

COMPLIANCE CONFUSION: STATE VS. FEDERAL CREDIT UNIONS

Credit Union Myth #1:

We are a federally chartered credit union, so we don't have to follow state law.

Credit Union Myth #2:

We are a state-chartered credit union, so we don't have to follow NCUA regulations.

You thought it was that easy? Of course it isn't that easy! This is the complicated world of compliance.

Let us clear up a few things...

- 1) As a federal credit union, you DO have to follow MANY state laws; and
- 2) As a state-chartered credit union, you DO have to follow MANY NCUA regulations.

Federal Credit Unions

State laws DO affect you! You are NOT exempt from all state law. Many FCUs think that the Federal Credit Union Act (FCUA) and NCUA regulations preempt state law, thereby making FCUs exempt from *all* state laws. That is an incorrect statement. The FCUA and NCUA regulations do, in fact, preempt state law in a few limited areas; however, they *do not exempt FCUs from all state laws*.

Federal preemption refers to the invalidation of state law when it conflicts with federal law. Express preemption occurs when a federal statute explicitly confirms Congress' intent to preempt state law. Preemption can also occur absent express Congressional intent when state law conflicts with federal law. Our discussion below deals primarily with areas of federal credit union law that expressly preempt state law. Please keep in mind it is possible that preemption in other areas could occur due to a conflict of the wording of a state statute.

Federal Preemption on Lending

Section 701.21(b)(1) of NCUA regulations (Loans to Members and Lines of Credit to Members) discusses NCUA's preemption powers regarding lending. Specifically, the regulation details that NCUA's authority preempts any state law purporting to limit or affect:

1. Rates of interest and amounts of finance charges, including:
 - a. The frequency or the increments by which a variable interest rate may be changed;

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- b. The index to which a variable interest rate may be tied;
 - c. The manner or timing of notifying the borrower of a change in interest rate;
 - d. The authority to increase the interest rate on an existing balance;
 - e. Late charges; and
 - f. Closing costs, application, origination, or other fees.
2. Terms of repayment, including:
 - a. The maturity of loans and lines of credit;
 - b. The amount, uniformity, and frequency of payments, including the accrual of unpaid interest if payments are insufficient to pay all interest due;
 - c. Balloon payments; and
 - d. Prepayment limits.
 3. Conditions related to:
 - a. The amount of the loan or line of credit;
 - b. The purpose of the loan or line of credit;
 - c. The type or amount of security and the relation of the value of the security to the amount of the loan or line of credit;
 - d. Eligible borrowers; and
 - e. The imposition and enforcement of liens on the shares of borrowers and accommodation parties.

What lending matters are NOT preempted? Just about everything else having to do with lending.

NCUA's rule 701.21 clarifies that it is not NCUA's intent to preempt state laws that do not affect rates, terms of repayment and other conditions described above concerning loans and lines of credit. For example, NCUA rules do not preempt state laws on the following issues (in other words, FCUs need to comply with these state laws):

1. Insurance laws (Texas Insurance Code);
2. Laws related to transfer of and security interests in real and personal property (except for due-on-sale clauses) (Texas Business and Commerce Code Chapter 9/Secured Transactions; Texas Constitution Article 16, Sec 50 dealing with the homestead, home equity loans, home improvement loans, etc.);
3. Conditions related to:
 - a. Collection costs and attorneys' fees;
 - b. Requirements that consumer lending documents be in "plain language"; and
 - c. The circumstances in which a borrower may be declared in default and may cure default.

The rule also states that it is not NCUA's intent to preempt state laws affecting aspects of credit transactions that are primarily regulated by federal law other than the Federal Credit Union Act, for example, state laws concerning credit cost disclosure requirements, credit discrimination, credit reporting practices, unfair credit practices, and debt collection practices. Applicability of

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state law in these instances should be determined pursuant to the preemption standards of the relevant federal law and regulations.

Federal Preemption on Accounts

701.35 of NCUA's regulations (Share, Share Draft, and Share Certificate Accounts) discusses NCUA's preemption of state law on account matters. Specifically, it preempts state law attempting to regulate the types of fees or charges and other matters affecting the "opening, maintaining, and closing of a share, share draft, or share certificate account." NCUA legal opinions further explain NCUA's position that state laws attempting to govern account fees and charges, including inactive or dormant accounts, are preempted. So yes, FCUs ARE exempt from the Texas Property Code section prohibiting the assessment of fees on inactive accounts. FCUs are also exempt from the Texas Business Code section prohibiting the imposition of a fee for cashing a check.

However, FCUs ARE subject to other state laws dealing with accounts such as Texas Business & Commerce Code Chapters 3 & 4 dealing with negotiable instruments (checks) and bank deposits and collections.

