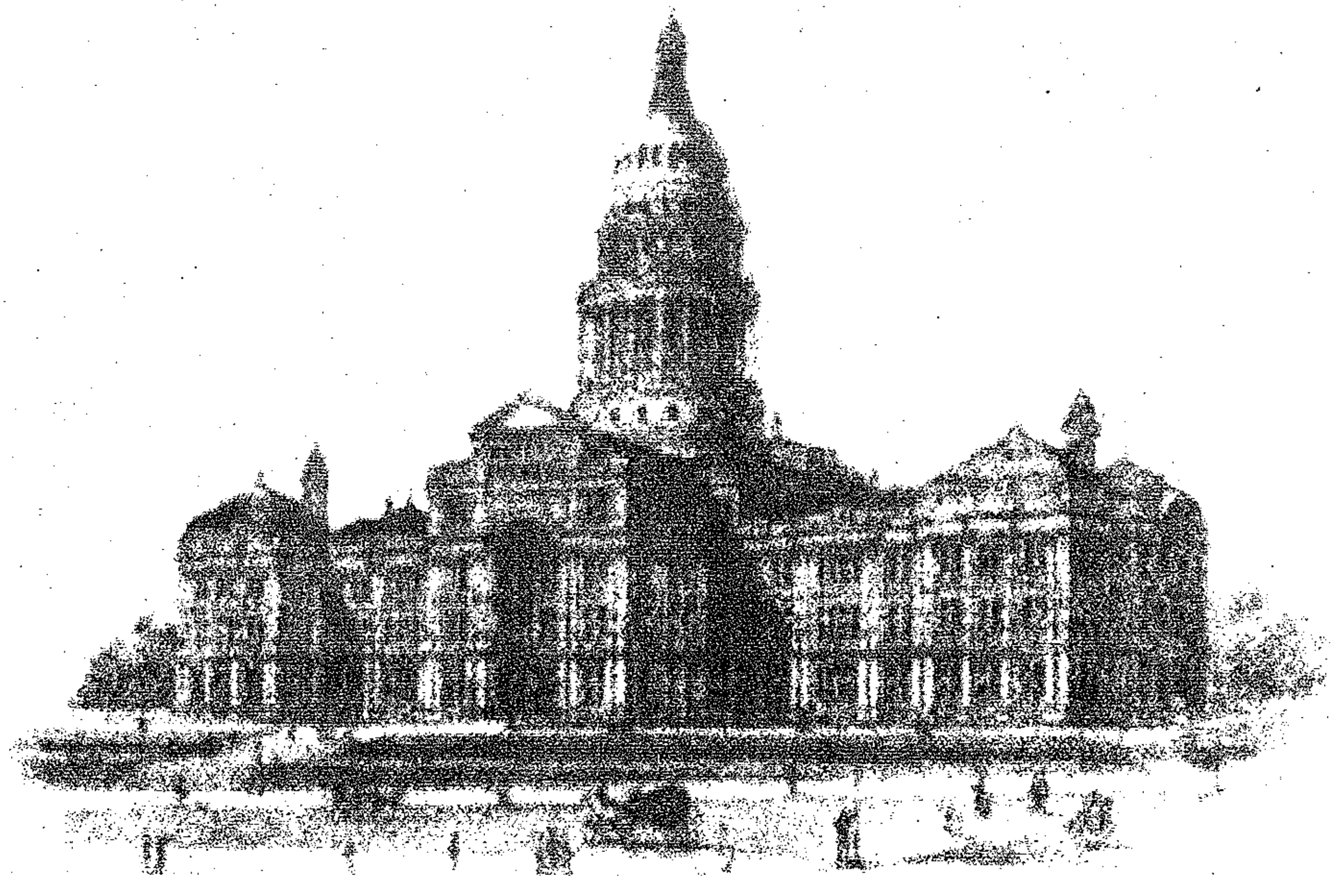
Discussion

We issued a notice of proposed rulemaking (NPRM) to amend 14 CFR part 39 to include an AD that would apply to the specified products. That NPRM was published in the **Federal Register** on April 7, 2010 (75 FR 17630). That NPRM proposed to correct an unsafe condition for the specified products. The MCAI states:

> In completing a review of Engine Manual repair/acceptance limits for titanium compressor shafts, Rolls-Royce has found the specified limits to be incorrect such that the shot peened surface layer at life critical features (the axial dovetail slots) may have been inadvertently removed in-service. Removal of the shot peened layer results in increased vulnerability of the part to tensile stresses, which could reduce the life of the shaft to below the published life limits. The acceptable limits for material loss on these surfaces have now been corrected in the Engine Manual.
>
> This AD identifies shafts for which such dressing operations have been known to have been carried out and requires that an inspection for compliance with the corrected Engine Manual limits be accomplished and that the shafts be dispositioned accordingly.

LEGISLATIVE REPORT

PREEMPTION OF FINANCIAL SERVICES STUDY



REPORT PREPARED BY
FINANCE COMMISSION OF TEXAS AND
CREDIT UNION COMMISSION OF TEXAS
SUBMITTED DECEMBER 2006

PREEMPTION OF FINANCIAL SERVICES STUDY

EXECUTIVE SUMMARY

This report regarding the study of how federal preemption affects the financial services industry in Texas was mandated by House Bill 955 ("HB 955"), as passed by the Texas Legislature in 2005. HB 955 requires a joint effort by the Finance Commission of Texas and the Credit Union Commission of Texas to review state and federal laws regarding financial institutions, determine how preemption affects those laws, and report the findings to the legislature, including recommendations. This study discusses the basics of federal preemption, the role of parity, recent legal decisions involving preempted state laws governing the operating subsidiaries of national banks, and items for further consideration by the legislature to address the effects of federal preemption.

WHAT IS FEDERAL PREEMPTION?

In our federal system, the national government and those of the fifty states have inherent authority to exercise jurisdiction over many of the same fields of law. This concurrent jurisdictional scheme produces situations where state and federal law can conflict, especially in the financial services arena. To resolve these conflicts, the Supremacy Clause of the United States Constitution has been the primary argument set forth by the Office of the Comptroller of the Currency ("OCC") as the basis for its actions. In general, Congress has the authority to preempt state law to whatever extent it believes necessary to achieve its purposes, and thus, congressional intent at the time of a federal statute's passage is the determining factor in deciding whether a state statute is preempted by federal law.

All types of preemption are prevalent in the financial services industry. Two of the most sweeping federal preemption statutes related to lending are the Depository Institutions Deregulation and Monetary Control Act of 1980 ("DIDMCA") and the Alternative Mortgage Transactions Parity Act of 1982 ("AMTPA").

The frustration of the courts in dealing with complex preemption questions, often involving implicit and ambiguously stated congressional intentions, led the courts to begin relying on the expertise of federal agencies, a decision that in hindsight has greatly infringed on the states' powers to enact laws affecting their citizens and to have impact within their geographical boundaries. The deference afforded the preemption positions taken by federal agencies continues to restrict state power to this day.

PARITY

The concept of competitive parity has its origins in the National Bank Act itself, which explicitly provides that national banks must look to home state law in areas such as usury, trust powers, and, as added by the 1920s McFadden Act, intrastate branching. These provisions were originally designed to ensure that national banks would have competitive parity with home-state state banks in an intrastate banking framework.

Banking expanded to become an increasingly multi-state business after the 1960s, as the development of multi-state credit cards and interstate offers of consumer credit signaled the development of a banking (now financial services) marketplace that is truly national in scope. The advantages of federal preemption became more apparent as multi-state banks struggled to comply with a complex and sometimes contradictory matrix of state laws. A trend developed among the larger banks of converting to a federal charter, leading the states to begin attempts to ensure competitive parity. Today, every state has a so-called "parity statute" on its books that, to a greater or lesser degree, attempts to permit state banks to ignore restrictive state laws that national banks are free to ignore as a result of preemption.

Texas Finance Code § 93.008 provides parity between state-chartered thrifts and state-chartered banks, and parity between state-chartered thrifts and federal thrifts and national banks. In addition, Finance Code § 93.008(b) provides a "super-parity" provision for state-chartered thrifts which mirrors the "super-parity" provision of Finance Code § 32.010 applicable to state-chartered banks. Texas Finance Code § 123.003 provides parity by enlarging the powers of a state-chartered credit union so that a Texas credit union can "engage in any activity in which it could engage, exercise any power it could exercise, or make any loan or investment it could make, if it were operating as a federal credit union."

OPERATING SUBSIDIARIES OF NATIONAL BANKS AND FEDERAL THRIFTS

Nondepository lenders play a vital role in the financial services industry. Nondepository lenders are creatures of state law, and thus, rely heavily on state law to operate. A subset of these nondepository lenders consists of the operating subsidiaries of national banks and of federal thrifts.

Traditionally, operating subsidiaries of federal depository institutions have been licensed by the states to conduct certain financial activities. However, a recent trend has emerged where, on the basis of claimed federal preemption, operating subsidiaries have relinquished their state licenses, arguing that they can conduct the same financial activities as their parent institutions without needing to meet state licensing requirements.

The leading case on federal preemption regarding the operating subsidiaries of national banks is *Wachovia Bank, N.A. v. Watters*, 431 F.3d 556 (6th Cir. 2005). In *Watters*, the Sixth Circuit was faced with the issue of whether the National Bank Act, 12 U.S.C. § 21, *et seq.*, and the OCC's regulations preempted state banking laws regarding the operating subsidiaries of national banks. The Sixth Circuit Court upheld the OCC's interpretation of its regulations, and Wachovia Mortgage was free to engage in first and secondary mortgage lending in Michigan and was not required to maintain state registration or comply with the preempted Michigan regulations. However, the U.S. Supreme Court recently granted certiorari in the *Watters* case, which could change the legal landscape in this area.

Although the *Watters* line of cases has for the time being expanded preemption with regard to operating subsidiaries for those jurisdictions, the Fifth Circuit, which includes Texas, has not yet ruled on this issue. Federal preemption concerning operating subsidiaries is not a well-settled area of law. The purpose of Congress is the ultimate factor in determining whether state law is preempted. The congressional intent is strikingly silent in the *Watters* line of cases. One of the main arguments presented against preemption in the area of operating subsidiaries is that the preemption rulings are a violation of the Tenth Amendment.

ITEMS FOR FURTHER CONSIDERATION

The efforts of the 79th Texas Legislature in the passage of HB 955 were directed at balancing interests in light of preemption concerns. Those efforts successfully identified and addressed several provisions of law that were related to issues of disparate impact as compared to other states or due to preemption. After review and consideration of the prior legislative action and the current status of Texas law governing financial institutions, the Finance Commission of Texas and the Credit Union Commission of Texas have identified the following sections of law as being ripe for further study and consideration by the Texas Legislature:

- Texas Property Code, § 73.003;
- Texas Business and Commerce Code, §§ 4.112, 4.406(b), 26.02(g), and 35.61; and
- Texas Finance Code, § 34.203, § 123.003, and Chapters 305 and 349.

These sections of law merely identify the specific legal provisions that appear to be preempted by federal action. This report does not make a recommendation as to the action that the Texas Legislature should take regarding these provisions. In some cases, the legislature may choose to simply repeal the section. In others, the legislature may choose to retain the specific provision because it provides sound public policy and may later be reinvigorated through federal administrative action or litigation.

PREEMPTION OF FINANCIAL SERVICES STUDY

PURPOSE AND SCOPE

Section 7.03 of House Bill 955 ("HB 955") mandates a joint study by the Finance Commission of Texas and the Credit Union Commission of Texas ("commissions") regarding state laws "related to financial institutions" that are or may be federally preempted.[1] Specifically:

> SECTION 7.03. Not later than December 31, 2006, the Finance Commission of Texas and the Credit Union Commission shall:
>
> (1) compare state laws related to financial institutions with applicable federal laws;
>
> (2) determine which state laws may be preempted by federal law, rule, or order;
>
> (3) determine which state laws may be invalidated by state or federal court ruling; and
>
> (4) report their findings to the legislature, with recommended statutory changes.[2]

Burt Solomons, Chair of the House Financial Institutions Committee and author of HB 955, has clarified the intent of this preemption study in a letter dated March 21, 2006, to the commissions, which is attached in its entirety as Exhibit A. As stated by Chairman Solomons in that letter, the purpose of this study is to provide "a good basic discussion of the types of federal preemption and the process of preemption. Further, the study should reference the particular state laws expressly preempted or otherwise are widely understood and accepted to be preempted. I realize that this study mandate could be perceived quite broadly; however, that was not my intent."[3] Chairman Solomons also explained that the preemption study has the purpose of "furthering the modernization of the Finance Code" and allowing the legislature "to continue the 'clean up' of out-of-date or obsolete provisions of the Code."[4]

In light of the intent of the study as outlined by Chairman Solomons and in fulfillment of the mandate above, this document contains a general discussion of preemption as it pertains to

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[1] HB 955, 79th Leg., § 7.03 (2005).

[2] *Id.*

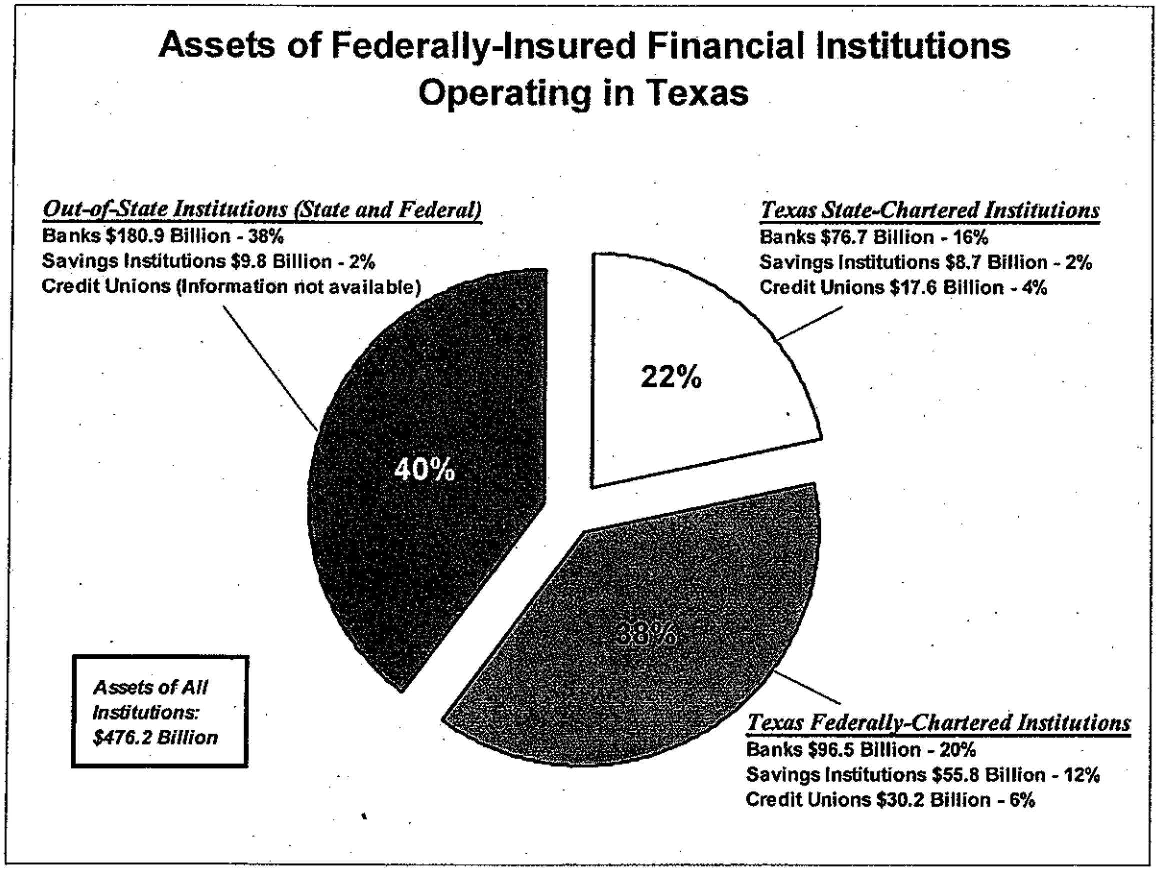
[3] Burt Solomons, *Preemption Study Letter of Intent to Credit Union Commission and Finance Commission*, p. 1 (Mar. 21, 2006).

