TEXAS DEPARTMENT OF BANKING

Bank & Trust
Law and Guidance Manual
Binder Edition

2016

Select Provisions of the

Texas Finance Code
Texas Administrative Code
Select Legal Opinions
Supervisory Memorandums
Regulatory Guidances

BANK & TRUST LAW AND GUIDANCE MANUAL
BINDER EDITION

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MISSION STATEMENT

THE FINANCE COMMISSION OF TEXAS

The mission of the Finance Commission of Texas is to ensure that the banks, savings institutions, consumer credit grantors, and other regulated entities chartered or licensed under state law operate as sound and responsible institutions that enhance the financial well-being of the citizens of Texas.

The Finance Commission of Texas is the "oversight body" for the Texas Department of Banking, the Texas Department of Savings and Mortgage Lending, and the Office of Consumer Credit Commissioner. As such, it is the policy making body of these agencies. These three agencies are housed in the State Finance Commission Building at 2601 North Lamar Boulevard, Austin, Texas 78705. The Commission appoints and employs the commissioners at will as the chief executive officers of the three agencies; approves departmental budgets; researches various aspects of the availability, quality, and prices of financial services in Texas, and reports to the Legislature; and adopts rules and general policies for the entities supervised by the three agencies.

The Finance Commission of Texas is a board of private citizens appointed by and responsible to the Governor of Texas, subject to Senate confirmation. The composition of the Commission includes:

- two state bankers,
- one state savings executive,
- one consumer credit executive,
- one residential mortgage loan originator, and
- six public members, one of whom must be a certified public accountant.

Members serve overlapping, six-year terms; members with expired appointments continue serving until their replacements are named. The Governor appoints the presiding officer, currently William White, a credit consumer executive from Georgetown, Texas. The Commission is required to meet at least six times annually. All meetings are subject to the Open Meetings Act and are generally posted seven days in advance in the *Texas Register* at http://www.sos.state.tx.us.

The Finance Commission of Texas has three standing committees: Audit Committee, Study Committee and Strategic Planning Committee. The Audit Committee receives and acts on reports prepared by the Commission's internal auditor (currently an external CPA firm). The Study Committee provides direction and guidance concerning studies about consumer credit, small business, financial services along with researching high cost mortgage lending in Texas. The Strategic Planning Committee oversees the direction and scope of the agencies strategic planning. Commissioner Charles G. Cooper, Texas Department of Banking, was appointed to serve as the Executive Director effective May 1, 2014.

You may reach the Finance Commission members by corresponding with the Commission's headquarters office, or by contacting the Executive Director, both at 2601 N. Lamar, Austin, Texas 78705, (512) 936-6222, or by email at finance.commission@fc.texas.gov. The Finance Commission’s web site is http://www.fc.texas.gov.

MISSION STATEMENT

THE TEXAS DEPARTMENT OF BANKING

The mission of the Texas Department of Banking is to ensure Texas has a safe, sound and competitive financial services system.

The Department of Banking regulates all state-chartered banks, with authority to meet its responsibility for maintaining a sound banking system. Methods used include several types of on- and off-site examinations, meetings with bank officers and boards of directors, and problem-monitoring techniques. The most common form of supervision is the on-site examination, which determines the amount and soundness of a bank's capital funds, the quality of its assets and management practices, and the level and stability of its earnings and liquidity.

In addition to bank supervision, the Department regulates all trust companies, money services businesses, prepaid funeral benefits contract sellers and perpetual care cemeteries. The Department also registers private child support enforcement agencies.

The Department is authorized to employ 205 employees and maintains regional offices in Houston, Dallas, San Antonio, and Lubbock in addition to its headquarters in Austin.

CONSTITUTION OF THE STATE OF TEXAS 1876
ARTICLE XVI. GENERAL PROVISIONS

SELECT SECTIONS

SECTION 16. CORPORATIONS WITH BANKING AND DISCOUNTING PRIVILEGES

Sec. 16. Corporations with Banking and Discounting Privileges.

(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.

No state bank shall be chartered until all of the authorized capital stock has been subscribed and paid in full in cash. Except as may be permitted by the Legislature pursuant to Subsections (b), (d), and (e) of this Section 16, a state bank shall not be authorized to engage in business at more than one place which shall be designated in its charter; however, this restriction shall not apply to any other type of financial institution chartered under the laws of this state.

No foreign corporation, other than the national banks of the United States domiciled in this State, shall be permitted to exercise banking or discounting privileges in this State.

(b) If it finds that the convenience of the public will be served thereby, the Legislature may authorize State and national banks to establish and operate unmanned teller machines within the county or city of their domicile. Such machines may perform all banking functions. Banks which are domiciled within a city lying in two or more counties may be permitted to establish and operate unmanned teller machines within both the city and the county of their domicile. The Legislature shall provide that a bank shall have the right to share in the use of these teller machines, not situated at a banking house, which are located within the county or the city of the bank's domicile, on a reasonable, nondiscriminatory basis, consistent with anti-trust laws. Banks may share the use of such machines within the county or city of their domicile with savings and loan associations and credit unions which are domiciled in the same county or city.

(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.

(d) The Legislature may authorize a state bank or national bank of the United States domiciled in this State to engage in business at more than one place if it does so through the purchase and assumption of certain assets and liabilities of a failed state bank or a failed national bank of the United States domiciled in this State.

(e) The Legislature shall authorize a state bank or national bank of the United States domiciled in this State to establish and operate banking facilities at locations within the county or city of its domicile, subject to limitations the Legislature imposes. The Legislature may permit a bank domiciled within a city located in two or more counties to establish and operate branches within both the city and the county of its domicile, subject to limitations the Legislature imposes.

(f) A bank may not be considered a branch or facility of another bank solely because it is owned or controlled by the same stockholders as the other bank, has common accounting and administrative systems with the other bank, or has a name similar to the other bank's or because of a combination of those factors.

(Amended Nov. 8, 1904, and Aug. 23, 1937; Subsecs. (a) and (b) amended Nov. 4, 1980; Subsec. (c) added Nov. 6, 1984; Subsecs. (a) and (c) amended and (d)-(f) added Nov. 4, 1986.)

SECTION 50. HOMESTEAD; PROTECTION FROM FORCED SALE; MORTGAGES, TRUST DEEDS, AND LIENS

Sec. 50. Homestead; Protection From Forced Sale; Mortgages, Trust Deeds, and Liens.

(a) The homestead of a family, or of a single adult person, shall be, and is hereby protected from forced sale, for the payment of all debts except for:

(1) the purchase money thereof, or a part of such purchase money;

(2) the taxes due thereon;

(3) an owelty of partition imposed against the entirety of the property by a court order or by a written agreement of the parties to the partition, including a debt of one spouse in favor of the other spouse resulting from a division or an award of a family homestead in a divorce proceeding;

(4) the refinance of a lien against a homestead, including a federal tax lien resulting from the tax debt of both spouses, if the homestead is a family homestead, or from the tax debt of the owner;

(5) work and material used in constructing new improvements thereon, if contracted for in writing, or work and material used to repair or renovate existing improvements thereon if:

(A) the work and material are contracted for in writing, with the consent of both spouses, in the case of a family homestead, given in the same manner as is required in making a sale and conveyance of the homestead;

(B) the contract for the work and material is not executed by the owner or the owner's spouse before the fifth day after the owner makes written application for any extension of credit for the work and material, unless the work and material are necessary to complete immediate repairs to conditions on the homestead property that materially affect the health or safety of the owner or person residing in the homestead and the owner of the homestead acknowledges such in writing;

(C) the contract for the work and material expressly provides that the owner may rescind the contract without penalty or charge within three days after the execution of the contract by all parties, unless the work and material are necessary to complete immediate repairs to conditions on the homestead property that materially affect the health or safety of the owner or person residing in the homestead and the owner of the homestead acknowledges such in writing; and

(D) the contract for the work and material is executed by the owner and the owner's spouse only at the office of a third-party lender making an extension of credit for the work and material, an attorney at law, or a title company;

(6) an extension of credit that:

(A) is secured by a voluntary lien on the homestead created under a written agreement with the consent of each owner and each owner's spouse;

(B) is of a principal amount that when added to the aggregate total of the outstanding principal balances of all other indebtedness secured by valid encumbrances of record against the homestead does not exceed 80 percent of the fair market value of the homestead on the date the extension of credit is made;

(C) is without recourse for personal liability against each owner and the spouse of each owner, unless the owner or spouse obtained the extension of credit by actual fraud;

(D) is secured by a lien that may be foreclosed upon only by a court order;

(E) does not require the owner or the owner's spouse to pay, in addition to any interest, fees to any person that are necessary to originate, evaluate, maintain, record, insure, or service the extension of credit that exceed, in the aggregate, three percent of the original principal amount of the extension of credit;

(F) is not a form of open-end account that may be debited from time to time or under which credit may be extended from time to time unless the open-end account is a home equity line of credit;

(G) is payable in advance without penalty or other charge;

(H) is not secured by any additional real or personal property other than the homestead;

(I) is not secured by homestead property that on the date of closing is designated for agricultural use as provided by statutes governing property tax, unless such homestead property is used primarily for the production of milk;

(J) may not be accelerated because of a decrease in the market value of the homestead or because of the owner's default under other indebtedness not secured by a prior valid encumbrance against the homestead;

(K) is the only debt secured by the homestead at the time the extension of credit is made unless the other debt was made for a purpose described by Subsections (a)(1)-(a)(5) or Subsection (a)(8) of this section;

(L) is scheduled to be repaid:

(i) in substantially equal successive periodic installments, not more often than every 14 days and not less often than monthly, beginning no later than two months from the date the extension of credit is made, each of which equals or exceeds the amount of accrued interest as of the date of the scheduled installment; or

(ii) if the extension of credit is a home equity line of credit, in periodic payments described under Subsection (t)(8) of this section;

(M) is closed not before:

(i) the 12th day after the later of the date that the owner of the homestead submits a loan application to the lender for the extension of credit or the date that the lender provides the owner a copy of the notice prescribed by Subsection (g) of this section;

(ii) one business day after the date that the owner of the homestead receives a copy of the loan application if not previously provided and a final itemized disclosure of the actual fees, points, interest, costs, and charges that will be charged at closing. If a bona fide emergency or another good cause exists and the lender obtains the written consent of the owner, the lender may provide the documentation to the owner or the lender may modify previously provided documentation on the date of closing; and

(iii) the first anniversary of the closing date of any other extension of credit described by Subsection (a)(6) of this section secured by the same homestead property, except a refinance described by Paragraph (Q)(x)(f) of this subdivision, unless the owner on oath requests an earlier closing due to a state of emergency that:

(a) has been declared by the president of the United States or the governor as provided by law; and

(b) applies to the area where the homestead is located;

(N) is closed only at the office of the lender, an attorney at law, or a title company;

(O) permits a lender to contract for and receive any fixed or variable rate of interest authorized under statute;

(P) is made by one of the following that has not been found by a federal regulatory agency to have engaged in the practice of refusing to make loans because the applicants for the loans reside or the property proposed to secure the loans is located in a certain area:

(i) a bank, savings and loan association, savings bank, or credit union doing business under the laws of this state or the United States;

(ii) a federally chartered lending instrumentality or a person approved as a mortgagee by the United States government to make federally insured loans;

(iii) a person licensed to make regulated loans, as provided by statute of this state;

(iv) a person who sold the homestead property to the current owner and who provided all or part of the financing for the purchase;

(v) a person who is related to the homestead property owner within the second degree of affinity or consanguinity; or

(vi) a person regulated by this state as a mortgage broker; and

(Q) is made on the condition that:

(i) the owner of the homestead is not required to apply the proceeds of the extension of credit to repay another debt except debt secured by the homestead or debt to another lender;

(ii) the owner of the homestead not assign wages as security for the extension of credit;

(iii) the owner of the homestead not sign any instrument in which blanks relating to substantive terms of agreement are left to be filled in;

(iv) the owner of the homestead not sign a confession of judgment or power of attorney to the lender or to a third person to confess judgment or to appear for the owner in a judicial proceeding;

(v) at the time the extension of credit is made, the owner of the homestead shall receive a copy of the final loan application and all executed documents signed by the owner at closing related to the extension of credit;

(vi) the security instruments securing the extension of credit contain a disclosure that the extension of credit is the type of credit defined by Section 50(a)(6), Article XVI, Texas Constitution;

(vii) within a reasonable time after termination and full payment of the extension of credit, the lender cancel and return the promissory note to the owner of the homestead and give the owner, in recordable form, a release of the lien securing the extension of credit or a copy of an endorsement and assignment of the lien to a lender that is refinancing the extension of credit;

(viii) the owner of the homestead and any spouse of the owner may, within three days after the extension of credit is made, rescind the extension of credit without penalty or charge;

(ix) the owner of the homestead and the lender sign a written acknowledgment as to the fair market value of the homestead property on the date the extension of credit is made;

