HOUSE RESEARCH ORGANIZATION bill analysis — 4/28/1999 — HB 2066 Marchant (CSHB 2066 by Averitt)

SUBJECT: Establishing interstate branch banking

COMMITTEE: Financial Institutions — committee substitute recommended

VOTE: 7 ayes — Averitt, Denny, Ehrhardt, Elkins, Marchant, Pitts, Juan Solis

0 nays

2 absent — Solomons, Grusendorf

WITNESSES: For — Karen Neeley, Independent Bankers Association of Texas; Michelle Roberts, Texas Bankers Association

Against — None

On — Catherine Ghiglieri, Texas Department of Banking; Jim Pledger, Texas Savings and Loan Department

BACKGROUND: In 1995, the Texas Legislature enacted "opt out" legislation to prohibit interstate branch banking in Texas. No Texas bank could merge with an out-of-state bank or establish a branch in another state. No out-of-state bank could establish a branch in Texas or acquire a Texas bank without establishing an in-state corporate entity with its own capital and board of directors. All banking corporations and savings and loan associations operating in Texas had to be domiciled in Texas, that is, organized under Texas law with headquarters in the state.

The "opt out" bill was permitted under the federal Riegle-Neal Interstate Banking and Branching Efficiency Act (Riegle-Neal) of 1994. All state "opt out" legislation had to be enacted before June 1, 1997. However, the federal Office of the Comptroller of the Currency (OCC) ruled that this state's "opt out" law did not meet the requirements of Reigle-Neal, and thus Texas could not prohibit the merger of state and out-of-state banks. The OCC concluded that Texas law did not apply equally to all out-of-state banks because sec. 92.401 et seq., Finance Code, specifically allowed state savings banks from other states to merge with Texas state savings banks.

Only three other states have not opted in to interstate branching under Riegle-

Neal: Kansas, Missouri, and Montana. Both Kansas and Missouri have limited branching under their state laws. Only Montana expressly prohibits any form of interstate branching.

The state ultimately lost a court challenge to the OCC decision. Beginning in May 1998, the Texas Banking Commission began accepting applications to engage in interstate branching under the federal preemption of state laws.

Shortly after enactment of Riegle-Neal, all state banking departments began working through the Conference of State Banking Supervisors (CSBS) to develop a plan for interstate branching. A guiding principle was to preserve the attractiveness of a state bank charter within the new dual banking system. The resulting CSBS "Interstate Banking and Branching Supervision Protocol" became a model for state legislatures revising laws to provide for interstate branch banking.

A Texas Interstate Branching Task Force was formed in 1998, following the failed litigation effort to retain the state's "opt out" policy. It was comprised of a group of senior staff of the Texas Department of Banking (TDB), volunteer attorneys assembled by the banking associations, and other volunteers. The group proposed legislation modeled on the CSBS protocol, modified to reflect the market in Texas.

Under current law in Texas, as modified by the federal preemption, interstate branching only can be achieved through the acquisition of a financial institution that is at least five years old. Following the acquisition, the resulting bank and its affiliates cannot hold more than 20 percent of the total deposits in the state. The federal maximum is 30 percent, but applies only if the state has not enacted its own limit. Twelve states have no minimum age requirement before a bank can be acquired, and 14 states have no deposit cap.

"De novo" branching — simply opening a new bank as an branch of an out-of-state bank — is not permitted in Texas, and 38 other states also prohibit this means of entry into their banking markets.

Because Texas prohibits de novo branching, Texas banks can establish de novo branches in other states only if they have no reciprocity requirement. As of January, there were 10 such states (Maine, Maryland, Massachusetts, Michigan, Nevada, North Carolina, Ohio, Pennsylvania, Virginia, and West

Virginia). As a practical matter, few banks would enter another state without first acquiring another institution's assets.

The federal preemption of the state's "opt out" laws has created confusion regarding a number of fairly routine transactions, all of which were authorized in statute at a time when all financial institutions doing business in Texas were domiciled in Texas.

One example is inconsistency in state laws regarding the deposit of public funds since the advent of interstate branching. While state funds may be deposited by the Comptroller in banks "doing business" in the state, school districts are required to deposit funds in banks "domiciled" in the state. Other public funds may be deposited in banks "located" in the state. Prior to 1998, all of these laws referred to the same set of financial institutions, so the lack of consistency in requirements was not an issue. Today, some public funds can be thought of as being deposited incorrectly in interstate branches.

A second example involves the treatment of trust companies with respect to branching into Texas. Under Riegle-Neal, current state law could be interpreted to allow a de novo branch of an out-of-state trust company while prohibiting it for a bank. Another example involving trusts involves the location (situs) of administration for probate purposes. Before interstate branching, the situs of administration and the trust's principal office were the same physical location. Under Riegle-Neal, a trust's principal office can be located in another state, but state law still requires a situs of administration to be in Texas.

DIGEST:

CSHB 2066 would permit interstate branch banking in conformity with the federal preemption mandating interstate branch banking by making numerous amendments to the Finance Code and other laws. The bill specifically states that it is legislative intent not to discriminate against out-of-state banks and bank holding companies.

Entry into the state would be permitted by the acquisition of an existing branch or bank, the merger of banks or bank holding companies, and the establishment of de novo branches. The bill retains the state's current policy that a bank or bank holding company cannot possess more than 20 percent of the state's deposits and cannot acquire a bank that has not been operating at least five years. The deposit concentration provision also would be applied to

intrastate acquisitions. The bill would establish that an out-of-state bank may establish a de novo branch in Texas if its home state laws would permit a Texas bank to establish a de novo branch there.