[4] *Id.* at 2.

financial institutions and the commissions' findings regarding state laws for financial institutions that are widely understood to be preempted.

The Nature of Texas Financial Institutions

The importance of federal preemption is demonstrated by the following chart, which portrays the distribution of assets among banking, thrift, and credit union institutions in Texas as of December, 2005.[5] Over three-fourths (78%) of the financial institution assets in Texas are maintained in federal financial institutions and in out-of-state, state-chartered institutions, which can claim the benefits of federal preemption. The remaining balance of 22% is contained in Texas state-chartered banks, thrifts, and credit unions. Thus, with a super-majority of financial assets being controlled by entities that can potentially claim preemption, the very nature of Texas financial institutions reveals the significance of federal preemption in the State of Texas.



[5] Sources: Federal Deposit Insurance Corporation, National Credit Union Administration, and Texas Credit Union Department. Produced By: Texas Department of Banking. Asset information for in-state banks, savings institutions and credit unions is as of 12-31-05. For out-of-state institutions, asset figures are represented as deposit totals as of 6-30-05. Share information for the 13 out-of-state credit unions operating in Texas was not available.

SECTION I: WHAT IS FEDERAL PREEMPTION?

The Big Picture

In our federal system, the national government and those of the fifty states have inherent authority to exercise jurisdiction over many of the same fields of law. This concurrent jurisdictional scheme produces situations where state and federal law can conflict. To resolve these conflicts, the Supremacy Clause of the United States Constitution has been the primary argument set forth by the Office of the Comptroller of the Currency ("OCC") as the basis for its actions. The Supremacy Clause declares federal law to be "the supreme Law of the Land," superseding all inconsistent state legislation.[6] In general, Congress has the authority to preempt state law to whatever extent it believes necessary to achieve its purposes, and thus, congressional intent at the time of a federal statute's passage is the determining factor in deciding whether a state statute is preempted by federal law.

However, balanced against the Supremacy Clause is the Tenth Amendment to the U.S. Constitution, also known as the "States Rights' Amendment."[7] While almost all of the legal battles by the states against preemptive efforts of the OCC have focused on the argument that those preemptions have not been specifically provided in congressional acts, recently, the Tenth Amendment has taken the lead among the arguments presented by the states.[8]

In the numerous cases brought by the states against preemption opinions and rules, the congressional intent to preempt state law has been recognized by the courts in certain ways. _*Express*_ preemption is found when Congress specifically states an intention to supplant state law with federal legislation. _*Implied*_ preemption, on the other hand, exists where Congress has not expressly stated the intent to preempt state statutes, but preemption is found to be necessary based on the language of the statute. Implied preemption can be found even though Congress' intent to preempt is only "implicitly contained in [a statute's] structure and purpose."[9]

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[6] U.S. CONST. art. VI, cl. 2, known as the Supremacy Clause, states:

> This Constitution, and the Laws of the United States which shall be made in Pursuance thereof; and all Treaties made, or which shall be made, under the Authority of the United States, shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding.

[7] U.S. CONST. amend. X states:

> The powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or to the people.

[8] *See, e.g.*, Petition for Writ of Certiorari, *Watters v. Wachovia Bank, N.A.*, 2006 WL 1068854, at *26 (U.S. No. 05-1342) (Apr. 18, 2006); *see also* discussion *infra* under Section VIII, "Operating Subsidiaries."

[9] *Fid. Fed. Sav. & Loan Ass'n v. de la Cuesta*, 458 U.S. 141, 153 (1982) (quoting *Jones v. Rath Packing Co.*, 430 U.S. 519, 525 (1977)).

Finally, implied preemption comes in two forms: *field* preemption and *conflict* preemption. "Generally, the preemption analysis begins with a presumption against preemption. However, where a state seeks to regulate a particular area of the law that has had a significant federal presence, the presumption against preemption is not triggered. Banking regulation is just such an area . . . ."[10] "When federal law preempts a field, it does not leave room for the states to supplement it."[11] Conflict preemption, on the other hand, arises if a state law conflicts with the federal law to such an extent that congressional intent in enacting the federal statute would be frustrated if the state law was permitted to stand. These simple statements, however, utterly fail to capture the complexity of modern preemption analysis, especially in the context of regulation of financial services.

The frustration of the courts in dealing with complex preemption questions, often involving implicit and ambiguously stated congressional intentions, led the courts to begin relying on the expertise of federal agencies, a decision that in hindsight has greatly infringed on the states' powers to enact laws affecting their citizens and to have impact within their geographical boundaries. The deference afforded the preemption positions taken by federal agencies continues to restrict state power to this day.

The Process of Preemption

Definitive rulings on preemption are determined by a court. A preemption challenge may be placed in front of a court in several different ways.

Preemption challenges in the financial services area generally take the form of a nationally-chartered bank, a federally-chartered thrift or a federally-chartered credit union ("federal financial institution"), objecting to the application of a state law or regulation to the lender's business practices. The federal financial institution may sue the state, enjoining the state from enforcing the provision, or the state may sue the federal financial institution for failure to comply. Hence, either party can institute legal proceedings to force the ultimate question before a court: must the federal financial institution comply with the state law or regulation enacted in the state where the federal financial institution operates? Because of the origin of the charter, the case then proceeds immediately to the federal court system.

All preemption challenges recently have involved national banks or federal thrifts, or their operating subsidiaries. In some of these cases, the national bank or federal thrift has asked the federal regulator for a determination that a certain state law or regulation does not apply and is preempted. The federal regulator has then supported the federal financial institution in its judicial challenge of the provision if the state continues to assert the provision's applicability to the institution.

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[10] *Silvas v. E*Trade Mortgage Corp.*, 421 F. Supp. 2d 1315, 1318 (S.D. Cal. 2006) (internal citation omitted).

[11] *Id.* at 1319 (citations omitted).

Some examples of preemption challenges may be instructive here:

- *A consequence of state legislation.* In this case, the state passes a law that prohibits a certain financial activity. A federal financial institution could then file suit, claiming that the new state provision is preempted by federal law (i.e., the National Bank Act, the Home Owners' Loan Act, or the Federal Credit Union Act) and does not apply to any business activity of the federal financial institution.

- *A regulator threatens action.* Suppose that a state-chartered operating subsidiary of a federal financial institution decides to relinquish its state license, but not its state charter, claiming that the state's licensing requirements are preempted by federal law. Then, the state regulator threatens to take action against the subsidiary for unlicensed activity. The subsidiary could respond by filing suit in court to seek a declaratory judgment stating that the state's licensing laws are federally preempted, and that the operating subsidiary does not need to comply with the state law.

- *A consequence of federal rulemaking.* Another potential scenario involves the question of preemption arising due to federal agency rulemaking (as described in more detail in the following section). Suppose that the OCC promulgates and adopts a rule that preempts state regulations regarding certain financial activities. In this situation, a state regulatory agency or a federal financial institution affected by the OCC rule could seek a preemption determination in court.

While these simplified examples are by no means all of the ways that preemption questions can arise in the financial services industry, they do provide some basic situations to illustrate the manner in which preemption challenges appear and are resolved.

Preemption by Federal Agency Regulations

Although the Supremacy Clause refers only to the "Constitution, and the Laws of the United States . . . and all Treaties made," the Supreme Court has held that "a federal agency acting within the scope of its congressionally delegated authority may pre-empt state regulation."[12] In fact, a federal agency with statutory authority to preempt state or local laws may go so far as to preempt all state regulations within the "area" over which the federal agency has been granted statutory authority.[13] In these circumstances, courts will conduct an intent analysis, not looking to the intent of Congress to preempt state law in a particular area, but rather to the extent to which Congress intended to grant the federal agency the legal authority to preempt all existing state law applicable to the federal financial institution.[14]

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[12] *La. Pub. Serv. Comm'n v. FCC*, 476 U.S. 355, 369 (1986) (citations omitted).

[13] *City of New York v. FCC*, 486 U.S. 57, 64 (1988) ("[I]n proper circumstances the agency may determine that its authority is exclusive and pre-empts any state efforts to regulate in the [agency's] area" (citing *de la Cuesta*, 458 U.S. at 152-54)).

[14] *Id.*

This delegation of authority from Congress to the relevant federal agency is given great deference by the courts. In *Chevron, U.S.A., Inc. v. Natural Resource Defense Council, Inc.*,[15] the Supreme Court held that agency action will not be reviewed by the courts if the action constitutes a "permissible construction of the statute," unless the action is "arbitrary, capricious, or manifestly contrary to the statute."[16] Even in cases where the legislative delegation of these powers to a federal agency is implied rather than explicit, a "court may not substitute its own construction of a statutory provision for a reasonable interpretation made by the administrator of an agency."[17]

It is the *Chevron* case and its legacy that in large part has led to the current state of affairs in federal preemption of state regulation of financial services offered by national banks and federal thrifts. The ability of a federal agency to preempt state statutes coupled with judicial deference to the decisions of federal regulators has vested enormous financial industry regulatory power in the OCC and the Office of Thrift Supervision ("OTS"). This power allows the OCC and the OTS to create a very favorable business environment for national banks and federal thrifts, allowing them to tailor their businesses to avoid the state-specific statutory burdens imposed upon their state-chartered competitors. One substantial result is that federal preemption reduces the ability of state legislatures to create reasonable and appropriate remedies for abuse of its citizens, as the customers of a federal financial institution have to seek redress of any grievance through the federal agency that supervises the federal financial institution, and will not have the benefit of their state law as an avenue for relief.

What Types of Preemption Are Prevalent in Financial Services?

All types of preemption are prevalent in the financial services industry. Perhaps the most common example of express preemption is preemption of interest rate regulation by the "most favored lender" statutes and by federal law regarding most home mortgages. Two of the most sweeping federal preemption statutes related to lending are the Depository Institutions Deregulation and Monetary Control Act of 1980 ("DIDMCA") and the Alternative Mortgage Transactions Parity Act of 1982 ("AMTPA"). Federal Circuit Judge Selya of the United States First Circuit has colorfully described federal interest rate preemption as a "train wreck . . . [involving] a headlong collision between a state-consumer protection law and a federal banking law," and, Judge Selya suggests, in this area "[f]ederal law has the right of way."[18]

Section 501 of DIDMCA (12 U.S.C. § 1735f-7) preempts state usury restrictions on federally-related mortgage loans. The federal law states that "[t]he provisions of the constitution of any State expressly limiting the rate or amount of interest, discount points, or other charges which may be charged, taken, received, or reserved by lenders and the provisions of any State law expressly limiting the rate or amount of interest, discount points, or other charges which may be

[15] *Chevron, U.S.A., Inc. v. Natural Res. Def. Council, Inc.*, 467 U.S. 837 (1984).

[16] *Id.* at 843-44 (footnotes omitted).

[17] *Id.* at 844 (footnote omitted).

[18] *Greenwood Trust Co. v. Mass.*, 971 F.2d 818, 821 (1st Cir. 1992).

charged, taken, received, or reserved" do not apply to federally-related mortgage loans.[19] A federally-related mortgage loan is any loan made by: (1) a federally-insured depository institution, (2) any lender regulated by an agency of the federal government, or (3) any creditor who makes mortgage loans aggregating more than $1 million per year.[20]

Section 521 of DIDMCA (12 U.S.C. § 1831d) provides "most favored lender" status for state-chartered banks and thrifts. Section 521 of DIDMCA is patterned after the provisions of the National Bank Act (12 U.S.C. § 85), and is intended to place state-chartered banks on an equal competitive footing with national banks. This section permits an insured multi-state state-chartered bank or an insured state-chartered thrift to charge interest on any loan at the higher of: (1) the rate permitted by the laws of the institution's home state, or (2) a rate equal to one percent over the discount rate on ninety-day commercial paper in effect at the Federal Reserve Bank in the district where the institution is located.[21] This provision permits a multi-state state-chartered bank or thrift to "export" the rate permitted in its home state to any host state where it does business. Therefore, if a Nevada-chartered bank conducts business in Texas, the bank may charge interest on loans made in Texas at the rates provided under Nevada law, even if those rates exceed what is permitted under the Texas Constitution or under Texas statutory law.

The AMTPA (12 U.S.C. § 3801, *et seq.*) preempts certain state law restrictions on alternate mortgage loans such as adjustable rate mortgages and mortgages with balloon payments. The OTS is given authority to issue regulations related to these transactions for loans made by state-chartered certified housing lenders (i.e. non-federally chartered lenders other than state-chartered commercial banks and credit unions). Prior to 2002, these regulations included preemption of state law restrictions on prepayment penalties. Illustrative of the preemption effect of AMTPA is the case of *McCarthy v. Option One Mortgage Corp.*[22] In *McCarthy*, an Illinois borrower entered into an adjustable rate loan. When the borrower attempted to pay off the loan after one year, the lender collected a prepayment penalty.[23] Illinois law prohibited the imposition of a prepayment penalty on loans where the interest rate exceeded 8%.[24] Because under AMTPA, OTS regulations permitted the imposition of prepayment penalties, the Illinois statute was preempted.[25] The Illinois statute is similar to Texas Finance Code § 302.102, which prohibits the imposition of prepayment penalties on residential loans which exceed 12% per annum. Under AMTPA and prior OTS regulations, the Texas statute might have been preempted to the extent that it purported to apply to adjustable rate mortgage loans. However, effective July 3, 2003, the OTS has amended its regulations to omit the regulation that preempted state prohibitions on

[19] 12 U.S.C. § 1735f-7(a).

[20] Real Estate Settlement Procedures Act of 1974 ("RESPA"), 12 U.S.C. § 2602(1).

[21] 12 U.S.C. § 1831d.

[22] *McCarthy v. Option One Mortgage Corp.*, 362 F.3d 1008 (7th Cir. 2004).

[23] *Id.* at 1010.

[24] *Id.* at 1011.

[25] *Id.* at 1013.

prepayment penalties. Therefore, it would appear that the change in the OTS regulations removed any question about the validity of Finance Code § 302.102 concerning adjustable rate mortgages as it relates to state-chartered certified housing lenders. As the Texas Legislature reviews whether or not to repeal provisions of Texas law which currently appear to be preempted, the legislature may want to consider the alternative option of leaving the statutes on the books. Like the Biblical Lazarus, the dead might one day be recalled to life.

Implied preemption is found most commonly in state laws that attempt to restrict the powers of federally-chartered financial institutions, although the federal banking regulators are working hard to articulate preemptive scope for the purpose of converting implied preemptions into express preemptions. The sources of implied preemption will primarily be the National Bank Act and the Home Owners' Loan Act.

The Fair Credit Reporting Act ("FCRA") contains five different classes of preemption that are relatively new and untested. The laws the FCRA affects generally relate to credit reports and identity theft, which are hot topics for most states. For a detailed discussion, please see Section X, "The Fair Credit Reporting Act and Identity Theft," contained *infra.*

What Laws Are Being Preempted by the OCC?