(x) except as provided by Subparagraph (xi) of this paragraph, the lender or any holder of the note for the extension of credit shall forfeit all principal and interest of the extension of credit if the lender or holder fails to comply with the lender's or holder's obligations under the extension of credit and fails to correct the failure to comply not later than the 60th day after the date the lender or holder is notified by the borrower of the lender's failure to comply by:

(a) paying to the owner an amount equal to any overcharge paid by the owner under or related to the extension of credit if the owner has paid an amount that exceeds an amount stated in the applicable Paragraph (E), (G), or (O) of this subdivision;

(b) sending the owner a written acknowledgement that the lien is valid only in the amount that the extension of credit does not exceed the percentage described by Paragraph (B) of this subdivision, if applicable, or is not secured by property described under Paragraph (H) or (I) of this subdivision, if applicable;

(c) sending the owner a written notice modifying any other amount, percentage, term, or other provision prohibited by this section to a permitted amount, percentage, term, or other provision and adjusting the account of the borrower to ensure that the borrower is not required to pay more than an amount permitted by this section and is not subject to any other term or provision prohibited by this section;

(d) delivering the required documents to the borrower if the lender fails to comply with Subparagraph (v) of this paragraph or obtaining the appropriate signatures if the lender fails to comply with Subparagraph (ix) of this paragraph;

(e) sending the owner a written acknowledgement, if the failure to comply is prohibited by Paragraph (K) of this subdivision, that the accrual of interest and all of the owner's obligations under the extension of credit are abated while any prior lien prohibited under Paragraph (K) remains secured by the homestead; or

(f) if the failure to comply cannot be cured under Subparagraphs (x)(a)-(e) of this paragraph, curing the failure to comply by a refund or credit to the owner of $1,000 and offering the owner the right to refinance the extension of credit with the lender or holder for the remaining term of the loan at no cost to the owner on the same terms, including interest, as the original extension of credit with any modifications necessary to comply with this section or on terms on which the owner and the lender or holder otherwise agree that comply with this section; and

(xi) the lender or any holder of the note for the extension of credit shall forfeit all principal and interest of the extension of credit if the extension of credit is made by a person other than a person described under Paragraph (P) of this subdivision or if the lien was not created under a written agreement with the consent of each owner and each owner's spouse, unless each owner and each owner's spouse who did not initially consent subsequently consents;

(7) a reverse mortgage; or

(8) the conversion and refinance of a personal property lien secured by a manufactured home to a lien on real property, including the refinance of the

purchase price of the manufactured home, the cost of installing the manufactured home on the real property, and the refinance of the purchase price of the real property.

(b) An owner or claimant of the property claimed as homestead may not sell or abandon the homestead without the consent of each owner and the spouse of each owner, given in such manner as may be prescribed by law.

(c) No mortgage, trust deed, or other lien on the homestead shall ever be valid unless it secures a debt described by this section, whether such mortgage, trust deed, or other lien, shall have been created by the owner alone, or together with his or her spouse, in case the owner is married. All pretended sales of the homestead involving any condition of defeasance shall be void.

(d) A purchaser or lender for value without actual knowledge may conclusively rely on an affidavit that designates other property as the homestead of the affiant and that states that the property to be conveyed or encumbered is not the homestead of the affiant.

(e) A refinance of debt secured by a homestead and described by any subsection under Subsections (a)(1)-(a)(5) that includes the advance of additional funds may not be secured by a valid lien against the homestead unless:

(1) the refinance of the debt is an extension of credit described by Subsection (a)(6) of this section; or

(2) the advance of all the additional funds is for reasonable costs necessary to refinance such debt or for a purpose described by Subsection (a)(2), (a)(3), or (a)(5) of this section.

(f) A refinance of debt secured by the homestead, any portion of which is an extension of credit described by Subsection (a)(6) of this section, may not be secured by a valid lien against the homestead unless the refinance of the debt is an extension of credit described by Subsection (a)(6) or (a)(7) of this section.

(g) An extension of credit described by Subsection (a)(6) of this section may be secured by a valid lien against homestead property if the extension of credit is not closed before the 12th day after the lender provides the owner with the following written notice on a separate instrument:

"NOTICE CONCERNING EXTENSIONS OF CREDIT DEFINED BY SECTION 50(a)(6), ARTICLE XVI, TEXAS CONSTITUTION:

"SECTION 50(a)(6), ARTICLE XVI, OF THE TEXAS CONSTITUTION ALLOWS CERTAIN LOANS TO BE SECURED AGAINST THE EQUITY IN YOUR HOME. SUCH LOANS ARE COMMONLY KNOWN AS EQUITY LOANS. IF YOU DO NOT REPAY THE LOAN OR IF YOU FAIL TO MEET THE TERMS OF THE LOAN, THE LENDER MAY FORECLOSE AND SELL YOUR HOME. THE CONSTITUTION PROVIDES THAT:

"(A) THE LOAN MUST BE VOLUNTARILY CREATED WITH THE CONSENT OF EACH OWNER OF YOUR HOME AND EACH OWNER'S SPOUSE;

"(B) THE PRINCIPAL LOAN AMOUNT AT THE TIME THE LOAN IS MADE MUST NOT EXCEED AN AMOUNT THAT, WHEN ADDED TO THE PRINCIPAL BALANCES OF ALL OTHER LIENS AGAINST YOUR HOME, IS MORE THAN 80 PERCENT OF THE FAIR MARKET VALUE OF YOUR HOME;

"(C) THE LOAN MUST BE WITHOUT RECOURSE FOR PERSONAL LIABILITY AGAINST YOU AND YOUR SPOUSE UNLESS YOU OR YOUR SPOUSE OBTAINED THIS EXTENSION OF CREDIT BY ACTUAL FRAUD;

"(D) THE LIEN SECURING THE LOAN MAY BE FORECLOSED UPON ONLY WITH A COURT ORDER;

"(E) FEES AND CHARGES TO MAKE THE LOAN MAY NOT EXCEED 3 PERCENT OF THE LOAN AMOUNT;

"(F) THE LOAN MAY NOT BE AN OPEN-END ACCOUNT THAT MAY BE DEBITED FROM TIME TO TIME OR UNDER WHICH CREDIT MAY BE EXTENDED FROM TIME TO TIME UNLESS IT IS A HOME EQUITY LINE OF CREDIT;

"(G) YOU MAY PREPAY THE LOAN WITHOUT PENALTY OR CHARGE;

"(H) NO ADDITIONAL COLLATERAL MAY BE SECURITY FOR THE LOAN;

"(I) THE LOAN MAY NOT BE SECURED BY HOMESTEAD PROPERTY THAT IS DESIGNATED FOR AGRICULTURAL USE AS OF THE DATE OF CLOSING, UNLESS THE

AGRICULTURAL HOMESTEAD PROPERTY IS USED PRIMARILY FOR THE PRODUCTION OF MILK;

"(J) YOU ARE NOT REQUIRED TO REPAY THE LOAN EARLIER THAN AGREED SOLELY BECAUSE THE FAIR MARKET VALUE OF YOUR HOME DECREASES OR BECAUSE YOU DEFAULT ON ANOTHER LOAN THAT IS NOT SECURED BY YOUR HOME;

"(K) ONLY ONE LOAN DESCRIBED BY SECTION 50(a)(6), ARTICLE XVI, OF THE TEXAS CONSTITUTION MAY BE SECURED WITH YOUR HOME AT ANY GIVEN TIME;

"(L) THE LOAN MUST BE SCHEDULED TO BE REPAID IN PAYMENTS THAT EQUAL OR EXCEED THE AMOUNT OF ACCRUED INTEREST FOR EACH PAYMENT PERIOD;

"(M) THE LOAN MAY NOT CLOSE BEFORE 12 DAYS AFTER YOU SUBMIT A LOAN APPLICATION TO THE LENDER OR BEFORE 12 DAYS AFTER YOU RECEIVE THIS NOTICE, WHICHEVER DATE IS LATER; AND MAY NOT WITHOUT YOUR CONSENT CLOSE BEFORE ONE BUSINESS DAY AFTER THE DATE ON WHICH YOU RECEIVE A COPY OF YOUR LOAN APPLICATION IF NOT PREVIOUSLY PROVIDED AND A FINAL ITEMIZED DISCLOSURE OF THE ACTUAL FEES, POINTS, INTEREST, COSTS, AND CHARGES THAT WILL BE CHARGED AT CLOSING; AND IF YOUR HOME WAS SECURITY FOR THE SAME TYPE OF LOAN WITHIN THE PAST YEAR, A NEW LOAN SECURED BY THE SAME PROPERTY MAY NOT CLOSE BEFORE ONE YEAR HAS PASSED FROM THE CLOSING DATE OF THE OTHER LOAN, UNLESS ON OATH YOU REQUEST AN EARLIER CLOSING DUE TO A DECLARED STATE OF EMERGENCY;

"(N) THE LOAN MAY CLOSE ONLY AT THE OFFICE OF THE LENDER, TITLE COMPANY, OR AN ATTORNEY AT LAW;

"(O) THE LENDER MAY CHARGE ANY FIXED OR VARIABLE RATE OF INTEREST AUTHORIZED BY STATUTE;

"(P) ONLY A LAWFULLY AUTHORIZED LENDER MAY MAKE LOANS DESCRIBED BY SECTION 50(a)(6), ARTICLE XVI, OF THE TEXAS CONSTITUTION;

"(Q) LOANS DESCRIBED BY SECTION 50(a)(6), ARTICLE XVI, OF THE TEXAS CONSTITUTION MUST:

"(1) NOT REQUIRE YOU TO APPLY THE PROCEEDS TO ANOTHER DEBT EXCEPT A DEBT THAT IS SECURED BY YOUR HOME OR OWED TO ANOTHER LENDER;

"(2) NOT REQUIRE THAT YOU ASSIGN WAGES AS SECURITY;

"(3) NOT REQUIRE THAT YOU EXECUTE INSTRUMENTS WHICH HAVE BLANKS FOR SUBSTANTIVE TERMS OF AGREEMENT LEFT TO BE FILLED IN;

"(4) NOT REQUIRE THAT YOU SIGN A CONFESSION OF JUDGMENT OR POWER OF ATTORNEY TO ANOTHER PERSON TO CONFESS JUDGMENT OR APPEAR IN A LEGAL PROCEEDING ON YOUR BEHALF;

"(5) PROVIDE THAT YOU RECEIVE A COPY OF YOUR FINAL LOAN APPLICATION AND ALL EXECUTED DOCUMENTS YOU SIGN AT CLOSING;

"(6) PROVIDE THAT THE SECURITY INSTRUMENTS CONTAIN A DISCLOSURE THAT THIS LOAN IS A LOAN DEFINED BY SECTION 50(a)(6), ARTICLE XVI, OF THE TEXAS CONSTITUTION;

"(7) PROVIDE THAT WHEN THE LOAN IS PAID IN FULL, THE LENDER WILL SIGN AND GIVE YOU A RELEASE OF LIEN OR AN ASSIGNMENT OF THE LIEN, WHICHEVER IS APPROPRIATE;

"(8) PROVIDE THAT YOU MAY, WITHIN 3 DAYS AFTER CLOSING, RESCIND THE LOAN WITHOUT PENALTY OR CHARGE;

"(9) PROVIDE THAT YOU AND THE LENDER ACKNOWLEDGE THE FAIR MARKET VALUE OF YOUR HOME ON THE DATE THE LOAN CLOSES; AND

"(10) PROVIDE THAT THE LENDER WILL FORFEIT ALL PRINCIPAL AND INTEREST IF THE LENDER FAILS TO COMPLY WITH THE LENDER'S OBLIGATIONS UNLESS THE LENDER CURES THE FAILURE TO COMPLY AS PROVIDED BY SECTION 50(a)(6)(Q)(x), ARTICLE XVI, OF THE TEXAS CONSTITUTION; AND

"(R) IF THE LOAN IS A HOME EQUITY LINE OF

CREDIT:

"(1) YOU MAY REQUEST ADVANCES, REPAY MONEY, AND REBORROW MONEY UNDER THE LINE OF CREDIT;

"(2) EACH ADVANCE UNDER THE LINE OF CREDIT MUST BE IN AN AMOUNT OF AT LEAST $4,000;

"(3) YOU MAY NOT USE A CREDIT CARD, DEBIT CARD, OR SIMILAR DEVICE, OR PREPRINTED CHECK THAT YOU DID NOT SOLICIT, TO OBTAIN ADVANCES UNDER THE LINE OF CREDIT;

"(4) ANY FEES THE LENDER CHARGES MAY BE CHARGED AND COLLECTED ONLY AT THE TIME THE LINE OF CREDIT IS ESTABLISHED AND THE LENDER MAY NOT CHARGE A FEE IN CONNECTION WITH ANY ADVANCE;

"(5) THE MAXIMUM PRINCIPAL AMOUNT THAT MAY BE EXTENDED, WHEN ADDED TO ALL OTHER DEBTS SECURED BY YOUR HOME, MAY NOT EXCEED 80 PERCENT OF THE FAIR MARKET VALUE OF YOUR HOME ON THE DATE THE LINE OF CREDIT IS ESTABLISHED;

"(6) IF THE PRINCIPAL BALANCE UNDER THE LINE OF CREDIT AT ANY TIME EXCEEDS 50 PERCENT OF THE FAIR MARKET VALUE OF YOUR HOME, AS DETERMINED ON THE DATE THE LINE OF CREDIT IS ESTABLISHED, YOU MAY NOT CONTINUE TO REQUEST ADVANCES UNDER THE LINE OF CREDIT UNTIL THE BALANCE IS LESS THAN 50 PERCENT OF THE FAIR MARKET VALUE; AND

"(7) THE LENDER MAY NOT UNILATERALLY AMEND THE TERMS OF THE LINE OF CREDIT.