Federal Preemption on Taxation

Section 122 of the FCU Act, 12 U.S.C. §1768, exempts FCUs from all federal, state, and local taxes except for nondiscriminatory taxes on real property and tangible personal property. Also, FCUs, as federal instrumentalities, have the same immunity from state and local taxes as the United States government. While FCUs are generally exempt from taxes, these exemptions do not apply when a state imposes the tax on a seller or vendor who passes the cost of the tax on to the federal instrumentality that purchases the goods or service.

Therefore, FCUs are exempt from Texas sales and use taxes. However, FCUs are NOT exempt from all state taxation. As stated above, FCUs may be subject to taxes on real property and tangible personal property.

An Overview of State Law Areas that Apply to FCUs

This is not an exhaustive list, but here is a sampling of many state laws with which FCUs must comply:

1. Texas Constitution
 - a. Prohibition on Lotteries/raffles
 - b. Home equity, Home improvement, Reverse Mortgages, etc.
2. Texas Business & Commerce Code
 - a. Chapter 2, UCC Sales
 - b. Chapter 3 & 4, Law of Checks
 - c. Chapter 17, Deceptive Trade Practices
 - d. Title 11, Personal Identifying Information (Protection of private information, Identity theft, etc)

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3. Business Organizations Code
 - a. Chapter 22 Non-profit Corporations
 - b. Various other business structure laws if engaged in CUSOs, etc.
4. Texas Family Code
 - a. Child Support Liens and Levies
5. Texas Finance Code
 - a. Chapter 59, Safe Deposit Boxes, ATM Safety Requirements
 - b. Chapter 391, Furnishing False Credit Information
 - c. Chapter 392, Debt Collection
6. Texas Human Resource Code
 - a. Reporting of Suspected Elder Exploitation
7. Texas Insurance Code
 - a. Automobile Insurance
 - b. Homeowners Insurance
 - c. Title Insurance
 - d. Health, Life, Group Life Insurance
 - e. Unemployment Insurance
8. Texas Labor Code
 - a. Wage, Discrimination, Unemployment, Workers Compensation, Employee Benefits, etc.
9. Texas Occupations Code
 - a. Charitable Raffles
10. Texas Penal Code
 - a. Prohibition on Gambling, Lotteries, Raffles, etc.
 - b. Fraud, Embezzlement, etc.
11. Texas Probate Code
 - a. Chapter XI, Non-testamentary Transfers and Account Card Issues Such as Ownership and Survivorship
 - b. Deceased Member Issues (Administration of Estates, Alternatives to Probate)
 - c. Chapter XII, Powers of Attorney
 - d. Chapter XIII, Guardianship
12. Texas Property Code
 - a. Title 5, Exempt Property and Liens, Foreclosures
 - b. Title 6, Unclaimed Property
 - c. Mechanics liens
 - d. Chapter 141, Transfers to Minors
13. Texas Tax Code
 - a. Real Property Taxes, Tangible Personal Property Taxes
14. Texas Transportation Code
 - a. Chapter 501, Certificate of Title Act/Electronic Lien Titling
 - b. Chapter 502 Registration of Motor Vehicles

State-Chartered Credit Unions

Most SCUs know that they are subject to myriad federal laws and regulations. However, there is sometimes confusion regarding which NCUA regulations apply to SCUs. The issue can be a little confusing, but a good “cheat sheet” is the table of contents in NCUA’s Regulations Manual (<http://www.ncua.gov/Legal/Documents/NCUARegulationsManual.pdf>). The manual itself is not always up to date with the latest revisions, but the table of contents is still a good guide as to which sections apply to federally insured state-chartered credit unions as well as FCUs. Such sections are marked with an asterisk and include:

1. Part 702, Prompt Corrective Action
2. Part 704, Corporate Credit Unions
3. Part 705, Community Development Revolving Loan Program for Credit Unions
4. Part 707, Truth in Savings
5. Part 709, Involuntary Liquidation of Federal Credit Unions and Adjudication of Creditor Claims Involving Federal Insured Credit Unions in Liquidation
6. Part 711, Management Official Interlocks
7. Part 716, Privacy of Consumer Financial Information
8. Part 722, Appraisals
9. Part 723, Member Business Loans (although TX has an exception and can follow the Texas Credit Union Department MBL rules approved by NCUA)
10. Part 724, Central Liquidity Facility
11. Part 740, Accuracy of Advertising and Notice of Insured Status
12. Part 741, Requirements for Insurance
13. Part 745, Share Insurance
14. Part 747, Administrative Actions, Adjudicative Hearings, Rules of Practice and Procedure, and Investigations
15. Part 760, Loans in Areas Having Special Flood Hazards

Any questions? Call the Compliance Hounds at TCUL’s Information Central at (800) 442-5762 x8515.