In January 2004, the OCC aggressively amended its preemption regulations to more closely match those of the OTS and to more explicitly articulate its views. Challenges to these regulations by the states have been unsuccessful so far. In one of its press releases, the OCC compared the types of laws it says its rules preempt with those preempted by the OTS and the National Credit Union Association ("NCUA") rules. The two OCC charts contained in Exhibits B and C included at the end of this report are good reference tools regarding the types of laws involved. (The inclusion of these charts does not necessarily indicate agreement with their content.)

The states are experiencing great frustration in fighting preemption. The heavy burden the states carry is easy to see from the following statement by Federal Circuit Judge Benavides, in *Wells Fargo Bank, N.A. v. James*, the case regarding "on-us" check cashing fees:

> Appellant suggests, however, that . . . Congress did not intend to tacitly export to [the OCC] the diverse range non-banking policy issues that are here implicated, concerning, for example, the negotiability of checks, consumer protection, or even labor compensation. Nonetheless, it is often if not always the case that in exercising the discretion committed it by Congress, an agency necessarily, and perhaps even inadvertently, sweeps into its legislative reach significant policy decisions outside its area of specific commitment. In this way, the inherent limitations of any agency as congressional-delegatee are, in part, illuminated: Here, the constituency positively affected by the OCC's position is concentrated, organized and well-funded, and also happens to be the regulated industry. In contrast, the constituency which is adversely affected by the decision, though vast, is diffuse, unorganized, and definitionally ill-funded. It may be that these competing interests could better be balanced, as Appellant suggests, by a national

> Congress whose commitments are diverse and universal, or even by the people as they are represented in the state legislatures, than by a solitary institution whose focus is a single industry. However, our review here is limited to discerning whether Congress intended to delegate this question to the OCC, not whether we think such a delegation wise. Of course, should Congress be dissatisfied with the OCC's decision concerning the fee at issue here, Congress is free to revisit the question with subsequent legislation. Consequently, we find that in promulgating § 7.4002(a), the OCC has operated within the sphere delegated it by Congress.[26]

SECTION II: THE ECONOMICS OF PREEMPTION

When studying federal preemption in the context of regulation of financial services, one aspect that should not be overlooked is the economic factor associated with preemption. Clearly, compliance with state laws and regulations results in some degree of costs. The costs associated with that regulatory burden are necessary expenses for any entity that desires to operate in a regulated field. Weighing the burden of those costs of compliance inevitably impacts the decision of an entity determining whether to pursue a preemption challenge in court or whether to comply with certain state laws and regulations.

When a financial institution is faced with a new state law requiring a change in compliance practices that potentially could be challenged on the basis of federal preemption, the institution has to consider the impact of implementing the change in contrast to the costs of challenging the change. Alternatively, if a financial institution believes that through a preemption challenge a particular state law prohibiting or restricting the charging of certain fees may be preempted, the institution may deem that the potential benefits of a successful preemption challenge outweigh the costs of pursuing that challenge. If a state law, however, only requires minimal cost or effort to comply, often the costs of observing the state law are less than the costs of a protracted legal battle. The costs of a preemption challenge have the potential to be sizable, so the avoidance of these costs is an important variable in a decision to comply or challenge a state statute or regulation. Furthermore, an institution also must weigh the costs of potentially defending litigation brought by plaintiff borrowers for the institution's alleged failure to comply with a state law or regulation. Even if the institution successfully defends its action or lack of action on the basis of preemption, it still has incurred the costs of litigation. The avoidance of these types of costs is another critical factor in the economics of preemption.

While states should not completely rely on the forecasted economic costs of compliance to predict whether legislation will be effective, this information can surely offer an indication of whether an entity will comply with a new state law or regulation. States may be able to logically infer the impact of legislation by evaluating its economic aspects; however, a commensurate risk of defending a preemption challenge, even on the sole basis of principle, may accompany the legislative act.

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[26] *Wells Fargo Bank, N.A. v. James*, 321 F.3d 488, 493-94 (5th Cir. 2003).

Parity Regarding Banking Entities

Since the creation of the national banking system in the 1860s, the United States has had a "dual banking system."[27] Although some thought the new federal system might replace the existing state banking system in each state, a dual banking system resulted instead. The concept of competitive parity has its origins in the National Bank Act itself, which explicitly provides that national banks must look to home state law in areas such as usury, trust powers, and, as added by the 1920s McFadden Act, intrastate branching,[28] although preemptive erosion is occurring in each of these areas. These provisions were originally designed to ensure that national banks would have competitive parity with home-state state banks in an intrastate banking framework. The later establishment of the Federal Reserve System and Federal Deposit Insurance Corporation ("FDIC") insurance treated national and state-chartered banks equally and thus supported competitive parity in the dual banking system.

After the 1960s, banking expanded to become an increasingly multi-state business, as the development of multi-state credit cards and interstate offers of consumer credit signaled the development of a banking (now financial services) marketplace that is truly national in scope. The advantages of federal preemption became more apparent as multi-state banks struggled to comply with a complex and sometimes contradictory matrix of state laws, and a trend developed among the larger banks of converting to a federal charter. This trend threatened the state-chartered portion of the dual banking system, leading the states to begin attempts to ensure competitive parity. Today, every state has a so-called "parity statute" on its books that, to a greater or lesser degree, attempts to permit state banks to ignore restrictive state laws that national banks are free to ignore as a result of preemption. At the end of this report, please refer to the chart contained in Exhibit D, "State Bank Parity with Federal Banks."

However, these parity statutes for state banks are fraught with legal problems. First, an irreconcilable conflict between two state statutes is generally resolved by giving precedence to the later-enacted statute. If the restrictive state law that a state bank seeks to ignore was enacted after the parity statute, it is difficult to argue that the parity statute controls. How can a state legislature enact a statute that restricts the right of all future legislatures to enact statutes within a given range of subjects? Thus, parity statutes are not the panacea one might hope, but rather provide only a "safety net" of sorts that attempts to instill and retain confidence that the state charter is adaptable. Generally, a parity determination is in effect an announcement that the state

[27] "Dual banking system" refers to the parallel state and federal structures for the charter, supervision, and regulation of depository institutions. It encompasses both the powers, activities, and competitiveness of chartered banks as well as the powers, policies, and institutional structure of the bank regulatory agencies at the state and federal levels. Throughout the history of the dual banking system, one of its most important features has been a relative balance between the state and national systems, both in numerical terms and in the perception among bankers of the relative attractiveness of the two types of charters.

[28] *See* 12 U.S.C. §§ 36, 85, 92a.

will not enforce the preempted state law against state banks, which may prevent hasty action by state banks to convert to federal charters. Unless the legislature takes prompt action to appropriately revise or repeal the offending state law, a significant risk exists that a court will find that the law is nevertheless binding on state banks.

The Texas Constitution and Texas Finance Code § 32.009

Unique among the states, Texas placed its parity provision in the Texas Constitution, thereby ensuring that a preempted state statute would also be unconstitutional and unenforceable against Texas state banks. The core of state bank parity with national banks is embodied in Texas Constitution, Article XVI, § 16(c), added in 1984 by constitutional amendment. Texas Finance Code, § 32.009, originally enacted in 1995, implements parity between national and state banks under Article XVI, § 16(c). (Section 32.009, "Parity Between State and National Banks," is attached in its entirety as Exhibit E.) The following paragraphs describe the background underlying development of § 32.009.

In late 1993, the Texas Banking Commissioner formed the Texas Banking Code Revision Task Force and charged it with conducting a thorough review of the Texas Banking Code of 1943. The guiding principles of the Task Force were (1) to promote the dual banking system by ensuring that the proposed Texas Banking Act possesses attributes that make a state bank charter attractive in Texas, (2) to preserve and enhance the competitive parity between state banks and other forms of financial institutions in Texas, (3) to reduce the regulatory burden on state banks to the extent possible consistent with safety and soundness, and (4) to provide the flexibility in the proposed Texas Banking Act that is necessary to permit adaptability in the future in response to the continuing evolution of federal law and modern banking practice.

One of the Task Force's responsibilities was to address the impact and effect of Texas Constitution, Article XVI, § 16(c) on the needed modernization of the Texas Banking Code of 1943. The goal, first and foremost, was to promote the dual banking system by ensuring that the banking laws retain the attributes that make being a state-chartered bank in Texas so attractive. At the same time, the Task Force wished to support and enhance state banking without having the Texas banking laws merely mirror the National Bank Act.

Under former Article 342-113(4) of the Texas Banking Code of 1943, the Finance Commission of Texas was charged with promulgating rules to "permit state banks to transact their affairs in any manner . . . which they could do . . . were they organized and operating as a National bank under the laws of the United States; but . . . this authority . . . shall not abridge [State] laws . . . ."[29] This provision was used to implement competitive parity in a number of instances, but the language pre-dated the addition of Article XVI, § 16(c) to the Texas Constitution and was of very little use in interpreting the meaning of § 16(c). Further, the Finance Commission was not empowered at the time to deal with inconsistencies in state law.[30]

[29] TEX. BANKING CODE of 1943, TEX. REV. CIV. STAT., art. 342-113(4) (repealed 1995).

[30] *Bank of E. Tex. v. Jones*, 758 S.W.2d 293, 295-96 (Tex. App.--Tyler 1988, no writ).

An argument advanced in the modernization process, i.e. that Article XVI, § 16(c) is "self-activating" rather than "permissive," was viewed as detrimental to the dual banking system. If § 16(c) is viewed as fully self-activating, a state bank could exercise the rights and privileges of a national bank without seeking approval or permission of anyone, even if the exercise would be unlawful under state law. The Texas Legislature would be powerless to impose restrictions on state banks that were in conflict with federal law applicable to national banks, and regulations and interpretations under that law. However, if fully permissive, the Texas Legislature through laws, the Finance Commission through rules, or the Texas Banking Commissioner through opinions or policies would have to authorize the activity before a state bank could exercise a national bank right or privilege.

Texas Constitution, Article XVI, § 16 provides in pertinent part that:

> (a) The Legislature shall by general laws, authorize the incorporation of state banks and savings and loan associations and shall provide for a system of State supervision, regulation and control of such bodies which will adequately protect and secure the depositors and creditors thereof. . . .
>
> . . . .
>
> (c) A state bank created by virtue of the power granted by this section, notwithstanding any other provision of this section, has the same rights and privileges that are or may be granted to national banks of the United States domiciled in this State.

Legal techniques for statutory construction were of very little use in interpreting the ambiguous and conflicting subsections of § 16. Prior to 1984, § 16 was comprised of only subsections (a) and (b). Subsection (c), the provision at issue, was added in 1984. Subsections (d), (e), and (f) were added in 1986. While the later addition of the last three subsections would override any inconsistency with subsection (c) under established rules of statutory construction (*cf.*, Texas Government Code, § 311.026), subsection (c) has been applied by the Texas Legislature itself, with regard to branching, as if it overrides the latter three subsections (subsection (e) authorizes a state bank to branch only within the county of its domicile).

The Task Force took the position that state bank regulation would be chaotic and unpredictable if Texas Constitution, Article XVI, § 16(c) was fully self-activating, and such an interpretation would damage the dual banking system. The Task Force did not dispute that state banks should have the same rights and privileges as national banks, but believed an orderly system of implementation was essential to regulatory control. The Task Force viewed the Texas Constitution permitting such a reading because § 16(a), which authorizes the creation of state banks and a system of state regulation, must necessarily be considered a part of the Texas Constitution and not overridden by § 16(c), especially since § 16(c) expressly refers to state banks as "created by virtue of the power granted by this section." Under this view, §16(c) does not restrict the power of the Texas Legislature to provide a system of state regulation pursuant to § 16(a) that differs from, or is more restrictive than, the regulatory scheme imposed on national banks under federal law; nor does it prevent the Finance Commission of Texas, acting under authority granted by the Texas Legislature, from adopting a rule that differs from, or is more restrictive than, federal law and regulations, if such laws, rules, and regulations attempt to "adequately protect and secure the depositors and creditors" of state banks as required by § 16(a).

Section 32.009 represents a carefully crafted and negotiated provision that reinforces the power of the state legislature to enact laws regulating state banks, as provided by Article XVI, § 16(a), that might differ from national banking laws. Procedures are described for state banks to notify the Texas Banking Commissioner if the bank intends to conduct any activity permitted for a national bank where state laws are silent. Appropriate hearing and appeal provisions are included for persons affected by an adverse decision. The Finance Commission of Texas is expressly authorized to adopt rules permitting and regulating the activity, contrary to the result reached in *Bank of East Texas v. Jones.*[31]

Texas Finance Code § 32.010

Texas Finance Code, § 32.010, commonly called the "super-parity" provision, was originally enacted in 1999. (Section 32.010, "Additional Powers," is attached in its entirety as Exhibit F.) Amendments in 2001 were designed to conform with the Gramm-Leach-Bliley Act. The purpose of § 32.010 was to enhance the state bank charter <u>beyond</u> the national bank charter where possible, by granting a state bank any power authorized to a federally-insured, state or federal financial institution within the United States. Under 12 U.S.C. § 1831a and 12 C.F.R. part 362, a state bank is prohibited from engaging in an activity as principal in which a national bank cannot engage, *unless the FDIC permits it after making certain safety and soundness findings.* The FDIC has authorized numerous activities under this authority, all of which are believed to have arisen in other states. Texas Finance Code, § 32.010 has the presently untapped potential to extend those permissions to state banks in Texas.

Section 32.010 is procedurally modeled after § 32.009. Procedures are described for state banks to notify the Texas Banking Commissioner if the bank intends to conduct an activity claimed to be permitted by the FDIC within the United States for an insured institution. Appropriate hearing and appeal provisions are included for persons affected by an adverse decision. The Finance Commission of Texas is expressly authorized to adopt rules permitting and regulating the activity under similar standards as are provided by § 32.009.

The Application of Parity: Examples

The following are a few examples of the application of parity:

- A Texas administrative interpretation that the Texas Credit Code prohibited national banks from offering debt cancellation contracts for a fee was preempted in 1992. The same right was extended to state banks by the Texas Department of Banking.

[31] *Jones*, 758 S.W.2d 293.

- A Texas statute regarding insurance agent licensing that required all shareholders of a corporate licensee to also be licensed was preempted in 1997, for impermissibly restricting national banks from engaging in federally authorized activities. The Texas Department of Banking with the cooperation of the Texas Department of Insurance extended relaxed licensing requirements to state banks prior to amending the law in 1999.

- A Texas statute prohibiting interstate mergers under the Riegle-Neal Act was preempted in 1998 as to a national bank merger. The Texas Department of Banking extended interstate merger rights to state banks prior to amending state law in 1999.

- A Texas statute prohibited the charging of fees for cashing "on-us" checks. An "on us" check is a check drawn on the bank by one of the bank's customers. The prohibition was preempted for national banks by *Wells Fargo Bank, N.A. v. James*.[32] The court acknowledged the parity provision in the Texas Constitution and explicitly extended the benefit of its ruling to state banks.

Parity Regarding State Thrifts

Texas Finance Code, § 93.008 became effective on September 1, 1997. (Section 93.008, "Powers Relative to Other Financial Institutions," is attached in its entirety as Exhibit G.) Section 93.008(a) provides parity between state-chartered thrifts and state-chartered banks, and parity between state-chartered thrifts and federal thrifts and national banks. In addition, Finance Code, § 93.008(b) provides a "super-parity" provision for state-chartered thrifts which mirrors the "super-parity" provision of Finance Code, § 32.010 applicable to state-chartered banks.