"THIS NOTICE IS ONLY A SUMMARY OF YOUR RIGHTS UNDER THE TEXAS CONSTITUTION. YOUR RIGHTS ARE GOVERNED BY SECTION 50, ARTICLE XVI, OF THE TEXAS CONSTITUTION, AND NOT BY THIS NOTICE."

If the discussions with the borrower are conducted primarily in a language other than English, the lender shall, before closing, provide an additional copy of the notice translated into the written language in which the discussions were conducted.

(h) A lender or assignee for value may conclusively rely on the written acknowledgment as to the fair market value of the homestead property made in accordance with Subsection (a)(6)(Q)(ix) of this section if:

(1) the value acknowledged to is the value estimate in an appraisal or evaluation prepared in accordance with a state or federal requirement applicable to an extension of credit under Subsection (a)(6); and

(2) the lender or assignee does not have actual knowledge at the time of the payment of value or advance of funds by the lender or assignee that the fair market value stated in the written acknowledgment was incorrect.

(i) This subsection shall not affect or impair any right of the borrower to recover damages from the lender or assignee under applicable law for wrongful foreclosure. A purchaser for value without actual knowledge may conclusively presume that a lien securing an extension of credit described by Subsection (a)(6) of this section was a valid lien securing the extension of credit with homestead property if:

(1) the security instruments securing the extension of credit contain a disclosure that the extension of credit secured by the lien was the type of credit defined by Section 50(a)(6), Article XVI, Texas Constitution;

(2) the purchaser acquires the title to the property pursuant to or after the foreclosure of the voluntary lien; and

(3) the purchaser is not the lender or assignee under the extension of credit.

(j) Subsection (a)(6) and Subsections (e)-(i) of this section are not severable, and none of those provisions would have been enacted without the others. If any of those provisions are held to be preempted by the laws of the United States, all of those provisions are invalid. This subsection shall not apply to any lien or extension of credit made after January 1, 1998, and before the date any provision under Subsection (a)(6) or Subsections (e)-(i) is held to be preempted.

(k) "Reverse mortgage" means an extension of credit:

(1) that is secured by a voluntary lien on homestead property created by a written agreement with the consent of each owner and each owner's

spouse;

(2) that is made to a person who is or whose spouse is 62 years or older;

(3) that is made without recourse for personal liability against each owner and the spouse of each owner;

(4) under which advances are provided to a borrower:

(A) based on the equity in a borrower's homestead; or

(B) for the purchase of homestead property that the borrower will occupy as a principal residence;

(5) that does not permit the lender to reduce the amount or number of advances because of an adjustment in the interest rate if periodic advances are to be made;

(6) that requires no payment of principal or interest until:

(A) all borrowers have died;

(B) the homestead property securing the loan is sold or otherwise transferred;

(C) all borrowers cease occupying the homestead property for a period of longer than 12 consecutive months without prior written approval from the lender;

(C-1) if the extension of credit is used for the purchase of homestead property, the borrower fails to timely occupy the homestead property as the borrower's principal residence within a specified period after the date the extension of credit is made that is stipulated in the written agreement creating the lien on the property; or

(D) the borrower:

(i) defaults on an obligation specified in the loan documents to repair and maintain, pay taxes and assessments on, or insure the homestead property;

(ii) commits actual fraud in connection with the loan; or

(iii) fails to maintain the priority of the lender's lien on the homestead property, after the lender gives notice to the borrower, by promptly discharging any lien that has priority or may obtain priority over the lender's lien within 10 days after the date the borrower receives the notice, unless the borrower:

(a) agrees in writing to the payment of the obligation secured by the lien in a manner acceptable to the lender;

(b) contests in good faith the lien by, or defends against enforcement of the lien in, legal proceedings so as to prevent the enforcement of the lien or forfeiture of any part of the homestead property; or

(c) secures from the holder of the lien an agreement satisfactory to the lender subordinating the lien to all amounts secured by the lender's lien on the homestead property;

(7) that provides that if the lender fails to make loan advances as required in the loan documents and if the lender fails to cure the default as required in the loan documents after notice from the borrower, the lender forfeits all principal and interest of the reverse mortgage, provided, however, that this subdivision does not apply when a governmental agency or instrumentality takes an assignment of the loan in order to cure the default;

(8) that is not made unless the prospective borrower and the spouse of the prospective borrower attest in writing that the prospective borrower and the prospective borrower's spouse received counseling regarding the advisability and availability of reverse mortgages and other financial alternatives that was completed not earlier than the 180th day nor later than the 5th day before the date the extension of credit is closed;

(9) that is not closed before the 12th day after the date the lender provides to the prospective borrower the following written notice on a separate instrument, which the lender or originator and the borrower must sign for the notice to take effect:

"IMPORTANT NOTICE TO BORROWERS RELATED TO YOUR REVERSE MORTGAGE

"UNDER THE TEXAS TAX CODE, CERTAIN ELDERLY PERSONS MAY DEFER THE COLLECTION OF PROPERTY TAXES ON THEIR RESIDENCE HOMESTEAD. BY RECEIVING THIS REVERSE MORTGAGE YOU MAY BE REQUIRED TO FORGO ANY PREVIOUSLY APPROVED DEFERRAL OF PROPERTY TAX

COLLECTION AND YOU MAY BE REQUIRED TO PAY PROPERTY TAXES ON AN ANNUAL BASIS ON THIS PROPERTY.

"THE LENDER MAY FORECLOSE THE REVERSE MORTGAGE AND YOU MAY LOSE YOUR HOME IF:

"(A) YOU DO NOT PAY THE TAXES OR OTHER ASSESSMENTS ON THE HOME EVEN IF YOU ARE ELIGIBLE TO DEFER PAYMENT OF PROPERTY TAXES;

"(B) YOU DO NOT MAINTAIN AND PAY FOR PROPERTY INSURANCE ON THE HOME AS REQUIRED BY THE LOAN DOCUMENTS;

"(C) YOU FAIL TO MAINTAIN THE HOME IN A STATE OF GOOD CONDITION AND REPAIR;

"(D) YOU CEASE OCCUPYING THE HOME FOR A PERIOD LONGER THAN 12 CONSECUTIVE MONTHS WITHOUT THE PRIOR WRITTEN APPROVAL FROM THE LENDER OR, IF THE EXTENSION OF CREDIT IS USED FOR THE PURCHASE OF THE HOME, YOU FAIL TO TIMELY OCCUPY THE HOME AS YOUR PRINCIPAL RESIDENCE WITHIN A PERIOD OF TIME AFTER THE EXTENSION OF CREDIT IS MADE THAT IS STIPULATED IN THE WRITTEN AGREEMENT CREATING THE LIEN ON THE HOME;

"(E) YOU SELL THE HOME OR OTHERWISE TRANSFER THE HOME WITHOUT PAYING OFF THE LOAN;

"(F) ALL BORROWERS HAVE DIED AND THE LOAN IS NOT REPAID;

"(G) YOU COMMIT ACTUAL FRAUD IN CONNECTION WITH THE LOAN; OR

"(H) YOU FAIL TO MAINTAIN THE PRIORITY OF THE LENDER'S LIEN ON THE HOME, AFTER THE LENDER GIVES NOTICE TO YOU, BY PROMPTLY DISCHARGING ANY LIEN THAT HAS PRIORITY OR MAY OBTAIN PRIORITY OVER THE LENDER'S LIEN WITHIN 10 DAYS AFTER THE DATE YOU RECEIVE THE NOTICE, UNLESS YOU:

"(1) AGREE IN WRITING TO THE PAYMENT OF THE OBLIGATION SECURED BY THE LIEN IN A MANNER ACCEPTABLE TO THE LENDER;

"(2) CONTEST IN GOOD FAITH THE LIEN BY, OR DEFEND AGAINST ENFORCEMENT OF THE LIEN IN, LEGAL PROCEEDINGS SO AS TO PREVENT THE ENFORCEMENT OF THE LIEN OR FORFEITURE OF ANY PART OF THE HOME; OR

"(3) SECURE FROM THE HOLDER OF THE LIEN AN AGREEMENT SATISFACTORY TO THE LENDER SUBORDINATING THE LIEN TO ALL AMOUNTS SECURED BY THE LENDER'S LIEN ON THE HOME.

"IF A GROUND FOR FORECLOSURE EXISTS, THE LENDER MAY NOT COMMENCE FORECLOSURE UNTIL THE LENDER GIVES YOU WRITTEN NOTICE BY MAIL THAT A GROUND FOR FORECLOSURE EXISTS AND GIVES YOU AN OPPORTUNITY TO REMEDY THE CONDITION CREATING THE GROUND FOR FORECLOSURE OR TO PAY THE REVERSE MORTGAGE DEBT WITHIN THE TIME PERMITTED BY SECTION 50(k)(10), ARTICLE XVI, OF THE TEXAS CONSTITUTION. THE LENDER MUST OBTAIN A COURT ORDER FOR FORECLOSURE EXCEPT THAT A COURT ORDER IS NOT REQUIRED IF THE FORECLOSURE OCCURS BECAUSE:

"(1) ALL BORROWERS HAVE DIED; OR

"(2) THE HOMESTEAD PROPERTY SECURING THE LOAN IS SOLD OR OTHERWISE TRANSFERRED."

"YOU SHOULD CONSULT WITH YOUR HOME COUNSELOR OR AN ATTORNEY IF YOU HAVE ANY CONCERNS ABOUT THESE OBLIGATIONS BEFORE YOU CLOSE YOUR REVERSE MORTGAGE LOAN. TO LOCATE AN ATTORNEY IN YOUR AREA, YOU MAY WISH TO CONTACT THE STATE BAR OF TEXAS."

"THIS NOTICE IS ONLY A SUMMARY OF YOUR RIGHTS UNDER THE TEXAS CONSTITUTION. YOUR RIGHTS ARE GOVERNED IN PART BY SECTION 50, ARTICLE XVI, OF THE TEXAS CONSTITUTION, AND NOT BY THIS NOTICE."

(10) that does not permit the lender to commence foreclosure until the lender gives notice to the borrower, in the manner provided for a notice by mail related to the foreclosure of liens under Subsection (a)(6) of this section, that a ground for foreclosure exists and gives the borrower at least 30 days, or at least 20 days in the event of a default under Subdivision (6)(D)(iii) of this subsection, to:

(A) remedy the condition creating the ground for foreclosure;

(B) pay the debt secured by the homestead property from proceeds of the sale of the homestead property by the borrower or from any other sources; or

(C) convey the homestead property to the lender by a deed in lieu of foreclosure; and

(11) that is secured by a lien that may be foreclosed upon only by a court order, if the foreclosure is for a ground other than a ground stated by Subdivision (6)(A) or (B) of this subsection.

(l) Advances made under a reverse mortgage and interest on those advances have priority over a lien filed for record in the real property records in the county where the homestead property is located after the reverse mortgage is filed for record in the real property records of that county.

(m) A reverse mortgage may provide for an interest rate that is fixed or adjustable and may also provide for interest that is contingent on appreciation in the fair market value of the homestead property. Although payment of principal or interest shall not be required under a reverse mortgage until the entire loan becomes due and payable, interest may accrue and be compounded during the term of the loan as provided by the reverse mortgage loan agreement.

(n) A reverse mortgage that is secured by a valid lien against homestead property may be made or acquired without regard to the following provisions of any other law of this state:

(1) a limitation on the purpose and use of future advances or other mortgage proceeds;

(2) a limitation on future advances to a term of years or a limitation on the term of open-end account advances;

(3) a limitation on the term during which future advances take priority over intervening advances;

(4) a requirement that a maximum loan amount be stated in the reverse mortgage loan documents;

(5) a prohibition on balloon payments;

(6) a prohibition on compound interest and interest on interest;

(7) a prohibition on contracting for, charging, or receiving any rate of interest authorized by any law of this state authorizing a lender to contract for a rate of interest; and

(8) a requirement that a percentage of the reverse mortgage proceeds be advanced before the assignment of the reverse mortgage.

(o) For the purposes of determining eligibility under any statute relating to payments, allowances, benefits, or services provided on a means-tested basis by this state, including supplemental security income, low-income energy assistance, property tax relief, medical assistance, and general assistance:

(1) reverse mortgage loan advances made to a borrower are considered proceeds from a loan and not income; and

(2) undisbursed funds under a reverse mortgage loan are considered equity in a borrower's home and not proceeds from a loan.