The bill would provide a "super parity" provision, to be codified as sec. 32.010, Finance Code, that would allow a Texas bank to perform an act, own property, or offer a product or service that is permitted for any domestic depository institution by the laws of any state or federal law. However, "super parity" could not be used to circumvent certain state laws, including those regarding branching limitations, the sale of insurance products, interest rate restrictions, fiduciary obligations, and consumer protection.

The banking commissioner would have regulatory authority over banks' intentions to utilize "super parity," and the commissioner could prohibit a bank from exercising this power if specific authority for it did not exist, federal law preempted its use, or it would adversely affect the soundness of the bank.

The bill would add a new chapter 9 to the Texas Trust Company Act (art. 342a-1.001 et seq., VTCS) to implement interstate expansion for trust companies. An out-of-state trust company would be allowed to conduct business in this state at an office, other than a bank branch, under rules to be issued by the banking commissioner. The bill would stipulate that these trust companies are subject to the franchise tax, as well as to minimum capital and other regulatory standards applicable to state trust companies. As for bank branches, the bill would establish a de novo reciprocity policy, and acquisitions of Texas trust companies would be subject to similar requirements as banks.

The bill would broaden requirements that all out-of-state financial institutions register with the Secretary of State, which would have to qualify them to do business in Texas. It would allow state banks and other domestic institutions to designate a registered agent to expedite the service of process. The bill would establish a fee schedule for these designations. The bill would authorize a state bank to act as an agent for another depository institution without regard to whether the state bank was an affiliate or otherwise related to the other institution.

The bill would provide for issues regarding public deposits under interstate

branching. It would amend various sections of statutes to authorize the deposit of state, school district, local government, and other public funds with branches of banks located in the state, in addition to banks domiciled here.

The bill would allow the sale of a trust department to another financial institution and provide for fiduciary substitution by operation of law. The bill would override provisions in older wills and trusts that require a "national bank domiciled" in this state as trustee or executor. However, the bill would still enforce locale requirements of a will or trust, including the location of the principal office and the type of financial institution.

The bill contains detailed provisions for the operation of foreign banks in Texas. It would eliminate geographic limits and net worth size requirements for state branches of foreign banks. The bill would adopt procedures consistent with the federal International Banking Act of 1978, which allows foreign banks to accept uninsured deposits. However, state branches of foreign banks would not be able to accept U.S. deposits of less than $100,000 and foreign bank agencies could not accept U.S. deposits at all. A foreign bank agency could be upgraded to a branch under the new state law.

The bill would enable the banking commissioner to coordinate and share information with other states' bank supervisory and regulatory agencies and organizations. The banking commissioner would be authorized to take enforcement action against any bank holding company, trust company, or foreign bank violating Texas law or operating in an unsafe, unsound manner as if it were a Texas bank. The commissioner would notify and consult with the regulators in that bank's home territory. The banking commissioner would be allowed to conduct examinations and require periodic reports from out-of-state banks to determine whether they are being operated in a safe, sound manner in accordance with Texas law.

The bill would subject all banks operating in Texas to state franchise taxes, regardless of where the banks are domiciled.

The bill would provide a transition period for certain branches of interstate banks to file required reports, extending the deadline for those reports to January 1, 2000.

The bill would take effect on September 1, 1999.

SUPPORTERS SAY:

The banking industry in Texas needs legislative action to set the parameters for branch banking because the federal government has preempted the state's opt out legislation that was intended to prohibit interstate branching here. Texas has lost a court challenge to the preemption, and state law now must be changed to deal with the new interstate banking environment.

State laws must be revised to conform to the federal mandate, and to assure the certainty of deposits, insurance, trusts, public fund investment decisions, probate procedures, and civil practices. CSHB 2066 would provide a framework for interstate branch banking that is acceptable to all interested parties.

CSHB 2066 would preserve the attractiveness of a state charter while it implements federal requirements to accommodate to interstate branching. The bill would maintain the deposit concentration limit, the minimum age limit, and the de novo reciprocity requirements for banks entering the state. It also would include a necessary provision to protect state banks' ability to compete favorably with out-of-state institutions called "super parity." The bill would limit the powers of all institutions under super parity to keep banks from circumventing usury laws, fiduciary obligation requirements, taxes and fees, regulatory decisions, and consumer protection laws.

The bill would protect consumer expectations that the executor of a trust, if a bank or other financial institution, would continue to operate locally even if an institution is acquired by, or merged with, an out-of-state bank. Such a requirement is not counter to an interstate branching environment and would fulfill the wishes and expectations of trust beneficiaries.

The bill would conform state laws with federal statutes regarding entry of a foreign bank branch into Texas. Most foreign banks operating in the United States are engaged in so-called "wholesale banking" and are located in New York, Chicago, Los Angeles, and Miami. None of these states permit de novo branching, making it very difficult for a foreign bank to branch here by this means. Foreign banks could enter via acquisition, but it is unlikely that a foreign bank would buy a domestic branch, strip its commercial and retail operations, and use it for these wholesale activities.

The new registered agent provisions are desirable for all financial institutions because it would allow judgment creditors and financial institutions to serve

and service writs of garnishment and other collection remedies.

OPPONENTS SAY: No apparent opposition.

NOTES: The substitute makes several minor, technical changes to the original.

The companion bill, SB 861 by Fraser, was reported favorably as substituted by the Senate Economic Development Committee on April 9.

HB 2067 by Marchant, which would subject all banks and other financial institutions operating in this state to the franchise tax, passed the House on April 21 and has been referred to the Senate Finance Committee.