Parity Regarding Credit Unions

To fully understand the impact of preemption on state-chartered credit unions, the parity provision under the Texas Credit Union Act ("TCUA") must be considered. In adopting amendments to § 123.003 of the Texas Finance Code, the Texas Legislature enlarged the powers of a state-chartered credit union so that a Texas credit union can "engage in any activity in which it could engage, exercise any power it could exercise, or make any loan or investment it could make, if it were operating as a federal credit union."[33] This provision is commonly referred to as a parity provision. The amendments to § 123.003 became effective on September 1, 2003.

The Texas Legislature did not provide legislative intent when it codified Texas Finance Code, § 123.003 which would indicate that the legislature meant to override the state's laws. If the Texas Legislature had envisioned that § 123.003 would have preempted state laws, the legislature could have made an express statement to this effect, such as it did in codifying Texas Finance Code, § 302.103, which covers loans subject to 12 U.S.C. §§ 1735f-7 and 1735f-7a (loans secured by real estate under the National Housing Act). Absent evidence to the contrary, it

[32] *James*, 321 F.3d 488.

[33] TEX. FIN. CODE § 123.003(a).

appears reasonable to presume that the Texas Legislature was not attempting to homogenize the TCUA with the Federal Credit Union Act, but rather to preserve the competitive parity of credit unions with respect to situations that are not otherwise authorized for credit unions under the laws of this state. To assume otherwise would be an improper delegation of authority to the National Credit Union Administration to regulate the activities of state-chartered credit unions.

Therefore, the parity provision does not act to preempt applicable state laws or any rules adopted by the Texas Credit Union Commission. Accordingly, it is the Texas Credit Union Department's position that Texas Finance Code, § 123.003 covers federal powers and authorities that are not otherwise addressed in state statute or rules.

As noted above, the parity provision is still valuable to state-chartered credit unions in those instances where the Federal Credit Union Act allows federal credit unions to engage in activities that are not addressed in the TCUA or Commission rules. However, in its current form, the parity provision is lacking. It is the Credit Union Department's opinion that, absent future action by the Texas Legislature, § 123.003 only grants credit unions all federal powers and authorities in existence as of September 1, 2003.

The Texas Constitution provides that the legislature is the state's lawmaking body. Its primary function is to enact laws to provide for the health, welfare, education, environment, and economic and general well-being of the citizens of Texas. Accordingly, any interpretation of the provision must not result in an improper delegation of future legislative power. Absent clear evidence to the contrary, it is the Credit Union Department's opinion that it could be an unconstitutional delegation of legislative power for the legislature to adopt a statute that, in effect, automatically adopts future federal statutes and rules as part of state law.[34] In other words, Texas Finance Code, § 123.003 could be subject to a constitutional challenge unless it specifies that the provision only applies to those federal powers and authorities that were authorized by the Texas Legislature as of a date certain. The Credit Union Department concludes that date to be September 1, 2003.

The Credit Union Department believes the Texas Legislature could correct this problem by amending § 123.003 as set forth in Exhibit H to allow the Credit Union Department Commissioner to approve an activity by a state credit union claimed to be permissible for federal or out-of-state credit unions.

Preemption is not a significant issue for state-chartered credit unions. Currently, the Department would suggest only one change to the TCUA in connection with the preemption issue. A revision to the parity provision in § 123.003 of the TCUA as set forth in Exhibit H is necessary to allow state-chartered credit unions parity with federal credit unions for all federal powers and authorities granted after September 1, 2003.

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[34] *See, e.g., Diversified Inv. P'ship v. Dep't of Soc. & Health Servs.*, 775 P.2d 947 (Wash. 1989) and *McCabe v. N.D. Workers Comp. Bureau*, 567 N.W.2d 201 (N.D. 1997).

The National Bank Act, OCC advisory opinions,[35] and the regulations of the OCC represent the primary basis for federal preemption of state law as it applies to national banks.

The OCC recently restated and codified its regulations regarding the extent to which the operations of national banks are subject to state laws, providing that national banks engage in the business of banking effectively subject only to the National Bank Act and the regulatory and enforcement authority of the OCC.[36] The OCC also revised its rule concerning its visitorial powers to make clear that it alone has the authority to bring enforcement actions against national banks and that state authorities cannot bring an action against a national bank or subsidiary in a state court.[37]

These new regulations, coupled with other OCC regulatory actions over the past few years, combine to clearly indicate the OCC's view that the states lack authority to (1) enact and enforce laws that obstruct, impair, or condition a national bank's exercise of its lending, deposit-taking, or other powers granted to it under federal law; and (2) to enforce state law against national banks and their operating subsidiaries in violation of its exclusive visitorial powers granted under federal law.

With respect to visitorial powers, federal law provides that:

> No national bank shall be subject to any visitorial powers except as authorized by Federal law, vested in the courts of justice or such as shall be, or have been exercised or directed by Congress or by either House thereof or by any committee of Congress or of either House duly authorized.[38]

The statute then permits lawfully authorized state auditors or examiners to review a national bank's records "solely to ensure compliance with applicable State unclaimed property or escheat laws upon reasonable cause to believe that the bank has failed to comply with such laws."[39]

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[35] "Both OTS and OCC issue advisory opinions on preemption. Federal savings associations and national banks may choose to rely on these opinions and conduct their business accordingly." However, "[t]hese opinions are advisory and subject to court challenge and review." United States General Accounting Office, General Government Division, *Role of the Office of Thrift Supervision and Office of the Comptroller of the Currency in the Preemption of State Law*, p. 2, Feb. 7, 2000.

[36] *See* 12 C.F.R. pts. 7 and 34.

[37] Final Rule on Visitorial Powers, 69 Fed. Reg. 1895, 1896 and 1900 (Jan. 13, 2004).

[38] 12 U.S.C. § 484(a).

[39] *See id.* § 484(b).

The OCC now defines visitorial powers to include not only examination or inspection of a national bank's books and records, but also "[r]egulation and supervision of activities authorized or permitted pursuant to federal banking law" and "[e]nforcing compliance with any applicable federal or state laws concerning those activities."[40] The OCC claims "exclusive visitorial authority with respect to the content and conduct of activities authorized for national banks under Federal law."[41]

Several exceptions to the OCC's exclusive visitorial powers laws are listed in 12 C.F.R. § 7.4000(b)(1). State or other federal officials may be authorized to:

- "Inspect the list of shareholders, provided that the official is authorized to assess taxes under state authority (12 U.S.C. 62 . . .);
- Review, at reasonable times and upon reasonable notice to a bank, the bank's records solely to ensure compliance with applicable state unclaimed property or escheat laws upon reasonable cause to believe that the bank has failed to comply with those laws (12 U.S.C. 484(b));
- Verify payroll records for unemployment compensation purposes (26 U.S.C. 3305(c));
- Ascertain the correctness of Federal tax returns (26 U.S.C. § 7602);
- Enforce the Fair Labor Standards Act (29 U.S.C. 211); and
- Functionally regulate certain activities, as provided under the Gramm-Leach-Bliley Act . . . ."[42]

The OCC has further interpreted the exception for "courts of justice" in 12 U.S.C. § 484(a) as strictly pertaining "to the powers inherent in the judiciary," meaning it "does not grant state or other governmental authorities any right to inspect, superintend, direct, regulate or compel compliance by a national bank with respect to any law, regarding the content or conduct of activities authorized for national banks under Federal law."[43]

The revised preemption regulations explicitly provide that state laws do not apply to national banks if such laws "obstruct, impair, or condition" the ability of national banks to exercise their federally authorized deposit-taking,[44] consumer lending,[45] or other powers.[46] However, state laws that only incidentally affect the deposit-taking, lending, or other operations of a national bank are

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[40] 12 C.F.R. § 7.4000(a)(2).

[41] *See id.* § 7.4000(a)(3).

[42] *See id.* § 7.4000(b)(1) (paragraph numbering omitted).

[43] *See id.* § 7.4000(b)(2).

[44] *See id.* § 7.4007(b).

[45] *See id.* §§ 7.4008(d), 34.3, 34.4.

[46] *See id.* § 7.4009(b).

not preempted.[47] When the OCC issued the new regulations, Comptroller of the Currency, John D. Hawke, Jr., issued a statement noting:

> The types of laws that the regulation preempts - including laws regulating loan terms, imposing conditions on lending and deposit relationships, and requiring state licenses - create impediments to the ability of national banks to exercise powers that are granted under federal law. These laws create higher costs and operational burdens that the banks either must shoulder, or pass on to consumers, or that may have the practical effect of driving them out of certain businesses.[48]

The OCC stated that its authority to issue the preemption regulations derives from 12 U.S.C. §§ 93a and 371.[49] Section 93a grants the OCC authority "to prescribe rules and regulations to carry out the responsibilities of the office" and § 371 grants the OCC authority to regulate national banks' real estate lending activities.

Under 12 C.F.R. § 7.4007(b)(2), "[a] national bank may exercise its deposit-taking powers without regard to state law limitations concerning:"

- "Abandoned and dormant accounts;
- Checking accounts;
- Disclosure requirements;
- Funds availability;
- Savings account orders of withdrawal;
- State licensing or registration requirements (except for purposes of service of process); and
- Special purpose savings services."[50]

Regarding non-real estate lending, 12 C.F.R. § 7.4008(d)(2) provides that a national bank or its operating subsidiary "may make non-real estate loans without regard to state law limitations concerning:"

- "Licensing, registration (except for purposes of service of process), filings, or reports by creditors;
- The ability of a creditor to require or obtain insurance for collateral or other credit enhancements or risk mitigants, in furtherance of safe and sound banking practices;
- Loan-to-value ratios;

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[47] Press Release, Office of the Comptroller of the Currency, Preemption Final Rule Questions and Answers, p. 2 (Jan. 7, 2004).

[48] Press Release, John D. Hawke, Jr., Comptroller of the Currency, Statement of Comptroller of the Currency John D. Hawke, Jr. Regarding the Issuance of Regulations Concerning Preemption and Visitorial Powers, p. 1 (Jan. 7, 2004).

[49] Final Rules on National Bank Preemption, 69 Fed. Reg. 1904, 1908-09 (Jan. 13, 2004).

[50] 12 C.F.R. § 7.4007(b)(2) (paragraph numbering and footnotes omitted).

- The terms of credit, including the schedule for repayment of principal and interest, amortization of loans, balance, payments due, minimum payments, or term to maturity of the loan, including the circumstances under which a loan may be called due and payable upon the passage of time or a specified event external to the loan;
- Escrow accounts, impound accounts, and similar accounts;
- Security property, including leaseholds;
- Access to, and use of, credit reports;
- Disclosure and advertising, including laws requiring specific statements, information, or other content to be included in credit application forms, credit solicitations, billing statements, credit contracts, or other credit-related documents;
- Disbursements and repayments; and
- Rates of interest on loans."[51]

With respect to real estate lending, 12 C.F.R. § 34.4(a) specifically states that "a national bank may make real estate loans . . . without regard to state law limitations concerning:"

- The amount of a loan in relation to the appraised value of the real estate;
- The schedule for the repayment of principal and interest;
- The term to maturity of the loan;
- "The aggregate amount of funds that may be loaned upon the security of real estate;" and
- The "[c]ovenants and restrictions that must be contained in a lease to qualify the leasehold as acceptable security for a real estate loan."[52]

12 C.F.R. §§ 7.4007, 7.4008, and 34.4 each set forth a non-exclusive list of state law subjects that generally are not inconsistent with the powers of national banks and will apply to national banks "to the extent that they only incidentally affect the exercise" of national banks' powers.[53] These areas of law include contracts, torts, criminal law, rights to collect debts, acquisition and transfer of real property, taxation, and zoning.[54] "Homestead laws specified in 12 U.S.C. 1462a(f)" are listed in 12 C.F.R. § 34.4(b)(4) as laws that will apply to a national bank, but only "to the extent that they only incidentally affect the exercise of national banks' real estate lending powers."

The authority of a national bank to charge interest, fees and other charges is set forth in 12 C.F.R. § 7.4001 and § 7.4002. The most favored lender doctrine set forth in 12 U.S.C. § 85 is addressed elsewhere in this study.

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[51] *See id.* § 7.4008(d)(2) (paragraph numbering and footnote omitted).

[52] 12 C.F.R. § 34.4(a) (paragraph numbering and footnote omitted; full list not included).

[53] *See id.* § 34.4(b).

[54] *Id.*

SECTION V: INTERSTATE (OR MULTI-STATE) STATE BANKS

State banks that operate in the interstate environment also can invoke federal preemption under 12 U.S.C. § 1831a(j), which states in pertinent part:

> (j) Activities of branches of out-of-State banks.
>
> (1) Application of host State law. The laws of a host State, including laws regarding community reinvestment, consumer protection, fair lending, and establishment of intrastate branches, shall apply to any branch in the host State of an out-of- State State bank to the same extent as such State laws apply to a branch in the host State of an out-of-State national bank. To the extent host State law is inapplicable to a branch of an out-of-State State bank in such host State pursuant to the preceding sentence, home State law shall apply to such branch.
>
> (2) Activities of branches. An insured State bank that establishes a branch in a host State may conduct any activity at such branch that is permissible under the laws of the home State of such bank, to the extent such activity is permissible either for a bank chartered by the host State (subject to the restrictions in this section) or for a branch in the host State of an out-of-State national bank.

State banks also can invoke the most favored lender doctrine as set forth in 12 U.S.C. § 1831d, addressed elsewhere in this study.

The FDIC has published proposed rules to clarify and implement 12 U.S.C. § 1831a(j) and § 1831d for the benefit of state banks but has yet to adopt final regulations.[55] The proposed rules in effect would serve as a special parity provision for state banks. For example, proposed 12 C.F.R. § 362.19(c) would provide in part:

> A host State law does not apply to an activity conducted at a branch in the host State of an out-of-State, State bank to the same extent that a Federal court or the Office of the Comptroller of the Currency has determined in writing that the particular host State law does not apply to an activity conducted at a branch in the host State of an out-of-State, national bank.[56]

SECTION VI: FEDERAL SAVINGS INSTITUTIONS

The Home Owners' Loan Act ("HOLA"), OTS advisory opinions, and the regulations of the OTS are the basis for federal preemption of state law as it applies to federally-chartered savings and loan associations and savings banks ("federal thrifts"). Section 5 of the HOLA (12 U.S.C. § 1464) and the OTS regulations create what has been suggested as a "cradle to . . . corporate

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[55] *See* Notice of Proposed Rulemaking: Interstate Banking; Federal Interest Rate Authority, 70 Fed. Reg. 60019 (Oct. 14, 2005).

[56] *See id.* at 60031, to be codified at 12 C.F.R. § 362.19(c).

grave" scheme of regulation so extensive as to leave no room for state regulation of federal thrifts.[57] Thus, the HOLA and OTS regulations constitute implicit field preemption of state law regarding federal thrifts. It has been suggested that the preemption of federal thrifts is even statutorily broader than that provided in the National Bank Act.[58] The OTS has promulgated a broadly-worded preemption rule which attempts to further its position that HOLA and OTS regulations constitute field preemption.

12 C.F.R. § 545.2 reads:

> The regulations in this part 545 are promulgated pursuant to the plenary and exclusive authority of the Office to regulate all aspects of the operations of Federal savings associations, as set forth in section 5(a) of the Act. This exercise of the Office's authority is preemptive of any state law purporting to address the subject of the operations of a Federal savings association.