(p) The advances made on a reverse mortgage loan under which more than one advance is made must be made according to the terms established by the loan documents by one or more of the following methods:

(1) an initial advance at any time and future advances at regular intervals;

(2) an initial advance at any time and future advances at regular intervals in which the amounts advanced may be reduced, for one or more advances, at the request of the borrower;

(3) an initial advance at any time and future advances at times and in amounts requested by the borrower until the credit limit established by the loan documents is reached;

(4) an initial advance at any time, future advances at times and in amounts requested by the borrower until the credit limit established by the loan documents is reached, and subsequent advances at times and in amounts requested by the borrower according to the terms established by the loan documents to the extent that the outstanding balance is repaid; or

(5) at any time by the lender, on behalf of the borrower, if the borrower fails to timely pay any of the following that the borrower is obligated to pay under the loan documents to the extent necessary to protect the lender's interest in or the value of the homestead property:

(A) taxes;

(B) insurance;

(C) costs of repairs or maintenance performed by a person or company that is not an employee of the lender or a person or company that directly or indirectly controls, is controlled by, or is under common control with the lender;

(D) assessments levied against the homestead property; and

(E) any lien that has, or may obtain, priority over the lender's lien as it is established in the loan documents.

(q) To the extent that any statutes of this state, including without limitation, Section 41.001 of the Texas Property Code, purport to limit encumbrances that may properly be fixed on homestead property in a manner that does not permit encumbrances for extensions of credit described in Subsection (a)(6) or (a)(7) of this section, the same shall be superseded to the extent that such encumbrances shall be permitted to be fixed upon homestead property in the manner provided for by this amendment.

(r) The supreme court shall promulgate rules of civil procedure for expedited foreclosure proceedings related to the foreclosure of liens under Subsection (a)(6) of this section and to foreclosure of a reverse mortgage lien that requires a court order.

(s) The Finance Commission of Texas shall appoint a director to conduct research on the availability, quality, and prices of financial services and research the practices of business entities in the state that provide financial services under this section. The director shall collect information and produce reports on lending activity of those making loans under this section. The director shall report his or her findings to the legislature not later than December 1 of each year.

(t) A home equity line of credit is a form of an open-end account that may be debited from time to time, under which credit may be extended from time to time and under which:

(1) the owner requests advances, repays money, and reborrows money;

(2) any single debit or advance is not less than $4,000;

(3) the owner does not use a credit card, debit card, or similar device, or preprinted check unsolicited by the borrower, to obtain an advance;

(4) any fees described by Subsection (a)(6)(E) of this section are charged and collected only at the time the extension of credit is established and no fee is charged or collected in connection with any debit or advance;

(5) the maximum principal amount that may be extended under the account, when added to the aggregate total of the outstanding principal balances of all indebtedness secured by the homestead on the date the extension of credit is established, does not exceed an amount described under Subsection (a)(6)(B) of this section;

(6) no additional debits or advances are made if the total principal amount outstanding exceeds an amount equal to 50 percent of the fair market value of the homestead as determined on the date the account is established;

(7) the lender or holder may not unilaterally amend the extension of credit; and

(8) repayment is to be made in regular periodic installments, not more often than every 14 days and not less often than monthly, beginning not later than two months from the date the extension of credit is established, and:

(A) during the period during which the owner may request advances, each installment equals or exceeds the amount of accrued interest; and

(B) after the period during which the owner may request advances, installments are substantially equal.

(u) The legislature may by statute delegate one or more state agencies the power to interpret Subsections (a)(5)-(a)(7), (e)-(p), and (t), of this section. An act or omission does not violate a provision included in those subsections if the act or omission conforms to an interpretation of the provision that is:

(1) in effect at the time of the act or omission; and

(2) made by a state agency to which the power of interpretation is delegated as provided by this subsection or by an appellate court of this state or the United States.

(v) A reverse mortgage must provide that:

(1) the owner does not use a credit card, debit card, preprinted solicitation check, or similar device to obtain an advance;

(2) after the time the extension of credit is established, no transaction fee is charged or collected solely in connection with any debit or advance; and

(3) the lender or holder may not unilaterally amend the extension of credit.

(Amended Nov. 6, 1973, and Nov. 7, 1995; Subsecs. (a)-(d) amended and (e)-(s) added Nov. 4, 1997; Subsecs. (k), (p), and (r) amended Nov. 2, 1999; Subsec. (a) amended Nov. 6, 2001; Subsecs. (a), (f), and (g) amended and (t) and (u) added Sept. 13, 2003; Subsec. (p) amended and (v) added Nov. 8, 2005; Subsecs. (a), (g), and (t) amended Nov. 6, 2007; amended to be effective November 5, 2013.)

DIRECTORY

FINANCE COMMISSION OF TEXAS
c/o Charles G. Cooper, Executive Director
2601 N. Lamar Boulevard
Austin, Texas 78705-4294
Phone: (512) 936-6222
Internet: *http://www.fc.texas.gov*

Commission Member	*Representation*	*Term Expiration*
Stacy G. London, Chair	Mortgage	Feb 1, 2020
Hilliard (Jay) Shands, III, Vice Chair	Banking	Feb 1, 2018
Robert (Bob) Borochoff	Public	Feb 1, 2022
Hector J. Cerna	Banking	Feb 1, 2020
Margaret (Molly) Curl, CPA	Public	Feb 1, 2022
Phillip A. Holt	Consumer Credit	Feb 1, 2022
William M. (Will) Lucas	Savings	Feb 1, 2018
Lori B. McCool	Public	Feb 1, 2020
Matthew (Matt) Moore	Public	Feb 1, 2022
Paul Plunket	Public	Feb 1, 2020
Vince E. Puente, Sr.	Public	Feb 1, 2018

TEXAS DEPARTMENT OF BANKING
2601 N. Lamar Boulevard
Austin, Texas 78705-4294
Phone: (512) 475-1300
Toll Free: 877-276-5554
Fax: (512) 475-1313
Internet: *http://www.dob.texas.gov*

Commissioner .... Charles G. Cooper
Deputy Commissioner .... Robert L. (Bob) Bacon
Deputy Commissioner .... Stephanie S. Newberg
General Counsel .... Catherine Reyer
Director, Bank and Trust Supervision .... Kurt Purdom
Director, Corporate Activities .... Dan Frasier
Director, Strategic Support .... Wendy Rodriguez
Director, Special Audits .... Russell Reese
Director, Administrative Services .... Sami Chadli

Ombudsman .... Phil Lena
Open Records Technician .... Anita Villarreal
Consumer Complaints Specialist .... David Guillen

TEXAS DEPARTMENT OF BANKING
REGIONAL OFFICES

Dallas Regional Office:

Larry Walker, Regional Director
12000 Ford Road, Suite 200
Dallas, Texas 75234
(972) 241-1426
(972) 241-1766 (fax)

Lubbock Regional Office:

James J. (Jeff) Anderson, Regional Director
4413 82nd Street, Suite 215
Lubbock, Texas 79424-3366
(806) 794-3763
(806) 794-3764 (fax)

Houston Regional Office:

Bobby Davenport, Regional Director
8588 Katy Freeway, Suite 345
Houston, Texas 77024
(713) 932-6146
(713) 932-9405 (fax)

San Antonio Regional Office:

Kenneth Kuntschik, Regional Director
2700 NE Loop 410, Suite 616
San Antonio, Texas 78217
(210) 271-3923
(210) 271-3948 (fax)

TEXAS DEPARTMENT OF BANKING
Law & Guidance Manual Binder
Update 9-2016

The enclosed Law & Guidance Manual pages contain updates to statutes, rules, regulatory guidance, supervisory memorandums, and legal opinions effective between July 1, 2016 and September 30, 2016, which pertain to financial institutions.

*§**http://www.constitution.legis.state.tx.us/.** A link to the Texas Administrative Code is available on this page.*

HIGHLIGHTS OF ENCLOSED UPDATES

STATUTES – TEXAS FINANCE CODE

There were no statute updates during this period.

RULES – TEXAS ADMINISTRATIVE CODE

Chapter 11 - Amendment	Miscellaneous 11.37. How Do I Provide Information to Consumers on How to File a Complaint?

REGULATORY GUIDANCE

The Department did not issue a regulatory guidance during this period.

SUPERVISORY MEMORANDUM

The Department did not issue a supervisory memorandum during this period.

FILING INSTRUCTIONS (Update No. 9-2016)

NOTE: *The pages listed below in the column headed "**Remove Pages**" are no longer required in your binder and should be discarded. Those listed in the column headed "**Insert Pages**" are pages included in this update and should be filed promptly in your binder.*

REMOVE PAGES	INSERT PAGES
Directory	
xv-xvi	xv-xvi
Rules	
2071-2072	2071-2072

The web version of the Law & Guidance Manual contains a search tool at the top of the page for easier navigation. The web version can be accessed on the Department's website at **http://www.dob.texas.gov/laws-regulations** under the Law and Guidance Manual panel.

AFTER FILING THE ABOVE:
File this Update 9-2016 under the tab **Updates**.

TEXAS FINANCE CODE

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TEXAS FINANCE CODE

TITLE 1. GENERAL PROVISIONS

CHAPTER 1. GENERAL PROVISIONS

CHAPTER 1. GENERAL PROVISIONS

Sec. 1.001. Purpose of Code. (a) This code is enacted as a part of the state's continuing statutory revision program, begun by the Texas Legislative Council in 1963 as directed by the legislature in the law codified as Section 323.007, Government Code. The program contemplates a topic-by-topic revision of the state's general and permanent statute law without substantive change.

(b) Consistent with the objectives of the statutory revision program, the purpose of this code is to make the law encompassed by this code more accessible and understandable by:

(1) rearranging the statutes into a more logical order;

(2) employing a format and numbering system designed to facilitate citation of the law and to accommodate future expansion of the law;

(3) eliminating repealed, duplicative, unconstitutional, expired, executed, and other ineffective provisions; and

(4) restating the law in modern American English to the greatest extent possible.

Sec. 1.002. Construction of Code. Chapter 311, Government Code (Code Construction Act), applies to the construction of each provision in this code except as otherwise expressly provided by this code.

Sec. 1.003. Reference in Law to Statute Revised by Code. A reference in a law to a statute or a part of a statute revised by this code is considered to be a reference to the part of this code that revises that statute or part of that statute.

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[The next chapter is Chapter 11]

TITLE 2. FINANCIAL REGULATORY AGENCIES

CHAPTER 11. FINANCE COMMISSION OF TEXAS

Subchapter A. General Provisions

Subchapter B. Composition and Operation

Subchapter C. Staff and Expenses

Subchapter D. Powers and Duties

CHAPTER 11. FINANCE COMMISSION OF TEXAS

Subchapter A. General Provisions

Sec. 11.001. Definitions. (a) The definitions provided by Section 31.002 apply to this chapter.

(b) In this chapter, "finance agency" means:

(1) the Texas Department of Banking;

(2) the Department of Savings and Mortgage Lending; or

(3) the Office of Consumer Credit Commissioner.

Sec. 11.002. Purpose of Commission; Strategic Plan. (a) The finance commission is responsible for overseeing and coordinating the Texas Department of Banking, the Department of Savings and Mortgage Lending, and the Office of Consumer Credit Commissioner and serves as the primary point of accountability for ensuring that state depository and lending institutions function as a system, considering the broad scope of the financial services industry. The finance commission is the policy-making body for those finance agencies and is not a separate state agency. The finance commission shall carry out its functions in a manner that protects consumer interests, maintains a safe and sound banking system, and increases the economic prosperity of the state.

(b) The finance commission shall prepare and periodically update a strategic plan for coordination of the state financial system. Each finance agency shall cooperate in preparation of the plan.

Subchapter B. Composition and Operation

Sec. 11.101. Appointment; Terms; Oath. (a) The Finance Commission of Texas is composed of 11 members appointed by the governor with the advice and consent of the senate.

(b) Members of the finance commission serve staggered six-year terms, with as near as possible to one-third of the members' terms expiring February 1 of each even-numbered year.

(c) An appointment to the finance commission must be made without regard to the race, color, age, sex, religion, disability, or national origin of the appointee.

Sec. 11.102. Qualifications of Members. (a) A member of the finance commission must be a registered voter of this state. Not more than two members may be residents of the same state senatorial district.

(b) Two members of the finance commission must be banking executives, one member of the finance commission must be a savings executive, one member of the finance commission must be a consumer credit executive, and one member of the finance commission must be a residential mortgage loan originator licensed under Chapter 156 or 157.

(c) Six members of the finance commission must be representatives of the general public. At least one of those members must be a certified public accountant.

(d) A person may not be a public member of the finance commission if the person or the person's spouse:

(1) is registered, certified, or licensed by a regulatory agency in an industry regulated by a finance agency;

(2) is employed by or participates in the management of a business entity or other organization regulated by or receiving money from a finance agency;

(3) owns or controls, directly or indirectly, more than a 10 percent interest in a business entity or other organization regulated by or receiving money from a finance agency; or

(4) uses or receives a substantial amount of tangible goods, services, or money from a finance agency other than compensation or reimbursement authorized by law for finance commission membership, attendance, or expenses.