12 C.F.R. § 560.2(a) reads:

> (a) *Occupation of field.* Pursuant to sections 4(a) and 5(a) of the HOLA, 12 U.S.C. 1463(a), 1464(a), OTS is authorized to promulgate regulations that preempt state laws affecting the operations of federal savings associations when deemed appropriate to facilitate the safe and sound operation of federal savings associations, to enable federal savings associations to conduct their operations in accordance with the best practices of thrift institutions in the United States, or to further other purposes of the HOLA. To enhance safety and soundness and to enable federal savings associations to conduct their operations in accordance with best practices (by efficiently delivering low-cost credit to the public free from undue regulatory duplication and burden), OTS hereby occupies the entire field of lending regulation for federal savings associations. OTS intends to give federal savings associations maximum flexibility to exercise their lending powers in accordance with a uniform federal scheme of regulation. Accordingly, federal savings associations may extend credit as authorized under federal law, including this part, without regard to state laws purporting to regulate or otherwise affect their credit activities, except to the extent provided in paragraph (c) of this section or § 560.110 of this part. For purposes of this section, "state law" includes any state statute, regulation, ruling, order or judicial decision.

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[57] *See Conference of Fed. Sav. & Loan Ass'ns v. Stein,* 604 F.2d 1256, 1260 (9th Cir. 1979) (quoting *State v. Coast Fed. Sav. & Loan Ass'n*, 98 F. Supp. 311, 316 (S.D. Cal. 1951)); *see also de la Cuesta*, 458 U.S. 141.

[58] *See* C.F. Muckenfuss, III & Robert C. Eager, *Preemption Under the Home Owners Loan Act* (February 10, 2003), as posted on the American Bar Association Banking Law Section Preemption Subcommittee website. The authors state that under the National Bank Act preemption is conflict preemption, but that the extensive activities and interpretive opinions and regulations issued by the OCC have essentially made this statutory difference inconsequential.

The subsections following 12 C.F.R. § 560.2(a) provide a laundry list of examples of state regulations that are preempted. This list is represented in the comparison charts provided in Exhibits B and C.

SECTION VII: CREDIT UNIONS

State law for credit unions has not been greatly impacted by preemption due to the dual chartering system and the Texas Finance Code's treatment of state-chartered credit unions. Credit unions chartered in the State of Texas are governed by the Texas Credit Union Act ("TCUA"). Federal credit unions are chartered by the National Credit Union Administration ("NCUA") and governed by the Federal Credit Union Act ("FCUA"). Federal credit unions are not subject to the provisions of the TCUA. Except for the provisions of Title II of the FCUA that are applicable to federally-insured credit unions, state-chartered credit unions are not subject to the FCUA. Any preemption by the NCUA of Texas statutes would be of other provisions in the Texas statutes that are applicable to financial institutions operating in this state, but which may not be applicable to Texas credit unions pursuant to the TCUA.

The FCUA and the NCUA's rules and regulations address federal preemption in several areas, including lending, deposit accounts, late charges, privacy, leasing, taxation and member business loans. A federal agency's preemption of state laws for federal credit unions does not always mean that federal credit unions are at an advantage. For instance, Texas state-chartered credit unions have more flexibility in offering interest rates than federal credit unions.

Lending

FCUA, 12 U.S.C. § 1757(5)(A), grants federal credit unions the power to make loans in conformity with rules set by the Board of the NCUA. NCUA rules and regulations, 12 C.F.R. § 701.21(b)(1) preempts state laws attempting "to regulate the rates, terms of repayment and other conditions of Federal credit union loans and lines of credit (including credit cards) to members." This would include the rate of interest, amount to be financed, indexes to which a variable rate may be tied, notifications to borrowers on interest rate changes, late charges, closing and application costs, maturity of loan or lines of credit, frequency of payments, balloon payments, prepayment limits, purpose of the loan, type or amount of security for the loan, borrower eligibility, and the imposition and enforcement of liens on the accounts of borrowers.[59] These preemption provisions pull federal credit unions out of virtually all of the lending provisions included in the Texas Finance Code.

Deposit Accounts

FCUA, 12 U.S.C. § 1757(6) grants federal credit unions the power to receive from its members payments representing equity on shares, share certificates, and share draft accounts "subject to such terms, rates, and conditions as may be established by the board of directors, within limitations prescribed by the [NCUA] Board." Additionally, federal law preempts § 73.003 of

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[59] 12 C.F.R. § 701.21(b)(1).

the Texas Property Code concerning the prohibitions of fees on inactive accounts with respect to federal credit unions. As a result, any state law attempting to govern accounts at federal credit unions would be preempted.

Late Charges

FCUA, 12 U.S.C. § 1757(10) grants federal credit unions the power to levy late charges in accordance with their bylaws for failure to meet obligations to the federal credit union. Accordingly, any state law attempting to regulate late fees at federal credit unions would be preempted.

Privacy

NCUA rules and regulations, part 716 governs privacy of consumer financial information. These regulations apply to federally-insured state-chartered credit unions as well as federal credit unions, and have been held by the NCUA to preempt state law on the matter. However, 12 C.F.R. § 716.17(b) specifically provides that state statutes and regulations providing consumers *greater* protection are permissible if they are not inconsistent with the provisions of the federal law and regulations.

Leasing

NCUA rules and regulations, 12 C.F.R. § 714.10 provides that federal credit unions must comply with state laws on consumer leasing to the extent that state laws are consistent with the federal Consumer Leasing Act (15 U.S.C. § 1667e), or provide members with greater protections or benefits than the Consumer Leasing Act.

Member Business Loans

NCUA rules and regulations, part 723 applies to federally-insured state-chartered credit unions as well as federal credit unions. Section 723.20 states that "[t]he NCUA Board may exempt federally insured state chartered credit unions in a given state from NCUA's member business loan rule if NCUA approves the state's rule . . . ."[60] Texas has received such an exemption and state-chartered credit unions operate under the Member Business Loan Rule promulgated by the Texas Credit Union Commission. Federal credit unions operate under the NCUA's member business loan rule.

State Laws Not Preempted

NCUA regulation states that the preemption rule is not intended to preempt state laws that do not affect rates, terms of repayment, and other conditions affecting loans as described above. Examples of matters not preempted include insurance laws, laws related to transfer of and security interests in real and personal property (except the use and exercise of due-on-sale

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[60] 12 C.F.R. § 723.20.

clauses), collection costs and attorneys' fees, requirements that consumer lending documents be in "plain language," and the circumstances in which a borrower may be declared in default and may cure default.

As a result, federal credit unions remain subject to certain provisions of Texas statutes, such as the Texas Debt Collection Act. Federal credit unions also remain subject to Texas insurance laws (with the exception of deposit insurance, which is governed by the FCUA through the National Credit Union Share Insurance Fund, managed by the NCUA) and Texas' version of the Uniform Commercial Code concerning secured transactions.

SECTION VIII: OPERATING SUBSIDIARIES

Background and History

While perhaps less visible, nondepository lenders play a vital role in the financial services industry. Nondepository lenders, e.g. mortgage companies, payday lenders, and small consumer loan companies, are creatures of state law. As such, these small lenders rely heavily on state law to operate. A subset of nondepository lenders consists of the operating subsidiaries of national banks and of federal thrifts.

For well over 40 years, federal depository institutions have created and utilized operating subsidiaries to carry out certain functions that appeared best removed from and not conducted by the parent financial institutions. Such functions serve to increase the efficiency of the parent depository institutions and are designed to limit liability of the parent. The states issue the charters of operating subsidiaries. Operating subsidiaries of federal financial institutions are incorporated at the state level. Such incorporation is a state function, not a federal function. Consequently, operating subsidiaries are created by and function under the authority of state law. In his recent law review article, Keith R. Fisher elaborated on this concept of state-created entities being regulated by the states:

> The primary regulator of any corporate entity is its chartering authority. For federally chartered depository institutions, such as national banks, that entity is the United States, but for all affiliates of those institutions, including . . . operating subsidiaries, the chartering authority is a sovereign state. That state has legitimate and compelling interests in preserving those institutions and in ensuring that those institutions serve the purposes for which they were created.[61]

Wholly-owned by the parent financial institutions, these subsidiaries operate independently, have a more singular purpose, and are able to specialize in certain areas. In fact, "the stated considerations motivating the initial adoption of the operating subsidiary rule in 1966 were that developing such subsidiaries would aid banks in 'controlling operations costs, improving effectiveness of supervision, [providing for] more accurate determination of profits,

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[61] Keith R. Fisher, *Towards a Basal Tenth Amendment: A Riposte to National Bank Preemption of State Consumer Protection Laws*, 29 Harv. J.L. & Pub. Pol'y 981, 1014-15 (2006).

decentralizing management decisions[,] or separating particular operations of the bank from other operations.'"[62]

"Operating subsidiaries were not recognized as a legitimate tool for carrying on the business of banking until the 1960s."[63] Even though "the history of banking laws indicates that operating subsidiaries have been treated distinctly by Congress and the OCC, . . . no statute speaks directly to the scope of federal versus state power over them."[64]

Recent Trends

Traditionally, operating subsidiaries of federal depository institutions have been licensed by the states to conduct certain financial activities. However, a recent trend has emerged where, on the basis of claimed federal preemption, operating subsidiaries have relinquished their state licenses, arguing that they can conduct the same financial activities as their parent institutions without needing to meet state licensing requirements.[65] Similarly, this trend of operating subsidiaries claiming federal preemption has also arisen in the context of challenges to state visitorial authority,[66] as well as in conjunction with a state's attempt to enforce state law and investigate alleged violations stemming from consumer complaints.[67]

The Office of Consumer Credit Commissioner ("OCCC") currently has several licensees that function as operating subsidiaries of federal financial institutions. Between January 16, 2003 and December 14, 2005, the OCCC received cancellation notices for 47 licenses from entities specifically stating that they were claiming federal preemption as operating subsidiaries of national banks as the reason for canceling their licenses.

The practical result of such a license cancellation by an operating subsidiary of a federal financial institution is that the operating subsidiary retains its incorporated status obtained under state law, and continues (generally) the same lending activity for which the subsidiary was originated and licensed under state law in the first place. However, with the license cancelled the

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[62] *Wells Fargo Bank, N.A. v. Boutris*, 419 F.3d 949, 960 (9th Cir. 2005) (quoting *Acquisition of Controlling Stock Interest in Subsidiary Operations Corporation, "Operating Subsidiary Rule")*, 31 Fed. Reg. 11, 459 at 11,460 (Aug. 31, 1966)) (alternation in original).

[63] *Wachovia Bank, N.A. v. Watters*, 431 F.3d 556, 561 (6th Cir. 2005), *cert. granted*, 2006 U.S. LEXIS 4690 (U.S. June 19, 2006) (No. 05-1342).

[64] *Wachovia Bank, N.A. v. Burke*, 414 F.3d 305, 318 (2d Cir. 2005), *petition for cert. filed*, 2005 U.S. LEXIS 9046 (U.S. Dec. 5, 2005) (No. 05-431).

[65] *See Burke*, 414 F.3d 305, and *Watters*, 431 F.3d 556.

[66] *See Boutris*, 419 F.3d 949, and *OCC v. Spitzer*, 396 F. Supp. 2d 383 (S.D.N.Y. 2005), *appeal pending*, No. 05-6001 (2d Cir.).

[67] *See Nat'l City Bank of Ind. v. Turnbaugh*, 367 F. Supp. 2d 805 (D. Md. 2005), *aff'd*, 463 F.3d 325 (4th Cir. 2006).

operating subsidiary is operating outside state law. The question of whether the subsidiary is operating illegally is still open.

2004 OCC Preemption Rules

The position maintained by these operating subsidiaries, as well as many others across the country, stems from the preemption rules promulgated by the OCC in 2004. The supplementary information included with the publication of these rules outlines the general types of state laws that are preempted, the standards to be used to determine whether other state laws would also be preempted, and the general types of state laws that would not be preempted, all with regard to national banks and their operating subsidiaries.[68] Examples of areas listed by the OCC rules where state laws are preempted include the following ten categories: licensing laws, filing requirements, terms of real estate loans, advertising, permissible rates of interest, permissible fees and non-interest charges, management of credit accounts, due-on-sale clauses, leaseholds as acceptable security, and mandated statements and disclosures.[69] Examples of areas where state laws are not preempted, (assuming such laws do not materially affect national bank operations): "contracts, debt collection, acquisition and transfer of property, taxation, zoning, crimes, torts, and homestead rights."[70] There is strong legal precedent for consumer protection and state regulatory enforcement of national banks. However, despite this precedent and heavy opposition to the rules, the OCC's preemption rules were adopted and went into effect on February 12, 2004.

Operating Subsidiaries of National Banks - Wachovia Bank v. Watters

The leading case on federal preemption regarding the operating subsidiaries of national banks is *Wachovia Bank, N.A. v. Watters.*[71] In *Watters*, the Sixth Circuit was faced with the issue of whether the National Bank Act, 12 U.S.C. § 21, *et seq.*, and the OCC's regulations preempted state banking laws regarding the operating subsidiaries of national banks.[72] The facts involved Wachovia Mortgage, a wholly-owned operating subsidiary of Wachovia Bank. Wachovia Mortgage relinquished its Michigan lending registration under the claim of federal preemption.[73] The Sixth Circuit Court upheld the OCC's interpretation of its regulations, stating that "[t]he regulations, specifically *section 7.4006*, simply reflect the eminently reasonable conclusion that when a bank chooses to utilize the authority it is granted under federal law, it ought not be hindered by conflicting state regulations".[74] Thus, Wachovia Mortgage was free to engage in first

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[68] *See* Notice of Proposed Rulemaking: Bank Activities and Operations; Real Estate Lending and Appraisals, 68 Fed. Reg. 46119 (Aug. 5, 2003).

[69] *See id.* at 46122-23.

[70] *See id.* at 46128 (footnote omitted); *see also* 12 C.F.R. § 7.4009.

[71] *Watters*, 431 F.3d 556.

[72] *Id.* at 557.

[73] *Id.* at 558.

[74] *Id.* at 562 (alteration in original).

and secondary mortgage lending in Michigan and was not required to maintain state registration or comply with the preempted Michigan regulations. However, the U.S. Supreme Court recently granted certiorari in the *Watters* case (see footnote *supra*), which could change the legal landscape in this area, as discussed *infra*.

Other 2005 Court Decisions - State Laws Preempted

Several other 2005 court decisions have aligned with the holding of the *Watters* case, including the appellate cases of *Wachovia Bank v. Burke* from the Second Circuit and *Wells Fargo Bank v. Boutris* from the Ninth Circuit, as well as the U.S. District Court cases of *OCC v. Spitzer* from the Southern District of New York and *National City Bank of Indiana v. Turnbaugh* from the District of Maryland.[75]

In *Burke*, a very similar fact pattern arose as in the *Watters* case, also involving Wachovia Mortgage surrendering its mortgage licenses and arguing preemption as an operating subsidiary of Wachovia Bank.[76] However, the *Burke* case concerned the state regulations of Connecticut, as opposed to those of Michigan. Although the events of *Burke* occurred in a different state and the case was heard by a different circuit court, the result was the same: the Second Circuit Court held that "the OCC regulations reflect a consistent and well-reasoned approach to preempting state regulation of operating subsidiaries," and thus, the OCC's rules preempted the conflicting Connecticut regulations.[77] The *Burke* case actually preceded the *Watters* case. In fact, the Sixth Circuit Court in the *Watters* case agreed with and heavily relied upon the reasoning and outcome of the *Burke* case, citing it often.[78]

The *Boutris* and *Spitzer* cases arose in the context of states attempting to enforce state laws by exercising their visitorial authority over operating subsidiaries. In *Boutris*, after the California Commissioner of Corporations directed two national bank operating subsidiaries to conduct audits of their residential mortgage lending activities to determine whether proper interest was charged under California law, the operating subsidiaries objected to the Commissioner's request, arguing that they were only subject to the exclusive regulatory authority of the OCC.[79] The Ninth Circuit Court held that the National Bank Act, in conjunction with an OCC regulation, "preempt[ed] the exercise of visitorial authority over operating subsidiaries of national banks."[80] Similarly, via OCC regulation, California's licensing authority over operating subsidiaries was field-preempted.[81]

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[75] *See Burke*, 414 F.3d 305; *Boutris*, 419 F.3d 949; *Spitzer*, 396 F. Supp. 2d 383; and *Turnbaugh*, 463 F.3d 325.

[76] *Burke*, 414 F.3d at 310.

[77] *Id.* at 321.

[78] *See, e.g., Watters*, 431 F.3d at 561-63.

[79] *Boutris*, 419 F.3d at 955.

[80] *Id.* at 970.

[81] *Id.*

The *Spitzer* case also involved visitorial authority and residential mortgage lending. In *Spitzer*, the Attorney General of the State of New York was seeking to investigate potential racial discrimination by several national banks that were providing mortgages to New York consumers.[82] Like the Ninth Circuit in *Boutris*, the District Court for the Southern District of New York upheld the OCC's exclusive visitorial authority over the operating subsidiaries of national banks, thus enjoining the New York State Attorney General from conducting this investigation into the banks' residential lending practices.[83] However, the court in the *Spitzer* case was quick to note the following: "This opinion says nothing about whether it is better public policy to vest visitorial powers over national banks in state attorneys general as well as in the OCC."[84]

The *Turnbaugh* case involved two operating subsidiaries of National City Bank of Indiana, a national bank with operating subsidiaries having offices in Maryland. These subsidiaries had been examined and investigated several times in the past by the Maryland Commissioner of Financial Regulation.[85] As a result of two consumer complaints, the Commissioner sought information from the operating subsidiaries to determine whether they were charging prepayment penalties in violation of Maryland law.[86] Falling in line with *Watters* and the other cases cited above, the Maryland District Court held that "the Maryland laws are preempted by the federal regulatory regime established pursuant to the *National Bank Act*."[87]

Operating Subsidiaries of Federal Thrifts

Regarding the operating subsidiaries of federal thrifts, the OTS has had a similar preemption provision in place well before the OCC's rules were promulgated in 2003. The OTS preemption regulation is located in 12 C.F.R. § 559.3(n)(1). The leading case in the area of federal preemption regarding the operating subsidiaries of federal thrifts is from Wisconsin, *WFS Financial, Inc. v. Dean*.[88] As with the recent trend concerning the operating subsidiaries of national banks, the *Dean* case resulted in the preemption of state regulatory provisions for the operating subsidiaries of federal thrifts.[89]

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[82] *Spitzer*, 396 F. Supp. 2d at 385.

[83] *Id.* at 386.

[84] *Id.*

[85] *Turnbaugh*, 367 F. Supp. 2d at 810.

[86] *Id.* at 810-11.

[87] *Id.* at 811 (emphasis in original).

[88] *WFS Financial, Inc. v. Dean*, 79 F. Supp. 2d 1024 (W.D. Wis. 1999).

[89] *Id.* at 1028.

Chevron Deference

In light of the lack of specific, documented congressional intent concerning operating subsidiaries, all of these courts applied the principle of "*Chevron* deference" in determining whether the OCC's interpretation of its regulations was reasonable.[90] As the *Burke* court explained, "Pursuant to Chevron, [the court] ask[s], first, 'whether the intent of Congress is clear as to the precise question at issue.' If Congress's intent is clear, 'that is the end of the matter. But if the statute is silent or ambiguous with respect to the specific issue, the question for the court is whether the agency's answer is based on a permissible construction of the statute.'"[91] All of these courts upheld the OCC's interpretation of its regulations and the National Bank Act, and preempted the state regulations (save one specific regulation from the *Boutris* case).

Unsettled Law in Texas

Although the *Watters* line of cases has for the time being expanded preemption with regard to operating subsidiaries for those jurisdictions, the Fifth Circuit, which includes Texas, has not yet ruled on this issue. Federal preemption concerning operating subsidiaries is not a well-settled area of law. The Supreme Court has stated that the question in each preemption case is the following: What was the purpose of Congress?[92] The purpose of Congress is the ultimate factor in determining whether state law is preempted. As stated earlier, the congressional intent is strikingly silent in the *Watters* line of cases. Likewise, the statutory authorities utilized by the OTS in promulgating 12 C.F.R. § 559.3(n)(1) do not reveal any intent by Congress to broadly preempt state licensing and registration requirements for state-chartered corporations.

As noted previously, the U.S. Supreme Court has recently granted certiorari in the *Watters* case. In addition to presenting an argument that the OCC's interpretation of 12 C.F.R. § 7.4006 is not entitled to *Chevron* deference, the petition to the Court also presents the argument that the lower court's preemption ruling is a violation of the Tenth Amendment.[93] The petition argues: "12 C.F.R. 7.4006 essentially federalizes a State corporation by converting it into an instrumentality of federal law. Such an effort is a significant intrusion on State sovereignty and is a violation of the Tenth Amendment by co-opting any ability of a State to regulate the State corporation to protect its citizens."[94] For more on this Tenth Amendment argument, please refer to Exhibit I, "Noteworthy Items from 'Federal Preemption in the Financial Institutions Arena,' Texas Tech University School of Law, April 19-21, 2006."

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[90] *See generally, Chevron*, 467 U.S. 837.

[91] *Burke*, 414 F.3d at 315 (quoting *NationsBank of N.C. v. Variable Annuity Life Ins. Co.*, 513 U.S. 251, 257 (1995) (internal citation omitted)).

[92] *Rice v. Santa Fe Elevator Corp.*, 331 U.S. 218, 230 (1947).

[93] Petition for Writ of Certiorari, *Watters v. Wachovia Bank, N.A.*, 2006 WL 1068854, at *26 (U.S. No. 05-1342) (Apr. 18, 2006).

[94] *Id.* (footnote omitted).

As further evidence of the unsettled nature of this area of law, a petition for a writ of certiorari has been filed with the U.S. Supreme Court in the *Burke* case (see footnote *supra*), which is factually similar to *Watters*. An appeal is also pending in the *Spitzer* case (see footnote *supra*). Consequently, the high court could greatly alter the current law regarding preemption and operating subsidiaries.

Many state agencies and financial scholars still maintain positions against federal preemption in the area of operating subsidiaries, echoing the argument presented by the petitioner in the *Watters* case. In opposition to the OCC's 2004 rules, Arthur E. Wilmarth, Jr., Professor of Law at George Washington University Law School stated: "Operating subsidiaries are chartered as separate and distinct corporate entities under the authority of state law. Because they are creatures of state law, operating subsidiaries must comply with all applicable state requirements. The OCC's rules effectively 'federalize' state-chartered subsidiaries by placing them under the exclusive supervisory control of the OCC."[95] Operating subsidiaries are created by state law, and as creatures of that state law, those entities that receive benefits under state law should also bear the responsibilities and liabilities that accompany those benefits.

SECTION IX: MORTGAGE BROKERS AND EXCLUSIVE AGENCY

The OTS and Exclusive Agency Challenge

The most significant current challenge to state regulation by the OTS is the controversy over whether the OTS regulations preempt any attempted regulation by the states of individual mortgage brokers who are "exclusive agents" of a federal thrift. The OTS issued an opinion on October 25, 2004 to State Farm Bank, F.S.B. stating that its "exclusive agents" were not subject to licensing by state authorities. The reach of this potential preemption extension is significant. If exclusive agents do not have to be licensed, then of course, these originators would not be subject to the same restrictions, statutory training requirements, and disclosure obligations imposed upon other mortgage brokers and loan officers. Moreover, if the OTS has the exclusive "visitorial powers" with respect to these originators, then even the Texas Attorney General might be prohibited from investigating and enforcing violations of state consumer protection statutes.

On June 21, 2006, the United States District Court for Connecticut rendered summary judgment that the OTS interpretation preempted the Connecticut statute requiring mortgage originators to be licensed under state law.[96] Therefore, State Farm agents are exempt from Connecticut licensing laws.[97] If upheld, this case has the effect of preempting the Texas Mortgage Broker

[95] Arthur E. Wilmarth, Jr., *The OCC's Preemption Rules Exceed the Agency's Authority and Present a Serious Threat to the Dual Banking System and Consumer Protection*, 23 Ann. Rev. Banking & Fin. L. 225, 232 (2004). Mr. Wilmarth still maintains this position, as evidenced by his subsequent publication: Arthur E. Wilmarth, Jr., *Preemption - OCC v. Spitzer: An Erroneous Application of Chevron That Should Be Reversed*, BNA's Banking Report, Vol. 86, No. 8 (Feb. 20, 2006).

[96] *State Farm Bank, F.S.B. v. Burke*, 445 F. Supp. 2d 207, 221 (U.S. D.Conn. 2006).

[97] *Id.*

License Act (Texas Finance Code, Chapter 156) as it may apply to any "exclusive agent" of a federally-chartered thrift.

SECTION X: THE FAIR CREDIT REPORTING ACT AND IDENTITY THEFT

Generally, Texas can enact statutes that relate to the collection, distribution, or use of any information on consumers, or for the prevention or mitigation of identity theft, to the extent that those statutes are not inconsistent with any provision of the federal Fair Credit Reporting Act ("FCRA"). Nevertheless, the United States Congress has enacted certain provisions of the federal FCRA that cannot be altered, affected, annulled, or changed by state law. These provisions are set forth under the FCRA, 15 U.S.C. § 1681t.

The federal standard of preemption in this area is quite complex. The Fair and Accurate Credit Transactions Act ("FACT Act") of 2003, which amended the FCRA, contains five classes of preemption: (1) conflict preemption, (2) subject matter preemption related to specific sections as amended in 1996, (3) subject matter preemption related to one identity theft provision and two non-identity theft provisions, (4) disclosure-related preemption, and (5) conduct preemption.[98]

The subject matter preemption prevents states from enacting legally binding laws that address or relate to subjects or topics that are governed by the preemption. As an example, this preemption would annul any state law restricting, limiting, or addressing the information that is available to identity theft victims.

The disclosure-related preemption prevents states from enacting legally binding laws that relate to certain disclosures controlled by the preemption. As an example, a state cannot enact a statute that addresses the summary of rights of identity theft victims.

The conduct preemption prevents states from enacting legally binding laws that relate to the conduct of certain individuals, such as consumer reporting agencies and creditors. Under conduct preemption, state laws that regulated certain conduct by individuals are preempted after the federal law becomes effective. Therefore, a state could have enacted legally binding statutes until the federal law became effective. A perfect example of conduct preemption is the federal preemption pertaining to the truncation of credit card and debit card account numbers. As of 2005, state law pertaining to the truncation of credit card and debit card account numbers has become federally preempted due to the FACT Act's amendments to the FCRA.

In addition to the basic rule of conflict preemption running throughout the FACT Act, the particular items falling under subject matter, disclosure-related, and conduct preemption are outlined below. State laws covering these items are now preempted by federal law under the FCRA and the FACT Act's amendments.

[98] Gail Hillebrand, *After the FACTA: State Power to Prevent Identity Theft*, 17 Loy. Consumer L. Rev. 53, 57-58 (2004).

With respect to the federal FCRA, the subject matter preemption relates to:

- prescreening;
- time requirements for a credit reporting agency to take action involving disputes and reinvestigations;
- duties of a person who takes any adverse action with respect to a consumer; information contained in consumer reports (data relevance and obsolescence);
- responsibilities of persons who furnish information to credit reporting agencies;
- affiliate sharing of consumer information, including the use of information for solicitations for marketing purposes;
- information available for identity theft victims; and
- risk-based pricing notice.

With respect to the federal FCRA, the disclosure-related preemption relates to:

- summary of consumer rights to obtain and dispute information in consumer reports;
- summary of rights of identity theft victims;
- information available from businesses to identity theft victims; and
- credit score disclosures by credit bureaus and mortgage lenders.

With respect to the federal FCRA, the conduct preemption relates to:

- truncation of credit card and debit card numbers;
- fraud alerts, extended alert, active duty alerts and their referral among consumer reporting agencies;
- tradeline and other report information blocking by consumer reporting agencies;
- truncation of social security numbers by consumer reporting agencies;
- annual free credit reports by nationwide consumer reporting agencies;
- red flag guidelines for identity theft, prohibiting the sale or transfer of debt caused by identity theft, and debt collector conduct upon notice of identity theft;
- referral by nationwide consumer reporting agencies of file alerts, active duty alerts, blocking and similar actions and annual summary reports to the FTC;
- duties of furnishers upon notice of identity theft-related information; and
- disposal of consumer information.

In light of the preempted items listed above, the states continue to have some authority to enact laws in the area of identity theft. The following is a summary of the areas where states can arguably still legislate in reference to identity theft, as outlined by a 2004 law review article by Gail Hillebrand:

> After FACTA, states retain significant authority to protect their residents in the area of identity theft. States can still develop solutions in areas which are not addressed by the federal Act. Examples of state laws which should not be preempted include a security freeze, an obligation to take police reports, an obligation to destroy records which contain sensitive personal information,

restrictions on the use of Social Security numbers as personal identifiers and an obligation to notify consumers of data security breaches. States also can still act in areas such as medical privacy, insurance scoring, and most credit score issues.[99]

The Texas Legislature has enacted several laws relating to identity theft, including regulations in the following areas:

- confidentiality of social security numbers;
- credit reporting;
- extension of credit to identity theft victims;
- merchant or third party use of confidential information;
- procedures for taking a police report;
- procedures to dispute the accuracy of credit reports;
- security freezes; and
- truncating receipts.

Many of these provisions relating to identity theft are located within Chapter 20 of the Texas Business and Commerce Code.

Despite the position of certainty taken by Ms. Hillebrand (quoted above), the areas of continued state authority concerning identity theft is not well-defined. These provisions have not been tested in court within the preemption framework. For example, in reference to security freezes, Ms. Hillebrand believes that this is an area open to the states. However, the Federal Trade Commission ("FTC") has merely recognized that some states have enacted regulations regarding security freezes, but has not opined concerning the validity of security freezes in a preemption context.

SECTION XI: LOAN FEES AND PENALTIES

Loan Fees

The authority to charge and assess various fees and rates on loans is a critical component of the pricing and revenue structure for financial institutions. Naturally, the permission or prohibition on the charging of certain fees is of vital importance to institutions located within a state. Imbalance among state laws has created an environment where financial institutions seek to locate in states with more liberal laws, or where institutions can use the exportation of interest doctrine or preemption challenges to achieve the desired pricing structure.

The exportation doctrine operates under the principle that a bank located in one state is permitted to use the laws of its home state and export interest rates to borrowers located in other states. In other words, a bank located in South Dakota may make loans to borrowers in Texas, or any other state, using the interest rates and fee authority found in South Dakota law, without regard to the provisions of Texas law regulating the same subject. The exportation authority hinges on the

[99] *Id.* at 90.

definition of interest as found in federal law and regulation. Interest as used in 12 U.S.C. § 85 and 12 C.F.R. § 7.4001 currently means numerical periodic rates, non-sufficient funds (NSF) fees on payments, annual fees, late charges, overlimit fees, cash advance fees, membership fees, prepayment fees, fee for early closure of credit line, account opening fee, fee for exercising a fixed rate option, and a returned item fee for instruments drawn on the credit line charged before the account is terminated. Clearly, the "federal" definition of interest is very broad and is liberally applied. The result of this broad definition and liberal application permits federally-chartered financial institutions to export an expansive range of fees and interest rates from one state to the citizens of another state. Disparity among states' laws sets up the sophisticated "checkers match" where an institution operating in multiple states may jump over certain host state laws by following a few conditions. The crowning effect is that the institution may assess a wider range of fees and charges to consumers in the host state than the host state laws actually allow.