(e) For the purposes of this section:

(1) "Banking executive" means a person who:

(A) has had five years' or more executive experience in a bank during the seven-year period preceding the person's appointment; and

(B) is an officer of a state bank.

(2) "Savings executive" means a person who:

(A) has had five years' or more executive experience in a savings association or savings bank during the seven-year period preceding the person's appointment; and

(B) is an officer of a state savings association or savings bank.

(3) "Consumer credit executive" means a person who:

(A) has had five years' or more executive experience in an entity regulated by the consumer credit commissioner during the seven-year period preceding the person's appointment; and

(B) is an officer of an entity regulated by the consumer credit commissioner.

(4) "Residential mortgage loan originator" means a person who:

(A) has had five years' or more experience as a residential mortgage loan originator, as defined by Section 180.002, during the seven-year period preceding the person's appointment; and

(B) is a residential mortgage loan originator, as defined by Section 180.002.

(f) Experience as banking commissioner, deputy banking commissioner, examiner, or supervisor of examiners for a state or federal banking regulatory agency is considered executive experience in a bank for the purposes of Subsection (e)(1)(A). Experience as savings and mortgage lending commissioner, deputy savings and mortgage lending commissioner, examiner, or supervisor of examiners for a state or federal savings and loan regulatory agency is considered executive experience in a savings association or savings bank for the purposes of Subsection (e)(2)(A).

Sec. 11.1021. Conflict of Interest. (a) In this section, "Texas trade association" means a cooperative and voluntarily joined association of business or professional competitors in this state designed to assist its members and its industry or profession in dealing with mutual business or professional problems and in promoting their common interest.

(b) A person may not be a member of the finance commission if:

(1) the person is an officer, employee, or paid consultant of a Texas trade association in an industry regulated by a finance agency; or

(2) the person's spouse is an officer, manager, or paid consultant of a Texas trade association in an industry regulated by a finance agency.

(c) A person may not be a member of the finance commission if the person is required to register as a lobbyist under Chapter 305, Government Code, because of the person's activities for compensation on behalf of a profession related to the operation of a finance agency.

Sec. 11.103. Removal of Members. (a) It is a ground for removal from the finance commission that a member:

(1) does not have at the time of taking office the qualifications required by Section 11.102;

(2) does not maintain during service on the finance commission the qualifications required by Section 11.102;

(3) is ineligible for membership under Section 11.102 or 11.1021;

(4) cannot, because of illness or disability, discharge the member's duties for a substantial part of the member's term; or

(5) is absent from more than half of the regularly scheduled finance commission meetings that the member is eligible to attend during a calendar year without an excuse approved by a majority vote of the finance commission.

(b) If the banking commissioner, savings and mortgage lending commissioner, or consumer credit commissioner has knowledge that a potential ground for removal exists, the banking commissioner, savings and mortgage lending commissioner, or consumer credit commissioner shall notify the presiding officer of the finance commission of the potential ground. The presiding officer shall then notify the governor and the attorney general that a potential ground for removal exists. If the potential ground for removal involves the presiding officer, the banking commissioner, savings and mortgage lending commissioner, or consumer credit commissioner shall notify the next highest ranking officer of the finance commission, who shall then notify the governor and the attorney general that a potential ground for removal exists.

(c) The validity of an action of the finance commission is not affected by the fact that it was taken when a ground for removal of a member of the finance commission existed.

Sec. 11.104. Expenses and Compensation of Members. A member of the finance commission is entitled to:

(1) the reimbursement for reasonable and necessary expenses incidental to travel incurred in connection with the performance of official duties; and

(2) a per diem each day that the member engages in the business of the finance commission.

Sec. 11.105. Matter in Which Member Has Personal Interest. A member of the finance commission may not act or participate in the portion of a commission meeting during which the matter considered specifically relates to an entity:

(1) of which the member or the member's spouse is an officer, director, stockholder, shareholder, or owner; or

(2) in which the member or the member's spouse has another financial interest.

Sec. 11.106. Meetings. (a) The finance commission shall hold at least six regular public meetings during each calendar year on dates set by the commission.

(b) The presiding officer or three members of the finance commission may call a special public meeting of the commission.

(c) The finance commission may hold an open or closed special meeting by telephone conference call if:

(1) immediate action is required;

(2) the convening at one location of a quorum of the finance commission is difficult or impossible;

(3) notice is given for the meeting as for other meetings;

(4) the notice specifies a location for the meeting at which the public may attend;

(5) each part of the meeting that is required to be open to the public is audible to the public at the location specified in the notice of the meeting; and

(6) the meeting is tape-recorded and the tape recording of each portion of the meeting that is required to be open to the public is made available to the public.

Sec. 11.107. Presiding Officer. (a) The governor shall appoint a member of the finance commission as presiding officer of the commission. The presiding officer serves at the will of the governor.

(b) The presiding officer shall preside at and provide for the keeping of minutes of each public meeting of the finance commission.

(c) The presiding officer may:

(1) adopt rules and procedures as the presiding officer considers necessary for the orderly operation of the finance commission and for communication among the finance commission, the Texas Department of Banking, the Department of Savings and Mortgage Lending, and the Office of Consumer Credit Commissioner;

(2) adopt internal procedures governing the time and place of meetings, the type of notice for special public meetings, the manner in which public meetings are to be conducted, and other similar matters; and

(3) appoint committees composed of finance commission members as the presiding officer considers necessary to carry out the commission's business.

Sec. 11.108. Sunset Provision. The finance commission is subject to Chapter 325, Government Code (Texas Sunset Act). Unless continued in existence as provided by that chapter, the commission is abolished September 1, 2019.

Sec. 11.109. Standards of Conduct. The presiding officer of the finance commission or the presiding officer's designee shall provide to members of the finance commission, as often as necessary, information regarding the requirements for office under this title, including information regarding a person's responsibilities under applicable laws relating to standards of conduct for state officers.

Sec. 11.110. Training. (a) A person who is appointed to and qualifies for office as a member of the finance commission may not vote, deliberate, or be counted as a member in attendance at a meeting of the finance commission until the person completes a training program that complies with this section.

(b) The training program must provide the person with information regarding:

(1) the legislation that created the finance agencies and the finance commission;

(2) the programs operated by the finance agencies;

(3) the role and functions of the finance agencies;

(4) the rules of the finance commission with an emphasis on the rules that relate to disciplinary and investigatory authority;

(5) the current budget for the finance agencies;

(6) the results of the most recent formal audit of the finance agencies;

(7) the requirements of:

(A) the open meetings law, Chapter 551, Government Code;

(B) the public information law, Chapter 552, Government Code;

(C) the administrative procedure law, Chapter 2001, Government Code; and

(D) other laws relating to public officials, including conflict-of-interest laws; and

(8) any applicable ethics policies adopted by the finance commission or the Texas Ethics Commission.

(c) A person appointed to the finance commission is entitled to reimbursement under Section 11.104, as if the person were a member of the finance commission, for the travel expenses incurred in attending the training program regardless of whether the attendance at the program occurs before or after the person qualifies for office.

Sec. 11.111. Separation of Functions. The finance commission shall develop and implement policies that clearly separate the policymaking responsibilities of the finance commission and the management responsibilities of the banking commissioner, savings and mortgage lending commissioner, and consumer credit commissioner and staff of the finance agencies.

Sec. 11.112. Public Testimony. The finance commission shall develop and implement policies that provide the public with a reasonable opportunity to appear before the finance commission and to speak on any issue under the jurisdiction of the finance agencies.

Subchapter C. Staff and Expenses

Sec. 11.201. [Repealed][1]

Sec. 11.202. Hearings Officer and Auditor. (a) The finance commission shall direct a finance agency to employ an internal auditor to provide services to and facilitate commission oversight and control over the finance agencies.

(b) The Texas Department of Banking may employ a hearings officer to serve the finance agencies as determined by interagency agreement. For the purposes of Section 2003.021, Government Code, a hearings officer employed under this section is considered to be an employee of each agency for which hearing services are provided. The hearings officer's only duty is to preside over matters related to contested cases before a finance agency or the finance commission.

Sec. 11.203. Limitation on Direction of Auditor. The internal auditor reports to the finance commission and is not subject to direction by the employing finance agency.

Sec. 11.204. Sharing of Staff, Equipment, and Facilities; Allocation of Costs. (a) The finance commission shall use the staff, equipment, and facilities of the finance agencies to the extent necessary to carry out the finance commission's duties. To reduce administrative costs, the finance agencies shall share staff, equipment, and facilities to the extent that the sharing contributes to cost efficiency without detracting from the staff expertise needed for individual areas of agency responsibility.

(b) An interagency agreement must provide that the cost of staff used by the finance commission, including the internal auditor, is to be charged to the finance agencies in proportion to the amount of time devoted to each agency's business. All other costs of operation of the finance commission are to be shared by and included in the budgets of the finance agencies in proportion to the amount of cash receipts of each of those agencies.

(c) The finance commission shall have charge and control of the property known as the Finance Commission Building and use of staff, equipment, and facilities of the finance agencies. The Finance Commission Building refers to the property located in the city of Austin and titled in the name of the Banking Section of the Finance Commission of Texas, as described by deed recorded in Volume 5080, Page 1099, of the Deed Records of Travis County, Texas.

Subchapter D. Powers and Duties

Sec. 11.301. Banking Rules. The finance commission may adopt banking rules as provided by Section 31.003.

Sec. 11.302. Savings Association and Savings Bank Rules. (a) The finance commission may adopt rules applicable to state savings associations or to savings banks and may authorize state savings associations and savings banks to invest money of state savings associations or savings banks in any manner

[1] Repealed eff. Sept. 1, 2001, by Act of May 27, 2001, 77th Leg., ch. 867 (H.B. 1763), , §103, 2001 Tex. Sess. Law Serv. 1621, 1642 (Vernon).

permitted for a federal savings association or federal savings bank domiciled in this state. This subsection does not authorize the finance commission to diminish or limit a right or power specifically given to state savings associations or savings banks by state law.

(b) The finance commission may adopt rules to:

(1) prevent state savings associations or savings banks from concentrating an excessive or unreasonable portion of the resources of state savings associations or savings banks in a type or character of loan or security authorized by Subtitle B or C, Title 3; and

(2) establish standards for investments by state savings associations or savings banks, including limits on the amount that a state savings association or savings bank may invest in a type or character of investment to an amount or percentage of the savings association's or savings bank's assets or net worth.

Sec. 11.303. Disclosure of Certain Information to Finance Commission Prohibited. Information regarding the financial condition of a state savings association or savings bank obtained through examination or otherwise may not be disclosed to a member of the finance commission, except that the savings and mortgage lending commissioner may disclose to the finance commission a file or record pertinent to a hearing or matter pending before the commission.

Sec. 11.304. Consumer Credit Rules. The finance commission may adopt rules necessary to supervise the consumer credit commissioner and ensure compliance with Chapter 14 and Title 4.

Sec. 11.305. Research. (a) The finance commission shall instruct the consumer credit commissioner to establish a program to address alternatives to high-cost lending in this state. The program shall:

(1) study and report on the problem of high-cost lending, including without limitation the availability, quality, and prices of financial services, including lending and depository services, offered in this state to agricultural businesses, small businesses, and individual consumers in this state;

(2) evaluate alternatives to high-cost lending and the practices of business entities in this state that provide financial services to agricultural businesses, small businesses, and individual consumers in this state;

(3) develop models to provide lower-cost alternatives to assist borrowers who contract for high-cost loans; and

(4) track the location of lenders who enter into loan contracts providing for an interest charge authorized by Section 342.201, map the location of the lenders by senatorial district and by any other appropriate areas, provide other demographic information relating to the loans and the location of the lenders, and provide information on the changes in the distribution of the lenders from 1997 through the date of the report.

(b) The program may:

(1) apply for and receive public and private grants and gifts to conduct the research authorized by this section;

(2) contract with public and private entities to carry out studies and analyses under this section;

(3) provide funding for pilot programs; and

(4) make grants to nonprofit institutions working to provide alternatives to high-cost loans.

(c) Not later than December 1 of each year, the consumer credit commissioner shall provide to the legislature a report detailing its findings and making recommendations to improve the availability, quality, and prices of financial services.

(d) The Texas Department of Banking and the Department of Savings and Mortgage Lending shall jointly conduct a continuing review of the condition of the state banking system. The review must include a review of all available national and state economic forecasts and an analysis of changing banking practices and new banking legislation. Periodically the departments shall submit a report to the finance commission on the results of the review, including information relating to the condition of the state banking system at the time of the report and the predicted condition of that system in the future.

Sec. 11.3055. Financial Services Study. (a) The finance commission may assign the banking commissioner, savings and mortgage lending commissioner, or consumer credit commissioner to conduct research on:

(1) the availability, quality, and prices of financial services, including lending and depository services, offered in this state to agricultural businesses,

small businesses, and individual consumers in this state; and

(2) the practices of business entities in this state that provide financial services to agricultural businesses, small businesses, and individual consumers in this state.