The House Financial Institutions Committee studied the disparate effects of federal law and competing state laws during the 79th Legislative session. The committee formulated HB 955 to address some of the concerns raised about competitive equality while maintaining appropriate consumer protections. Texas law already contains freedom to assess fees and charges on commercial loans or other consumer loans under the general usury provisions with due regard for the maximum amount of interest authorized. For consumer loans, however, the committee found that additional flexibility was necessary. In particular, HB 955 contained a key section, codified in Texas Finance Code, § 303.017, that was specifically tailored for depository institutions and the authority to assess certain fees. The new section provides enhanced flexibility for depository institutions to assess reasonable and necessary fees on consumer loans. For consumer loans that are written under the alternative rate structure of Chapter 303 (current maximum annual rate of 18%) rather than the elevated rate structure of Chapter 342 (maximum annual rate of up to 32% under Subchapter E; maximum annual rate of up to 240% under Subchapter F), a depository institution may charge all reasonable and necessary fees associated with the loan, whether or not those fees are paid to third parties. The depository institution is still bound by the maximum rate limits of Chapter 303 and consideration for those rates factors into the authority to assess additional fees and charges.

While concerns may still be raised regarding the disparity between Texas law and the laws of other states, HB 955 significantly counterbalanced the maligned disparity. Given the relative recent nature of this authority, it seems prudent to monitor its use and application to determine if it satisfies its desired objective.

Usury Penalties

The matter of usury penalties is a troubled area for Texas financial institutions. Within the preemption framework, concerns have been raised that Texas creditors who commit a violation of Texas usury law may be subject to a different penalty standard than federally-insured financial institutions that commit the same violation.[100]

A summary of the basic usury penalties under the Texas Finance Code follows. For a Title 4, Subtitle A loan, if a usury violation occurs, the penalty is outlined by Chapter 305. Texas Finance Code, § 305.001 provides that the basic usury penalty is three times the usurious interest contracted for or received. However, if a consumer loan is involved and more than twice the amount of allowable interest is charged and received, an additional penalty is assessed under § 305.002 that is equal to all principal and interest charged and received. Chapter 349 outlines the usury penalties for Title 4, Subtitle B loans. Texas Finance Code, § 349.001 states that the basic usury penalty is twice all interest contracted for, charged or received; but if more than double the allowable interest is contracted for, charged or received on a consumer loan, an additional penalty equal to principal and interest is assessed to the violator under § 349.002.

Federal law prescribes a usury penalty in the National Bank Act, 12 U.S.C. § 86. Federal law requires the institution to waive all interest and to pay a penalty of twice the interest actually paid.[101] The conflict between the Texas usury penalties and the federal usury penalty has resulted in some federally-insured financial institutions in Texas being "subject to exclusive federal penalties that are more or less severe than state penalties for the identical violation depending on the nature and amount of the violation."[102]

The following chart entitled, "State vs. Federal Usury Penalties," provides a graphic summary of Texas and federal usury penalties.

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[100] Jeff Dunn, *Usury Penalties for Federally Insured Financial Institutions: Interplay with Texas Usury Law*, p. 1 (January 13, 2006).

[101] National Bank Act, 12 U.S.C. § 86.

[102] Dunn at 3.

STATE VS. FEDERAL USURY PENALTIES

Type of Loan	Texas state law penalty	Federal law penalty
Consumer Loan, Subtitle A • interest of 10% or less • primarily for personal, family, or household use • includes mortgage loans • depository institutions may engage in loans that provide for interest up to 18%	The greater of: (a) 300% of interest contracted for, charged, or received; or (b) $2000 or 20% of principal whichever is less. If more than twice the lawful amount of interest is charged and received, an additional penalty of principal and the interest charged and received is provided.	Waive all interest. 200% of interest actually paid.
Consumer Loan, Subtitle B • interest of greater than 10% • primarily for personal, family, or household use • includes secondary mortgage loans	300% of interest contracted for, charged, or received. If more than twice the lawful amount of interest is contracted for, charged or received, an additional penalty of principal and the interest is provided.	Waive all interest. 200% of interest actually paid.
Commercial Loan, Subtitle A • primarily for business, commercial, investment, agricultural, or similar purposes	300% of the excess interest contracted for or received.	Waive all interest. 200% of interest actually paid.

In order to address the potential inequities resulting from disparate penalties applying to the same violation just because of the lender type, the Texas Legislature has attempted to balance the interests of both creditors and obligors by providing for notice and the opportunity to cure violations, as outlined in Texas Finance Code, Chapters 305 and 349.

For a loan that is subject to Texas Finance Code, Title 4, Subtitle A, an obligor who wishes to pursue an action for usury must give the creditor pre-suit notice, as well as an opportunity to cure, before filing suit for usury penalties under Chapter 305. The Chapter 305 penalty provisions do not allow for any late cures. Chapter 349 (Subtitle B loans) does allow for late cures. However, any cure provided after the 60-day time period will not be given the same benefit as a timely cure.[103] Under Chapter 349, the cure forwarded after the expiration of the 60-day time period will only be able to reduce the statutory damages.

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[103] *See* TEX. FIN. CODE, Chapter 349.

The contents of the pre-suit or cure notice must meet several requirements, as outlined by Texas Finance Code, §§ 305.103, 349.201, and 349.202. All cure notices must be in writing, as oral notices have no effect.[104] Valid cure notices must also notify the obligor of the violation being cured.[105] In order to properly cure a violation, that violation must be corrected in an appropriate manner. For example, if required disclosures were not provided or required duties were not performed by the creditor, then the neglected disclosures must be given or the failed duties must be performed.[106] Concerning excess interest, the curing creditor must refund the excess to the obligor, or the obligor's principal balance should be credited along with interest.[107]

These notice and cure provisions in many respects offer greater protection to creditors and bank lenders than a federal law penalty scheme would provide. The Texas Legislature has carefully considered and crafted an approach that metes out punishment for violations while seeking to establish a fair system that allows for notice and cure of many violations. Setting aside this carefully-crafted system in favor of adopting the federal penalty system for federal financial institutions only creates a different yet still uneven playing field for state institutions.

SECTION XII: ITEMS FOR FURTHER CONSIDERATION

The efforts of the 79th Texas Legislature in the passage of HB 955 were directed at balancing interests in light of preemption concerns. Those efforts successfully identified and addressed several provisions of law that were related to issues of disparate impact as compared to other states or due to preemption. Because of the positive effects of HB 955, the complexity of preemption challenges of state law, the lack of wide agreement on provisions of the Texas Finance Code that are preempted, and the need to preserve and maintain important consumer protections, identifying provisions to further the efforts at modernizing the Finance Code has proven to be challenging, to say the least.

After review and consideration of the prior legislative action and the current status of Texas law governing financial institutions, the Finance Commission of Texas and the Credit Union Commission of Texas have identified the following sections of law as being ripe for further study and consideration by the Texas Legislature:

Texas Property Code, § 73.003 (unclaimed property provision) prohibits the imposition of fees on an inactive account, in contravention of 12 C.F.R. § 7.4007(b)(2)(i). While the state may step into the shoes of the "lost" deposit customer, it cannot unilaterally alter the terms of the customer's deposit contract by prohibiting contracted fees.[108]

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[104] *See* TEX. FIN. CODE, §§ 305.103, 349.201, and 349.202.

[105] *See id.*

[106] *See id.*

[107] *See id.*

[108] *See Anderson Nat'l Bank v. Luckett*, 321 U.S. 233 (1944).

Texas Business and Commerce Code, § 4.112 prohibits a bank from charging a fee to cash a check drawn on that bank. This statute was specifically preempted in litigation.[109]

Texas Business and Commerce Code, § 4.406(b) requires a bank that does not return items in a statement to provide at least two items per statement cycle at no charge, which is effectively a prohibition on a deposit account fee in contravention of 12 C.F.R. § 7.4002(a).

Texas Business and Commerce Code, § 26.02(g) requires a financial institution to post a notice to all customers that certain loan agreements must be in writing. This requirement contravenes 12 C.F.R. § 7.4009(c)(2)(viii).

Texas Finance Code, § 34.203 explicitly binds state banks to the provisions of Finance Code, Title 4, without regard to whether any specific provision can be applied to a national bank.

Texas Finance Code, § 123.003 could be amended as set forth in Exhibit H to allow the Texas Credit Union Department Commissioner to approve an activity by a state credit union claimed to be permissible for federal or out-of-state credit unions through parity.

Texas Finance Code, Chapters 305 and 349 provide state penalties for usury while federal law (12 U.S.C. § 86) has different standards, as discussed *supra* under "Usury Penalties."

Texas Business and Commerce Code, § 35.61 states that businesses are not allowed to print more than the last four (4) digits of a consumer's credit card or debit card number on receipts evidencing those transactions. However, the Fair Credit Reporting Act, 15 U.S.C. § 1681c(g) requires a lesser standard, permitting the printing of the last five (5) digits on such receipts.

The above listed sections of law merely identify the specific legal provisions that appear to be preempted by federal action. This report does not make a recommendation as to the action that the Texas Legislature should take regarding these provisions. In some cases, the legislature may choose to simply repeal the section. In others, the legislature may choose to retain the specific provision because it provides sound public policy and may later be reinvigorated through federal administrative action or litigation, similar to the prepayment penalties issue discussed *supra* under "What Types of Preemption Are Prevalent in Financial Services?".

In addition, the U.S. Supreme Court has recently granted certiorari in the *Wachovia Bank, N.A. v. Watters* case, as cited and discussed *supra* in Section X, "Operating Subsidiaries." The Court's ruling could significantly change the law concerning preemption and operating subsidiaries. As a result, it would be premature to suggest a direction in this area. Clearly, the State of Texas will closely monitor the progression of the Supreme Court's hearing of the *Watters* case.

The Credit Union Commission and the Finance Commission appreciate this opportunity to report to the Texas Legislature on preemption issues impacting the regulation and delivery of financial services in Texas. The commissions stand ready to respond to additional requests for information as required.

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[109] *James*, 321 F.3d 488; *see also* 12 C.F.R. § 7.4002(a).

Exhibit A

The State of Texas
House of Representatives

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BURT R. SOLOMONS
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March 21, 2006

Mr. Gary L. Janacek, Chair
Credit Union Commission of Texas
914 East Anderson Lane
Austin, Texas 78753

Mr. Vernon W. Bryant, Chair
Finance Commission of Texas
2601 North Lamar Boulevard
Austin, Texas 78705

RE: Preemption Study Letter of Intent to Credit Union Commission and Finance Commission

Dear Messrs. Janacek and Bryant:

During the 79th Regular Session, the Legislature enacted House Bill 955, which I authored, requiring the Credit Union Commission and the Finance Commission to study the preemption of financial services. The pertinent portion of the bill text reads:

SECTION 7.03. Not later than December 31, 2006, the Finance Commission of Texas and the Credit Union Commission shall:

(1) compare state laws related to financial institutions with applicable federal laws;
(2) determine which state laws may be preempted by federal law, rule, or order;
(3) determine which state laws may be invalidated by state or federal court ruling; and
(4) report their findings to the legislature, with recommended statutory changes.

I understand that some uncertainty has arisen regarding the scope and extent of the study. By this letter, I hope to offer some clarification. My intent is that the study should be designed in such a way that it offers a good basic discussion of the types of federal preemption and the process of preemption. Further, the study should reference the particular state laws expressly preempted or otherwise are widely understood and accepted to be preempted. I realize that this study mandate could be perceived quite broadly; however, that was not my intent. Clearly there are many areas and provisions of law in financial services that interested parties may view as challengeable on the basis of preemption. Others may rightfully disagree with this view. I do not believe that it would further the purposes of the study to provide an exhaustive review of

Exhibit A (continued)

these types of statutes for which there is not generally-accepted agreement as to the preemption determination.

I believe the value of this study lies in aiding the Financial Institutions Committee in furthering the modernization of the Finance Code which I began with HB 955. This study should also seek to provide the legislature with a document that outlines the basic principles of preemption. The commissions' identification of clearly preempted statutes will potentially form a basis for new legislation to continue the "clean up" of out-of-date or obsolete provisions of the Code.

I look forward to receiving the study report upon its completion. In the meantime, if I can offer any further clarification, please contact me.

Sincerely,

Burt Solomons
Chair, House Financial Institutions Committee

Exhibit B

COMPARISON OF THE OCC'S PREEMPTION RULES WITH THE OTS'S AND NCUA'S CURRENT RULES JANUARY 7, 2004

Types of State Laws Generally Preempted	OCC Rules	OTS Rules	NCUA Rules
Abandoned and dormant accounts (deposit-taking)	♦	♦	♦
Aggregate amount of funds that may be lent on the security of real estate	♦		
Checking/share accounts (deposit-taking)	♦	♦	♦
Covenants and restrictions necessary to qualify a leasehold as security property for a real estate loan	♦		
Access to, and use of, credit reports	♦	♦	
Terms of credit	♦	♦	♦
Creditor's ability to require or obtain insurance of collateral or other risk mitigants/credit enhancements	♦	♦	
Due-on-sale clauses	♦	♦	♦
Escrow, impound, and similar accounts	♦	♦	
Funds availability (deposit-taking)	♦	♦	
Interest rates	♦	♦	♦
Fees	♦	♦	♦
Licensing, registration, filings and reports	♦	♦	
Loan-to-value ratios	♦	♦	♦
Mandated statements and disclosure requirements	♦	♦	♦
Mortgage origination, processing and servicing	♦	♦	
Disbursements and repayments	♦	♦	♦
Savings account orders of withdrawal (deposit-taking)	♦	♦	
Security property, including leaseholds	♦	♦	♦
Special purpose saving services (deposit-taking)	♦	♦	

Exhibit C

Similarly, the OCC offered a chart of the types of laws it was *not* preempting, comparing its approach with that of OTS and NCUA:

Types of State Laws Generally NOT Preempted	OCC Rules	OTS Rules	NCUA Rules
Contracts	♦	♦	
Commercial		♦	
Torts	♦	♦	
Criminal law	♦	♦	
Homestead laws specified by Federal statute	♦	♦	
Debt collection	♦		
Acquisition and transfer of real property	♦	♦	♦
Taxation	♦		
Zoning	♦		
Collections costs and attorneys' fees			♦
Plain language requirements			♦
Default conditions			♦
Insurance			♦
Incidental effect only	♦	♦	

Exhibit D

STATE BANK PARITY WITH FEDERAL BANKS

All 50 states and the District of Columbia have parity statutes, listed below. Most statutes provide that the state regulatory authority must determine parity applies and approve a state bank's exercise of a right or power under parity by (1) declining to object after receiving notice from the state bank; or (2) issuing an authorizing order, rule or regulation.