(b) The banking commissioner, savings and mortgage lending commissioner, or consumer credit commissioner may:

(1) apply for and receive public and private grants and gifts to conduct the research authorized by this section; and

(2) contract with public and private entities to carry out studies and analyses under this section.

Sec. 11.306. Residential Mortgage Loan Origination Rules. The finance commission may adopt residential mortgage loan origination rules as provided by Chapter 156.

Sec. 11.307. Rules Relating to Consumer Complaints. (a) The finance commission shall adopt rules applicable to each entity regulated by the Texas Department of Banking or the Department of Savings and Mortgage Lending specifying the manner in which the entity provides consumers with information on how to file complaints with the appropriate agency.

(b) The finance commission shall adopt rules applicable to each entity regulated by a finance agency requiring the entity to include information on how to file complaints with the appropriate agency in each privacy notice that the entity is required to provide consumers under law, including Pub. L. No. 106-102.

Sec. 11.308. Interpretation of Home Equity Lending Law. The finance commission may, on request of an interested person or on its own motion, issue interpretations of Sections 50(a)(5)-(7), (e)-(p), (t), and (u), Article XVI, Texas Constitution. An interpretation under this section is subject to Chapter 2001, Government Code, and is applicable to all lenders authorized to make extensions of credit under Section 50(a)(6), Article XVI, Texas Constitution, except lenders regulated by the Credit Union Commission.[2] The finance commission and the Credit Union Commission shall attempt to adopt interpretations that are as consistent as feasible or shall state justification for any inconsistency.

[2] *See* Section 15.413, Finance Code.

Sec. 11.309. Rules Relating to Check Verification Entities. (a) In this section, “check verification entity” and “financial institution” have the meanings assigned by Section 523.052, Business & Commerce Code.

(b) The finance commission shall adopt rules:

(1) requiring a check verification entity to register with the banking commissioner:

(A) at the intervals the finance commission determines, but not less frequently than annually; and

(B) by providing to the banking commissioner the information that the finance commission determines is necessary to enable a financial institution or a check verification entity to comply with the requirements of Section 523.052, Business & Commerce Code;[3]

(2) authorizing the banking commissioner to charge a check verification entity a reasonable annual fee, not to exceed $100, to register with the commissioner; and

(3) requiring the banking commissioner to establish an electronic notification system, through secure e-mail or another secure system, to be used by a financial institution to notify check verification entities as required by Section 523.052, Business & Commerce Code.

(c) The finance commission may not impose a duty on the banking commissioner under Subsection (b)(3) to verify the validity or completeness of information transmitted through the electronic notification system.

(d) The banking commissioner may solicit and accept gifts, grants, and donations from public and private entities to establish and maintain the secure notification system.

[3] Section 11.309, Finance Code is effective September 1, 2007. However, a financial institution is not required to comply with Section 35.595, Business & Commerce Code before March 1, 2008. *See* Acts 2007, 80th Tex. Leg., R.S., ch. 1044 (H.B. 2002), §3.

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CHAPTER 12. TEXAS DEPARTMENT OF BANKING

Subchapter A. General Provisions

Subchapter B. Operation of Department

CHAPTER 12. TEXAS DEPARTMENT OF BANKING

Subchapter A. General Provisions

Sec. 12.001. Definitions. The definitions provided by Section 31.002 apply to this chapter.

Subchapter B. Operation of Department

Sec. 12.101. Banking Commissioner. (a) The banking commissioner is the chief executive officer of the Texas Department of Banking. The finance commission shall appoint the banking commissioner. The banking commissioner serves at the will of the finance commission and is subject to the finance commission's orders and directions.

(b) The banking commissioner must have not less than seven years' experience in banking or bank supervision.

(c) The finance commission shall set the compensation of the banking commissioner. The compensation shall be paid from money of the department.

Sec. 12.102. Deputy Banking Commissioners. (a) The banking commissioner shall appoint one or more deputy banking commissioners as necessary to the efficient operation of the department. The banking commissioner shall prescribe the qualifications and duties of a deputy banking commissioner.

(b) During the banking commissioner's absence or inability to serve, a deputy banking commissioner has the powers and shall perform the duties of the banking commissioner.

Sec. 12.103. [Repealed][1]

Sec. 12.104. Oath of Office. Before assuming the duties of office, each deputy banking commissioner, examiner, assistant examiner, conservator, supervisor, and special agent, and each other officer or employee specified by the banking commissioner, must take an oath of office to:

(1) discharge faithfully the duties assigned; and

(2) uphold the constitution and laws of this state and of the United States.

Sec. 12.105. Fees, Revenue, and Expenses; Audit. (a) The finance commission shall establish reasonable

[1] Repealed eff. Sept. 1, 2009, by 81st Leg., H.B. 2774.

and necessary fees for the administration of this chapter, Chapter 11, Chapter 13, and Subtitle A, Title 3.

(b) The costs of an audit of the department under Chapter 321, Government Code, shall be paid to the state auditor from the money of the department.

Sec. 12.106. Liability. (a) The banking commissioner, a member of the finance commission, a deputy banking commissioner, an examiner, assistant examiner, supervisor, conservator, agent, or other officer or employee of the department, or an agent of the banking commissioner is not personally liable for damages arising from the person's official act or omission unless the act or omission is corrupt or malicious.

(b) The attorney general shall defend an action brought against a person because of an official act or omission under Subsection (a) regardless of whether the defendant has terminated service with the department before the action commences.

Sec. 12.107. Conflict of Interest. (a) In this section, "Texas trade association" means a cooperative and voluntarily joined association of business or professional competitors in this state that:

(1) is primarily designed to assist its members and its industry or profession in dealing with mutual business or professional problems and in promoting their common interest; and

(2) includes business and professional competitors located in this state among its members.

(b) A person may not be a department employee if:

(1) the person is an officer, employee, or paid consultant of a Texas trade association in an industry regulated by the department; or

(2) the person's spouse is an officer, manager, or paid consultant of a Texas trade association in an industry regulated by the department.

(c) A person may not act as the general counsel to the department if the person is required to register as a lobbyist under Chapter 305, Government Code, because of the person's activities for compensation on behalf of a profession related to the operation of the department.

(d) A department employee may not:

(1) purchase an asset owned by a person regulated by the department in the possession of the banking commissioner or other receiver for purposes of liquidation, unless the asset is purchased at public auction or with the approval of the receivership court;

(2) except as provided by Subsection (e), become directly or indirectly indebted to a person regulated by the department;

(3) except as provided by Subsection (f), become directly or indirectly financially interested in a person regulated by the department; or

(4) obtain a product or service from a person regulated by the department, or an affiliate of a person regulated by the department, on terms or rates that are more favorable to the employee than those prevailing at the time for comparable transactions with or involving other similarly situated consumers.

(e) Subject to Subsection (d)(4) and except as otherwise provided by employment policies adopted by the banking commissioner, Subsection (d)(2) does not prohibit indebtedness of:

(1) a clerical or administrative employee to a person regulated by the department, if the employee does not exercise discretionary decision-making authority with respect to the person; or

(2) an employee of the department, other than a clerical or administrative employee, if the indebtedness was permissible when incurred and became prohibited indebtedness under Subsection (d)(2) as a result of employment by the department or a circumstance over which the employee has no control, including a merger, acquisition, purchase or sale of assets, or assumption of liabilities involving a regulated person, if the employee:

(A) repays the indebtedness; or

(B) does not knowingly participate in or consider any matter concerning the person to whom the employee is indebted.

(f) Except as otherwise provided by employment policies adopted by the banking commissioner, Subsection (d)(3) does not prohibit a financial interest of an employee of the department solely because:

(1) the employee owns publicly traded shares of a registered investment company (mutual fund) that owns publicly traded equity securities issued by a person regulated by the department; or

(2) the spouse of or other person related to the employee is employed by a person regulated by the department and receives equity securities of the person through participation in an employee benefit plan, including an employee stock option, bonus, or ownership plan, if:

(A) the sole purpose of the plan is to compensate employees with an ownership interest in the person for services rendered; and

(B) the employee does not knowingly participate in or consider any matter concerning the person until the spouse or other related person no longer owns equity securities issued by the person.

(g) The banking commissioner may adopt employment policies relating to this section, including policies to:

(1) require employees to notify the department of possible conflicts of interest;

(2) specify the manner or extent of required recusal;

(3) define the circumstances under which adverse employment action may be taken; and

(4) impose more restrictive requirements on senior officers of the department for whom recusal is not viable or consistent with the prudent exercise of the department's responsibilities.

(h) The finance commission may adopt rules to administer this section, including rules to:

(1) codify employment policies of the banking commissioner adopted under Subsection (g);

(2) define or further define terms used by this section; and

(3) establish limits, requirements, or exemptions other than those specified by this section, except that an exempted employee must be recused from participation in or consideration of all regulatory matters specifically concerning the person to whom the exempted indebtedness is owed or the financial interest relates.

(i) Before the 11th day after the date on which an employee begins employment with the department, the employee shall read the conflict-of-interest statutes, rules, and policies applicable to employees of the department and sign a notarized affidavit stating that the employee has read those statutes, rules, and policies.

Sec. 12.108. Consumer Information and Complaints. (a) The banking commissioner shall:

(1) prepare information of consumer interest describing:

(A) the regulatory functions of the department; and

(B) the department's procedures by which consumer complaints are filed with and resolved by the department; and

(2) make the information available to the public and appropriate state agencies.

(b) The department shall maintain a file on each written complaint filed with the department. The file must include:

(1) the name of the person who filed the complaint;

(2) the date the complaint is received by the department;

(3) the subject matter of the complaint;

(4) the name of each person contacted in relation to the complaint;

(5) a summary of the results of the review or investigation of the complaint; and

(6) an explanation of the reason the file was closed.

(c) The department shall provide to the person filing the complaint and to each person who is a subject of the complaint a written summary of the department's policies and procedures relating to complaint investigation and resolution.

Sec. 12.1085. **Financial Literacy Program.** (a) The department shall seek to improve the financial literacy and education of persons in this state and to encourage access to mainstream financial products and services by persons who have not previously participated in the conventional finance system, by:

(1) coordinating, encouraging, and aiding banks in the development and promotion of financial literacy

and education programs and community outreach;

(2) serving as a clearinghouse of information about financial literacy and education programs;

(3) creating and maintaining a resource bank of materials pertaining to financial literacy; and

(4) promoting replication of best practices and exemplary programs that foster financial literacy and education.

(b) The department may solicit and accept a gift, grant, or donation from any source, including a foundation, private entity, governmental entity, or institution of higher education, to assist in the implementation of this section.

Sec. 12.109. **Sunset Provision.** The office of banking commissioner is subject to Chapter 325, Government Code (Texas Sunset Act). Unless continued in existence as provided by that chapter, the office is abolished September 1, 2019.

Sec. 12.110. [Repealed][2]

Sec. 12.111. Standards of Conduct. The banking commissioner or the banking commissioner's designee shall provide to agency employees, as often as necessary, information regarding the requirements for office or employment under this chapter, including information regarding a person's responsibilities under applicable laws relating to standards of conduct for state officers or employees.

Sec. 12.112. Equal Employment Opportunity Policy. (a) The banking commissioner or the banking commissioner's designee shall prepare and maintain a written policy statement that implements a program of equal employment opportunity to ensure that all personnel decisions are made without regard to race, color, disability, sex, religion, age, or national origin.

(b) The policy statement must include:

(1) personnel policies, including policies relating to recruitment, evaluation, selection, training, and promotion of personnel, that show the intent of the department to avoid the unlawful employment practices described by Chapter 21, Labor Code; and

(2) an analysis of the extent to which the composition of the department's personnel is in accordance with state and federal law and a description of reasonable methods to achieve compliance with state and federal law.

(c) The policy statement must:

(1) be updated annually;

(2) be reviewed by the state Commission on Human Rights for compliance with Subsection (b)(1); and

(3) be filed with the governor's office.

Sec. 12.113. [Repealed][3]

[The next chapter is Chapter 16]

[2] Repealed eff. Sept. 1, 2001, by Act of May 15, 2001, 77th Leg., ch. 412, ' 1.05, 2001 Tex. Sess. Law Serv. 701 (Vernon).

[3] Repealed eff. Sept. 1, 2009, by 81st Leg., H.B. 874.

CHAPTER 16. FINANCIAL REGULATORY AGENCIES: SELF-DIRECTED AND SEMI-INDEPENDENT

CHAPTER 16. FINANCIAL REGULATORY AGENCIES: SELF-DIRECTED AND SEMI-INDEPENDENT

Sec. 16.001. Definitions**.** In this chapter:

(1) "Financial regulatory agency" means:

(A) the Texas Department of Banking;

(B) the Department of Savings and Mortgage Lending;

(C) the Office of Consumer Credit Commissioner; and

(D) the Credit Union Department.

(2) "Policy-making body" means:

(A) the Finance Commission of Texas for:

(i) the Texas Department of Banking;

(ii) the Department of Savings and Mortgage Lending; and

(iii) the Office of Consumer Credit Commissioner; and

(B) the Credit Union Commission for the Credit Union Department.