State	Constitutional or Statutory Provision
Alabama	Ala. Code 1975 § 5-5A-18.1
Alaska	AS 06.01.020
Arizona	A.R.S. § 6-184(A)(2)
Arkansas	A.C.A. § 23-47-101(c)
California	West's Ann.Cal.Fin.Code § 753
Colorado	C.R.S.A. § 11-105-304
Connecticut	C.G.S.A. § 36a-250
Delaware	5 Del.C. § 761(a)(17)
DC	DC ST § 26-1401.08
Florida	West's F.S.A. § 655.061
Georgia	Ga. Code Ann., § 7-1-61
Hawaii	HRS § 412:5-201
Idaho	I.C. § 26-1101
Illinois	205 ILCS 5/5 (11)
Indiana	IC 28-1-11-3.2
Iowa	I.C.A. § 524.802
Kansas	K.S.A. § 9-1715
Kentucky	KRS § 287.020 and § 287.102
Louisiana	LSA-R.S. 6:242
Maine	9-B M.R.S.A. § 416
Maryland	MD Code, Financial Institutions, § 5-504
Massachusetts	M.G.L.A. § 167F § 2
Michigan	M.C.L.A. 487.12204 and 487.14101
Minnesota	M.S.A. § 48.61
Mississippi	Miss. Code Ann. § 81-5-1
Missouri	V.A.M.S. 362.105 and 362.106
Montana	MCA 32-1-362
Nebraska	Neb.Rev.St. § 8-1,140
Nevada	N.R.S. 662.015

Exhibit D - STATE BANK PARITY WITH FEDERAL BANKS (continued)	
New Hampshire	N.H. Rev.Stat. § 394-A:7
New Jersey	N.J.S.A. 17:9A-24b.1
New Mexico	N.M.S.A. 1978, § 58-1-54
New York	McKinney's Banking Law § 14-g
North Carolina	N.C.G.S.A. § 54C-121 and § 54C-145
North Dakota	NDCC, 6-03-38
Ohio	R.C. § 1121.05
Oklahoma	6 Okl.St.Ann. § 402
Oregon	O.R.S. § 706.795 and § 708A.010
Pennsylvania	7 P.S. § 201
Rhode Island	RI ST § 19-3-1
South Carolina	Code 1976 § 34-1-110
South Dakota	SDCL § 51A-2-14.1
Tennessee	T.C.A. § 45.2-601
Texas	TX CONST Art.16, § 16(c); TX FIN §§ 32.009, 32.010, 31.003
Utah	U.C.A. 1953 § 7-1-301
Vermont	8 V.S.A. § 14106
Virginia	Va. Code Ann. § 6.1-5.1 and § 6.1-58.1
Washington	West's RCWA 30.04.215
West Virginia	W. Va. Code § 31A-3-2 and § 31A-8C-1
Wisconsin	W.S.A. 220.04 and 221.0322
Wyoming	W.S. 1977 § 13-2-101

Exhibit E

TEXAS FINANCE CODE
§ 32.009. PARITY BETWEEN STATE AND NATIONAL BANKS.

(a) Section 16(a), Article XVI, Texas Constitution, empowers the legislature to authorize the incorporation of state banks and provide for a system of state regulation and control of state banks that will adequately protect and secure depositors and creditors. Section 16(c), Article XVI, Texas Constitution, grants to state banks created by virtue of the power vested in the legislature by Section 16(a) of that article the same rights and privileges that are or may be granted to national banks domiciled in this state. The legislature finds that Section 16(c) of that article does not restrict the legislature's power to provide a system of state regulation under Section 16(a) of that article that differs from the regulatory scheme imposed on national banks under federal law or prevent the finance commission, acting under authority granted by the legislature for the purpose of implementing this subtitle, from adopting rules that differ from federal statutes and regulations or that reasonably regulate the method or manner by which a state bank exercises its rights and privileges if the rules are adopted after due consideration of the factors listed in Section 31.003(b). The legislature further finds that Section 16(c), Article XVI, Texas Constitution, does not limit any rights or powers specifically given to state banks by the laws of this state.

(b) A state bank that intends to exercise a right or privilege granted to national banks that is not authorized for state banks under the statutes and rules of this state shall submit a letter to the banking commissioner describing in detail the activity in which the bank intends to engage and the specific authority of a national bank to engage in that activity. The bank shall attach copies, if available, of relevant federal law, regulations, and interpretive letters. The bank may begin to perform the proposed activity after the 30th day after the date the banking commissioner receives the bank's letter unless the banking commissioner specifies an earlier or later date or prohibits the activity. The banking commissioner may prohibit the bank from performing the activity only if the banking commissioner finds that:

(1) a national bank domiciled in this state does not possess the specific right or privilege to perform the activity the bank seeks to perform; or

(2) the performance of the activity by the bank would adversely affect the safety and soundness of the bank.

(c) The banking commissioner may extend the 30-day period under Subsection (b) if the banking commissioner determines that the bank's letter raises issues requiring additional information or additional time for analysis. If the 30-day period is extended, the bank may perform the proposed activity only on prior written approval by the banking commissioner, except that the banking commissioner must approve or prohibit the proposed activity or convene a hearing under Section 31.201 not later than the 60th day after the date the banking commissioner receives the bank's letter. If a hearing is convened, the banking commissioner must approve or prohibit the proposed activity not later than the 30th day after the date the hearing is completed.

(d) A state bank that is denied the requested right or privilege to engage in an activity by the banking commissioner under this section may appeal as provided by Sections 31.202, 31.203, and 31.204 or may resubmit a letter under this subsection with additional information or authority relevant to the banking commissioner's determination. A denial is immediately final for purposes of appeal.

(e) To effectuate the Texas Constitution, the finance commission may adopt rules implementing the method or manner in which a state bank exercises specific rights and privileges granted under Section 16(c), Article XVI, Texas Constitution, including rules regarding the exercise of rights and privileges that would be prohibited to state banks but for Section 16(c) of that article. The finance commission may not adopt rules under this subsection unless it considers the factors listed in Section 31.003(b) and finds that:

(1) national banks domiciled in this state possess the rights or privileges to perform activities the rule would permit state banks to perform; and

(2) the rules contain adequate safeguards and controls, consistent with safety and soundness, to address the concern of the legislature evidenced by the state law the rules would impact.

(f) The exercise of rights and privileges by a state bank in compliance with and in the manner authorized by this section is not a violation of any statute of this state.

Exhibit F

TEXAS FINANCE CODE
§ 32.010. ADDITIONAL POWERS.

(a) Notwithstanding another law, a Texas state bank may perform an act, own property, or offer a product or service that is at the time permissible within the United States for a depository institution organized under federal law or the law of this state or another state, if the banking commissioner approves the exercise of the power as provided by this section, subject to the same limitations and restrictions applicable to the other depository institution by pertinent law, except to the extent the limitations and restrictions are modified by rules adopted under Subsection (e). This section may not be used by a Texas state bank to alter or negate the application of the laws of this state with respect to:

(1) establishment and maintenance of a branch in this state or another state or country;

(2) permissible interest rates and loan fees chargeable in this state;

(3) fiduciary duties owed to a client or customer by the bank in its capacity as fiduciary in this state;

(4) consumer protection laws applicable to transactions in this state; or

(5) licensing and regulatory requirements administered by a functional regulatory agency in this state, as defined by Section 31.303, including licensing and regulatory requirements pertaining to:

(A) insurance activities;

(B) securities activities; and

(C) real estate development, marketing, and sales activities.

(b) A state bank that intends to exercise a power, directly or through a subsidiary, granted by Subsection (a) that is not otherwise authorized for state banks under the statutes of this state shall submit a letter to the banking commissioner describing in detail the power that the bank proposes to exercise and the specific authority of another depository institution to exercise the power. The bank shall attach copies, if available, of relevant law, regulations, and interpretive letters. The bank may begin to exercise the proposed power after the 30th day after the date the banking commissioner receives the bank's letter unless the banking commissioner specifies an earlier or later date or prohibits the activity. The banking commissioner may prohibit the bank from exercising the power only if the banking commissioner finds that:

(1) specific authority does not exist for another depository institution to exercise the proposed power;

Exhibit F - § 32.010 (continued)

(2) if the state bank is insured by the Federal Deposit Insurance Corporation, the state bank is prohibited from exercising the power pursuant to Section 24, Federal Deposit Insurance Act (12 U.S.C. Section 1831a), and related regulations; or

(3) the exercise of the power by the bank would adversely affect the safety and soundness of the bank.

(c) The banking commissioner may extend the 30-day period under Subsection (b) if the banking commissioner determines that the bank's letter raises issues requiring additional information or additional time for analysis. If the 30-day period is extended, the bank may exercise the proposed power only on prior written approval by the banking commissioner, except that the banking commissioner must approve or prohibit the proposed power or convene a hearing under Section 31.201 not later than the 60th day after the date the banking commissioner receives the bank's letter. If a hearing is convened, the banking commissioner must approve or prohibit the proposed power not later than the 30th day after the date the hearing is completed.

(d) A state bank that is denied the requested power by the banking commissioner under this section may appeal as provided by Sections 31.202, 31.203, and 31.204 or may resubmit a letter under this section with additional information or authority relevant to the banking commissioner's determination. A denial is immediately final for purposes of appeal.

(e) To effectuate this section, the finance commission may adopt rules implementing the method or manner in which a state bank exercises specific powers granted under this section, including rules regarding the exercise of a power that would be prohibited to state banks under state law but for this section. The finance commission may not adopt rules under this subsection unless it considers the factors listed in Section 31.003(b) and finds that:

(1) the conditions for prohibition by the banking commissioner under Subsection (b) do not exist; and

(2) if the rights and privileges would be prohibited to state banks under other state law, the rules contain adequate safeguards and controls, consistent with safety and soundness, to address the concern of the legislature evidenced by the state law the rules would affect.

(f) The exercise of a power by a state bank in compliance with and in the manner authorized by this section is not a violation of any statute of this state.

Exhibit G

TEXAS FINANCE CODE
§ 93.008. POWERS RELATIVE TO OTHER FINANCIAL INSTITUTIONS.

(a) Subject to limitations prescribed by rule of the finance commission, a savings bank may make a loan or investment or engage in an activity permitted:

(1) under state law for a bank or savings and loan association; or

(2) under federal law for a federal savings and loan association, savings bank, or national bank if the financial institution's principal office is located in this state.

(b) Notwithstanding any other law, a savings bank organized and chartered under this chapter may perform an act, own property, or offer a product or service that is at the time permissible within the United States for a depository institution organized under federal law or the law of this state or another state if the commissioner approves the exercise of the power as provided by this section, subject to the same limitations and restrictions applicable to the other depository institution by pertinent law, except to the extent the limitations and restrictions are modified by rules adopted under Subsection (e). This section may not be used to alter or negate the application of the laws of this state with respect to:

(1) establishment and maintenance of a branch in this state or another state or country;

(2) permissible interest rates and loan fees chargeable in this state;

(3) fiduciary duties owed to a client or customer by the bank in its capacity as fiduciary in this state;

(4) consumer protection laws applicable to transactions in this state; or

(5) compliance with the qualified thrift assets test contained in Section 92.204.

(c) A savings bank that intends to exercise a power, directly or through a subsidiary, granted by Subsection (b) that is not otherwise authorized for savings banks under the statutes of this state shall submit a letter to the commissioner describing in detail the power that the savings bank proposes to exercise and the specific authority of another depository institution to exercise the power. The savings bank shall attach copies, if available, of relevant law, regulations, and interpretive letters. The commissioner may deny the bank from exercising the power if the commissioner finds that:

(1) specific authority does not exist for another depository institution to exercise the proposed power;

(2) if the savings bank is insured by the Federal Deposit Insurance Corporation, the savings bank is prohibited from exercising the power under Section 24, Federal Deposit Insurance Act (12 U.S.C. Section 1831a), and related regulations;

(3) the exercise of the power by the bank would adversely affect the safety and soundness of the bank; or

(4) at the time the application is made, the savings bank is not well capitalized and well managed.

(d) A savings bank that is denied the requested power by the commissioner under this section may appeal. The notice of appeal must be in writing and must be received by the commissioner not later than the 30th day after the date of the denial. An appeal under this section is a contested case under Chapter 2001, Government Code.

(e) To effectuate this section, the finance commission may adopt rules implementing the method or manner in which a savings bank exercises specific powers granted under this section, including rules regarding the exercise of a power that would be prohibited to savings banks under state law but for this section.

(f) The exercise of a power by a savings bank in compliance with and in the manner authorized by this section is not a violation of any statute of this state.

Exhibit H

TEXAS FINANCE CODE
§ 123.003. ENLARGEMENT OF POWERS.
(suggested amendments)

(a) Notwithstanding any other law and subject to Subsection (b), a [~~A~~] credit union may engage in any activity [~~in which it could engage~~], exercise any power [~~it could exercise~~], or make any loan or investment permissible for a credit union organized under federal law or the law of another state [~~it could make, if it were operating as a federal credit union~~].

(1) A credit union that intends to engage in an activity, exercise a power or make a loan or investment authorized under Subsection (a) shall submit written notice to the commissioner describing the activity, power, loan, or investment and the specific federal or state authority upon which the credit union is relying. The credit union may proceed as described in its notice upon the expiration of 30 days following submission, unless the commissioner extends the time period in accordance with this Subsection, or prohibits the activity, power, loan or investment.

(2) The commissioner may prohibit the credit union from proceeding as described in its notice only if the commissioner finds that:

(A) specific authority does not exist; or

(B) the engagement, exercise, or making would adversely affect the safety and soundness of the credit union.

(3) The commissioner may extend the 30-day period if the commissioner reasonably determines that the credit union's notice raises issues requiring additional information or additional time for analysis. If the 30-day period is extended, the credit union may not proceed without the commissioner's prior written approval, but in any event, the commissioner must either issue an approval or prohibition letter not later than the 60th day after submission of the notice.

(b) The commission may adopt rules relating to the exercise of powers or authorities granted under this Section [~~Notwithstanding any other law, and in addition to the powers and authorities conferred under Subsection (a), a credit union has the powers of authorities of a foreign credit union operating a branch in this state if the commissioner finds that exercise of those powers or authorities is convenient for and affords an advantage to the credit union's members and maintains the fairness of competition and parity between the credit union and any foreign credit union. A credit union does not have the field of membership powers or authorities of a foreign credit union operating a branch in this state~~].

Exhibit I

NOTEWORTHY ITEMS FROM "FEDERAL PREEMPTION IN THE FINANCIAL INSTITUTIONS ARENA" TEXAS TECH UNIVERSITY SCHOOL OF LAW APRIL 19-21, 2006

1. Keith R. Fisher, *Towards a Basal Tenth Amendment: A Riposte to National Bank Preemption of State Consumer Protection Laws*, 29 Harv. J.L. & Pub. Pol'y 981 (2006) (also Presented at "Federal Preemption in the Financial Institutions Arena" Conference, Texas Tech University School of Law, April 19-21, 2006). The Tenth Amendment to the U.S. Constitution provides: "The powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectfully, or to the people." In his article, Professor Fisher suggests that the Tenth Amendment may be used to challenge the OCC's preemption rules for national banks. Because the National Bank Act does not constitute field preemption, Professor Fisher argues that a governmental agency cannot by regulation preempt state law. Comment: Professor Fisher has been hired to write an *amicus* brief to the U.S. Supreme Court in the *Wachovia Bank, N.A. v. Watters* case (431 F.3d 556 (6th Cir. 2005), *cert. granted*, 2006 U.S. LEXIS 4690 (U.S. June 19, 2006) (No. 05-1342)), in which the circuit court declared that Michigan's law requiring licensure of mortgage originators may not be applied to an operating subsidiary of national banks.

2. Stacy Anderson, *Can States Tax National Banks to Protect Consumers from Predatory Lending?: An Analysis of Preemption and Dormant Commerce Clause Limits on the Delegated Taxing Power*, Presented at "Federal Preemption in the Financial Institutions Arena" Conference, Texas Tech University School of Law, April 19-21, 2006. The paper discusses a California legislative proposal (the Consumer Protection and Anti-Interest Rate Manipulation Act, A.B. 1375, introduced in February 2005). Under 12 U.S.C. § 548, Congress has expressly provided that with respect to tax laws, national banks shall be treated as state banks organized under the laws of the state in which the bank has its principal office. Because of this express statute and because taxation is an area exempted from the reach of the OCC's preemption regulation, the bill attempts to impose a 2.5% surcharge on net income on banks and financial companies who have credit card agreements containing terms deemed inequitable to consumers as specified in the bill.