Sec. 16.002. Self-Directed and Semi-Independent Status of Financial Regulatory Agencies. Notwithstanding any other provision of law, a financial regulatory agency is self-directed and semi-independent as specified by this chapter. Any Act of the 81st Legislature that relates to a financial regulatory agency and that is inconsistent with the agency being self-directed and semi-independent may be implemented by the financial regulatory agency only on authorization by the policy-making body of the financial regulatory agency.

Sec. **16.003. Budget, Revenues, and Expenses.** (a) A financial regulatory agency shall submit to the policy-making body of the financial regulatory agency a budget annually using generally accepted accounting principles. Notwithstanding any other provision of law, including the General Appropriations Act, the budget shall be adopted and approved only by the policy-making body of the financial regulatory agency.

(b) A financial regulatory agency shall be responsible for all direct and indirect costs of the agency's existence and operation. The financial regulatory agency may not directly or indirectly cause the general revenue fund to incur any cost.

(c) Subject to any limitations in a financial regulatory agency's enabling legislation, a financial regulatory agency may set the amounts of fees, penalties, charges, and revenues required or permitted by statute or rule as necessary for the purpose of carrying out the functions of the financial regulatory agency and funding the budget adopted and approved under Subsection (a).

(d) All fees and funds collected by a financial regulatory agency and any funds appropriated to the financial regulatory agency shall be deposited in interest-bearing deposit accounts in the Texas Treasury Safekeeping Trust Company. The comptroller shall contract with the financial regulatory agency for the maintenance of the deposit accounts under terms comparable to a contract between a commercial banking institution and the institution's customers.

(e) Periodically, each financial regulatory agency shall submit to the agency's policy-making body, as directed by the policy-making body, a report of the receipts and expenditures of the financial regulatory agency.

(f) The fiscal year for a financial regulatory agency begins on September 1 and ends on August 31.

Sec. 16.004. Audits. This chapter does not affect the duty of the state auditor to audit a financial regulatory agency. The state auditor shall enter into a contract and schedule with each financial regulatory agency to conduct audits, including financial reports and performance audits. The financial regulatory agency shall reimburse the state auditor for all costs incurred in performing the audits and shall provide to the governor a copy of any audit performed.

Sec. 16.005. Records; Reporting Requirements. (a) A financial regulatory agency shall keep financial and statistical information as necessary to disclose completely and accurately the financial condition and results of operations of the agency.

(b) Before the beginning of each regular session of the legislature, each financial regulatory agency shall submit to the legislature and the governor a report describing all of the agency's activities in the previous biennium. The report must include:

(1) an audit as required by Section 16.004;

(2) a financial report of the previous fiscal year, including reports on financial condition and results of operations;

(3) a description of all changes in fees imposed on regulated industries;

(4) a report on changes in the regulatory jurisdiction of the agency, including the number of chartered financial institutions, license holders, and registrants subject to the agency's jurisdiction and any changes in those figures; and

(5) a list of all new rules adopted or repealed.

(c) In addition to the reporting requirements of Subsection (b), not later than November 1 of each year, each financial regulatory agency shall submit to the governor, the committee of each house of the legislature that has jurisdiction over appropriations, and the Legislative Budget Board a report that contains:

(1) the salary for all financial regulatory agency personnel and the total amount of per diem expenses and travel expenses paid for all agency employees;

(2) the total amount of per diem expenses and travel expenses paid for each member of the agency's policy-making body, provided that only one report must be submitted regarding the Finance Commission of Texas;

(3) the agency's operating plan and annual budget; and

(4) a detailed report of all revenue received and all expenses incurred by the financial regulatory agency in the previous 12 months.

Sec. 16.006. Ability to Contract. (a) To carry out and promote the objectives of this chapter, a financial regulatory agency may enter into contracts and do all other acts incidental to those contracts that are necessary for the administration of the agency's affairs and for the attainment of the agency's purposes, except as limited by Subsection (b).

(b) Any indebtedness, liability, or obligation of the financial regulatory agency incurred under this section may not:

(1) create a debt or other liability of this state or another entity other than the financial regulatory agency; or

(2) create any personal liability on the part of the members of the policy-making body or the body's or agency's employees.

Sec. 16.007. Property. A financial regulatory agency may:

(1) acquire by purchase, lease, gift, or any other manner provided by law and maintain, use, and operate any real, personal, or mixed property, or any interest in property, necessary or convenient to the exercise of the powers, rights, privileges, or functions of the financial regulatory agency;

(2) sell or otherwise dispose of any real, personal, or mixed property, or any interest in property, that the financial regulatory agency determines is not necessary or convenient to the exercise of the agency's powers, rights, privileges, or functions;

(3) construct, extend, improve, maintain, and reconstruct, or cause to construct, extend, improve, maintain, and reconstruct, and use and operate all facilities necessary or convenient to the exercise of the powers, rights, privileges, or functions of the financial regulatory agency; and

(4) borrow money, as may be authorized from time to time by an affirmative vote of a two-thirds majority of the policy-making body of the financial regulatory agency, for a period not to exceed five years if necessary or convenient to the exercise of the financial regulatory agency's powers, rights, privileges, or functions.

Sec. **16.008. Suits.** The office of the attorney general shall represent a financial regulatory agency in any litigation. The attorney general may assess and collect from the financial regulatory agency reasonable attorney's fees associated with any litigation under this section.

Sec. **16.009. Post-Participation Liability.** (a) If a financial regulatory agency no longer has status under this chapter as a self-directed semi-independent financial regulatory agency for any reason, the agency shall be liable for any expenses or debts incurred by the agency during the time the agency was a self-directed semi-independent financial regulatory agency. The agency's liability under this section includes liability for any lease entered into by the agency. This state is not liable for any expense or debt covered by this subsection, and money from the general revenue fund may not be used to repay the expense or debt.

(b) If a financial regulatory agency no longer has status under this chapter as a self-directed semi-independent financial regulatory agency for any reason, ownership of any property or other asset acquired by the agency during the time the agency was a self-directed semi-independent financial regulatory agency, including unexpended fees in a deposit account in the Texas Treasury Safekeeping Trust Company, shall be transferred to this state.

Sec. **16.010. Due Process; Open Government.** A financial regulatory agency is:

(1) a governmental body for purposes of Chapters 551 and 552, Government Code; and

(2) a state agency for purposes of Chapters 2001 and 2005, Government Code.

Sec. **16.011. Membership in Employees Retirement System.** Employees of the financial regulatory agencies are members of the Employees Retirement System of Texas under Chapter 812, Government Code, and the agencies' transition to independent status as provided by this chapter has no effect on their membership or any benefits under that system.

Sec. 16.012. Gifts. (a) Notwithstanding any other law, a financial regulatory agency may not accept a gift, grant, or donation:

(1) from a party to an enforcement action; or

(2) to pursue a specific investigation or enforcement action.

(b) A financial regulatory agency must:

(1) report each gift, grant, or donation that the agency receives as a separate item in the agency's report required under Section 16.005(b); and

(2) include with the report a statement indicating the purpose for which each gift, grant, or donation was donated and used.

TITLE 3. FINANCIAL INSTITUTIONS AND BUSINESSES

SUBTITLE A. BANKS

CHAPTER 31. GENERAL PROVISIONS

Subchapter A. General Provisions

Subchapter B. Regulation of Banking by Banking Commissioner

Subchapter C. Administrative Procedure

Subchapter D. Confidentiality of Information

CHAPTER 31. GENERAL PROVISIONS

Subchapter A. General Provisions

Sec. 31.001. Short Title. This subtitle may be cited as the Texas Banking Act.

Sec. 31.002. Definitions. (a) In this subtitle:

(1) "Affiliate" means a company that directly or indirectly controls, is controlled by, or is under common control with a bank or other company.

(2) "Bank" means a state or national bank. If the context requires, the term includes a bank as

defined by Section 201.002(a)(4) that is organized under the laws of another state or country.

(3) “Bank holding company” has the meaning assigned by the Bank Holding Company Act of 1956 (12 U.S.C. Section 1841 et seq.) or a successor to that Act.

(4) “Banking” means the performance of the exclusive depository institution functions of accepting deposits and discounting loans and the performance of related activities that are not exclusive to banks or other depository institutions, including paying drafts or checks, lending money, and providing related financial services authorized by this subtitle.

(5) “Banking association” means a state bank that is organized under this subtitle as a corporation, authorized to issue shares of stock, and controlled by its shareholders.

(6) “Banking commissioner” means the banking commissioner of Texas or a person designated by the banking commissioner and acting under the banking commissioner’s direction and authority.

(7) “Board” means the board of directors of, or a person or group of persons acting in a comparable capacity for, a state bank or other entity. As the context requires, the term includes the board of managers of a limited banking association.

(8) “Branch” means a location of a bank, other than the bank’s home office, at which the bank engages the public in the business of banking. The term does not include:

(A) a drive-in facility located not more than 2,000 feet from the nearest wall of the home office or an approved branch office of the bank;

(B) a night depository;

(C) an electronic terminal;

(D) a deposit or loan production office as described by Section 32.204;

(E) a state or federally licensed armored car service or other courier service transporting items for deposit or payment, unless:

(i) the risk of loss of items in the custody of the service is borne by the employing bank; or

(ii) the items in the custody of the service are considered to be in customer accounts at the employing bank or federally insured through the employing bank;

(F) a location at which the bank offers exclusively nondepository financial products or services to the public, including financial, investment, or economic advisory services;

(G) a location that combines permissible non-branch functions or facilities; or

(H) another office or facility as provided by this subtitle or a rule adopted under this subtitle.

(9) “Capital” means:

(A) the sum of:

(i) the par value of all shares of the state bank having a par value that have been issued;

(ii) the consideration set by the board for all shares of the state bank without par value that have been issued, except a part of that consideration that:

(a) has been actually received;

(b) is less than all of that consideration; and

(c) the board, by resolution adopted not later than the 60th day after the date of issuance of those shares, has allocated to surplus with the prior approval of the banking commissioner; and

(iii) an amount not included in Subparagraphs (i) and (ii) that has been transferred to capital of the state bank, on the payment of a share dividend or on adoption by the board of a resolution directing that all or part of surplus be transferred to capital, minus each reduction made as permitted by law; less

(B) all amounts otherwise included in Paragraphs (A)(i) and (ii) that are attributable to the issuance of securities by the state bank and that the banking commissioner determines, after notice and an opportunity for hearing, should be classified as debt rather than equity securities.

(10) [Repealed][1]

(10-a) "Commercial activity" means an activity in which a bank holding company, financial holding company, national bank, or national bank financial subsidiary may not engage under United States law.

(11) "Company" includes a bank, trust company, corporation, partnership, association, business trust, or another trust.

(12) "Conservator" means the banking commissioner or an agent of the banking commissioner exercising the powers and duties provided by Subchapter B, Chapter 35.

(13) "Control" means:

(A) the ownership of or ability or power to vote, directly, acting through one or more other persons, or otherwise indirectly, 25 percent or more of the outstanding shares of a class of voting securities of a bank or other company;

(B) the ability to control the election of a majority of the board of a bank or other company;

(C) the power to exercise, directly or indirectly, a controlling influence over the management or policies of the bank or other company as determined by the banking commissioner after notice and an opportunity for hearing; or

(D) the conditioning of the transfer of 25 percent or more of the outstanding shares of a class of voting securities of a bank or other company on the transfer of 25 percent or more of the outstanding shares of a class of voting securities of another bank or other company.

(14) "Department" means the Texas Department of Banking.

(15) "Deposit" means the establishment of a debtor-creditor relationship represented by the agreement of the deposit debtor to act as a holding, paying, or disbursing agent for the deposit creditor. The term:

(A) includes:

(i) an unpaid balance of money that is received by the deposit debtor in the usual course of business in exchange for conditional or unconditional credit to a commercial, checking, savings, or time account of the deposit creditor or the creditor's designee, or that is evidenced by a certificate of deposit or similar instrument, a certified check or draft drawn against a deposit account, or a letter of credit or traveler's check on which the deposit debtor is primarily liable, but excluding an obligation arising under Chapter 152;

(ii) money or credit given for money received by the deposit debtor in the usual course of business for a special purpose, including money:

(a) held as escrow money, as security for an obligation due to the deposit debtor or another person, or as security for a loan;

(b) left with a deposit debtor by a deposit creditor to meet maturing obligations that are not yet due; and

(c) held by the deposit debtor to meet an acceptance or letter of credit;

(iii) an outstanding draft, cashier's check, money order, or other officer's check issued by the deposit debtor in the usual course of business for any purpose, including payment for services, dividends, or purchases; and

(iv) an obligation that the finance commission by rule defines as a deposit liability, except that the term may not include money received for immediate application to reduction of an indebtedness; and

(B) does not include an obligation that this subtitle or finance commission rule determines not to be a deposit liability.

(16) "Depository institution" means an entity with the power to accept deposits under applicable law.

(17) "Discount" means the retention by a lender of advance interest from loan proceeds. The term does not include the purchase of a promissory note or similar instrument at less than its face value unless the party selling the note is liable on the note as a maker, endorser, or guarantor.

[1] Repealed eff. Sept. 1, 2007, by Acts 2007, 80th Leg., ch. 110, §14.

(18) "Drive-in facility" means a facility offering one or more banking services other than originating or establishing a lending or deposit relationship solely to persons who remain outside the facility.

(19) "Electronic terminal" means an electronic device, other than a telephone or modem operated by a customer of a depository institution, through which a person may initiate an electronic fund transfer, as defined by 15 U.S.C. Section 1693a(6). The term includes a point-of-sale terminal, automated teller machine, or cash dispensing machine.

(20) "Equity capital" means the amount by which the total assets of a state bank exceed the total liabilities of the bank.

(21) "Equity security" means:

(A) stock, other than adjustable rate preferred stock and money market (auction rate) preferred stock;

(B) a certificate of interest or participation in a profit-sharing agreement, collateral-trust certificate, preorganization certificate or subscription, transferable share or participation share, investment contract, voting-trust certificate, or partnership interest;

(C) a security immediately convertible at the option of the holder without payment of substantial additional consideration into a security described by this subdivision;

(D) a security carrying a warrant or right to subscribe to or purchase a security described by this subdivision; and

(E) a certificate of interest or participation in, temporary or interim certificate for, or receipt for a security described by this subdivision that evidences an existing or contingent equity ownership interest.

(22) "Federal savings association" means a savings and loan association organized under federal law.

(23) "Federal savings bank" means a savings bank organized under federal law.

(24) "Finance commission" means the Finance Commission of Texas.

(25) "Financial institution" means a bank, savings association, or savings bank maintaining an office, branch, or agency office in this state.

(26) [Repealed][2]

(27) [Repealed][2]

(28) [Repealed][3]

(29) "Hazardous condition" means:

(A) a refusal by a state bank to permit examination of its books, papers, accounts, records, or affairs by the banking commissioner;

(B) a circumstance or condition in which an unreasonable risk of substantial loss is threatened to the depositors, creditors, or shareholders of a state bank, including a circumstance or condition in which a state bank:

(i) has inadequate equity capital, or the adequacy of its equity capital is threatened;

(ii) has concentrated an excessive or unreasonable portion of its assets in a type or character of loan or investment;

(iii) violates or refuses to comply with this subtitle, another statute or rule applicable to state banks, or a final and enforceable order of the banking commissioner;

(iv) is in a condition that renders the continuation of a particular business practice hazardous to the public or to its depositors and creditors;

(v) conducts business in an unsafe and unsound manner; or

(vi) is insolvent; or

[2] Repealed eff. May 29, 1999, by Acts 1999, 76th Leg., ch. 344, §9.002(1).

[3] Repealed eff. Sept. 1, 2007, by Acts 2007, 80th Leg., ch. 237, §80.

(C) a violation by a state bank of a condition of its chartering or an agreement entered into between the bank and the banking commissioner or the department.

(30) “Home office” means a location registered with the banking commissioner as the bank’s home office at which:

(A) the bank does business with the public;

(B) the bank keeps its corporate books and records; and

(C) at least one officer of the bank maintains an office.

(31) “Insolvent” means a circumstance or condition in which a state bank:

(A) is unable or lacks the means to meet its current obligations as they come due in the regular and ordinary course of business, even if the value of its assets exceeds its liabilities;

(B) has equity capital equal to two percent or less of its assets, as determined under regulatory accounting principles;

(C) fails to maintain deposit insurance with the Federal Deposit Insurance Corporation or its successor if the banking commissioner determines that deposit insurance is necessary for the safe and sound operation of the bank;

(D) sells or attempts to sell substantially all of its assets or merges or attempts to merge substantially all of its assets or business with another entity other than as provided by Chapter 32; or

(E) attempts to dissolve or liquidate other than as provided by Chapter 36.

(32) “Investment security” means a marketable obligation evidencing indebtedness of a person in the form of a bond, note, debenture, or commonly known as an investment security, subject to further definition by rule adopted under this subtitle.

(33) “Limited banking association” means a state bank that is organized under this subtitle as a limited liability company, authorized to issue participation shares, and controlled by its participants.

(34) “Loans and extensions of credit” means direct or indirect advances of money by a state bank to a person that are conditioned on the obligation of the person to repay the money or that are repayable from specific property pledged by or on behalf of the person. The term includes a contractual liability of a state bank to advance money to or on behalf of a person, indebtedness evidenced by a lease financing transaction in which the bank is lessor, an overdraft funded by the bank on behalf of a person except for an intraday or daylight overdraft, or another indebtedness not otherwise classified as an investment security. The term does not include accrued and unpaid interest or discounted interest.

(35) “Manager” means a person elected to the board of a limited banking association.

(36) [Repealed][3]

(37) “National bank” means a banking association organized under 12 U.S.C. Section 21.

(38) “Officer” means the presiding officer of the board, the principal executive officer, or another officer appointed by the board of a state bank or other company, or a person or group of persons acting in a comparable capacity for the state bank or other company.

(39) “Operating subsidiary” means a company for which a state bank has the ownership, ability, or power to vote, directly, acting through one or more other persons, or otherwise indirectly, more than 50 percent of the outstanding shares of each class of voting securities or its equivalent of the company.

(40) “Participant” means an owner of a participation share in a limited banking association.

(41) [Repealed][3]

(42) “Participation agreement” means the instrument stating the agreement among the participants of a limited banking association relating to the rights and duties of the participants, including:

(A) allocations of income, loss, deduction, credit, distributions, liquidation rights, redemption rights, and liabilities of participants;

(B) procedures for elections and voting by participants; and

(C) any other matter not prohibited by or inconsistent with this subtitle.

(43) "Participation shares" means the units into which the proprietary interests of a limited banking association are divided or subdivided by means of classes, series, relative rights, or preferences.

(44) "Principal shareholder" means a person who owns or has the ability or power to vote, directly, acting through one or more other persons, or otherwise indirectly, 10 percent or more of the outstanding shares or participation shares of any class of voting securities of a bank or other company.

(45) "Regulatory accounting principles" means generally accepted accounting principles as modified by rules adopted under:

(A) this subtitle; or

(B) an applicable federal statute or regulation.

(46) "Savings association" means a state or federal savings association.

(47) "Savings bank" means a state or federal savings bank.

(48) "Shareholder" means an owner of a share in a banking association. As the context requires, the term includes a participant.

(49) "Shares" means the units into which the proprietary interests of a banking association are divided or subdivided by means of classes, series, relative rights, or preferences. As the context requires, the term includes participation shares.

(50) "State bank" means a banking association or limited banking association organized or reorganized under this subtitle, including an association organized under the laws of this state before September 1, 1995, with the express power to receive and accept deposits and possessing other rights and powers granted by this subtitle expressly or by implication. The term does not include a savings association, savings bank, or credit union. If the context requires, the term includes a bank as defined by Section 201.002(a)(4) that is organized under the laws of another state or country.

(51) "State savings association" means a savings and loan association organized under the laws of this state.

(52) "State savings bank" means a savings bank organized under or subject to Subtitle C. If the context requires, the term includes a savings bank organized under the laws of another state.

(53) "Subsidiary" means a bank or company that is controlled by another person. The term includes a subsidiary of a subsidiary.

(54) "Supervisor" means the banking commissioner or an agent of the banking commissioner exercising the powers and duties specified in Subchapter B, Chapter 35.

(55) "Surplus" means the amount by which the assets of a state bank exceed its liabilities, capital, and undivided profits.

(56) "Unauthorized activity" means an act or practice in this state by a person without a charter, license, permit, registration, or other authority issued or granted by the banking commissioner or other appropriate regulatory authority for which such a charter, license, permit, registration, or other authority is required.

(57) "Undivided profits" means the part of equity capital of a state bank equal to the balance of its net profits, income, gains, and losses since the date of its formation, minus subsequent distributions to shareholders and transfers to surplus or capital under share dividends or appropriate board resolutions. The term includes amounts allocated to undivided profits as a result of a merger.

(58) "Voting security" means a share or other evidence of proprietary interest in a state bank or other company that has as an attribute the right to vote or participate in the election of the board of the state bank or other company, regardless of whether the right is limited to the election of fewer than all of the board members. The term includes a security that is convertible or exchangeable into a voting security.

(b) The definitions shall be liberally construed to accomplish the purposes of this subtitle.

(c) The finance commission by rule may adopt other definitions to accomplish the purposes of this subtitle.

Sec. 31.003. Banking Rules. (a) The finance commission may adopt rules to accomplish the purposes of this subtitle and Chapters 11, 12, and 13,[4] including rules necessary or reasonable to:

(1) implement and clarify this subtitle and Chapters 11, 12, and 13;

(2) preserve or protect the safety and soundness of state banks;

(3) grant at least the same rights and privileges to state banks that are or may be granted to national banks domiciled in this state;

(4) recover the cost of maintaining and operating the department and the cost of enforcing this subtitle and other applicable law by imposing and collecting ratable and equitable fees for notices, applications, and examinations; and

(5) facilitate the fair hearing and adjudication of matters before the banking commissioner and the finance commission.[5]

(b) In adopting rules, the finance commission shall consider the need to:

(1) promote a stable banking environment;

(2) provide the public with convenient, safe, and competitive banking services;

(3) preserve and promote the competitive position of state banks with regard to national banks and other depository institutions in this state consistent with the safety and soundness of state banks and the state bank system; and

(4) allow for economic development in this state.

(c) The presence or absence in this subtitle or Chapter 11, 12, or 13 of a specific reference to rules regarding a particular subject does not enlarge or diminish the rulemaking authority provided by this section.

Sec. 31.004. Unauthorized Banking. (a) Except as otherwise provided by law, a person other than a depository institution authorized to conduct business in this state may not conduct the business of banking or represent to the public that it is conducting the business of banking in this state.

(b) This section does not prohibit the continued operation of a bank, trust company, bank and trust company, or savings bank by:

(1) a person, partnership, trustee, or trustee operating under a common law declaration of trust who:

(A) was actively engaged in the operation of the institution on June 13, 1923; or

(B) operated the institution for any period of at least 20 years before June 13, 1923, and resumed operations of the institution not later than June 13, 1924; or

(2) a legal representative or successor of a person or entity described by Subdivision (1).

Sec. 31.005. Implying That Person Is Bank. (a) A person may not use the term “bank,” “bank and trust,” or a similar term or a character, ideogram, phonogram, phrase, or foreign language word in its name, stationery, or advertising in a manner that would imply to the public that the person is engaged in the business of banking in this state.

(b) Subsection (a) does not apply to a depository institution or other entity organized under the laws of this state, another state, the United States, or a foreign sovereign state to the extent that the depository institution or other entity is:

(1) authorized under its charter or the laws of this state or the United States to use a term, word, character, ideogram, phonogram, or phrase prohibited by Subsection (a); and

(2) authorized by the laws of this state or the United States to conduct the activities in which it is engaged in this state.

(c) A person violating this section is subject to an enforcement action initiated by the banking commissioner under Subchapter C, Chapter 35, except that the maximum administrative penalty under Section 35.211 for violation involving only Subsection (a) is $500 for each day the violation continues.

Sec. 31.006. Liability of Depository Institution Directors and Personnel. (a) The provisions of the Business Organizations Code regarding liability, defenses, and indemnification of a director, officer, agent, or employee of a corporation apply to a director,

[4] See 7 Tex. Admin. Code (TAC) Chapters 3, 9-15.

[5] See 7 TAC Chapter 9, relating to rules of procedure.

officer, agent, or employee of a depository institution in this state. Except as limited by those provisions, a disinterested director, officer, or employee of a depository institution may not be held personally liable in an action seeking monetary damages arising from the conduct of the depository institution's affairs unless the damages resulted from the gross negligence or wilful or intentional misconduct of the person during the person's term of office or service with the depository institution.

(b) A director, officer, or employee of a depository institution is disinterested with respect to a decision or transaction if:

(1) the person fully discloses any interest in the decision or transaction and does not participate in the decision or transaction; or

(2) the decision or transaction does not involve any of the following:

(A) personal profit for the person through dealing with the depository institution or usurping an opportunity of the depository institution;

(B) buying or selling an asset of the depository institution in a transaction in which the person has a direct or indirect pecuniary interest;

(C) dealing with another depository institution or other person in which the person is a director, officer, or employee or otherwise has a significant direct or indirect financial interest; or

(D) dealing with a family member of the person.

(c) A director or officer who, in performing the person's duties and functions, acts in good faith and reasonably believes that reliance is warranted is entitled to rely on information, including an opinion, report, financial statement or other type of statement or financial data, decision, judgment, or performance, prepared, presented, made, or rendered by:

(1) one or more directors, officers, or employees of the depository institution, or of an entity under joint or common control with the depository institution, who the director or officer reasonably believes merit confidence;

(2) legal counsel, a public accountant, or another person who the director or officer reasonably believes merits confidence; or

(3) a committee of the board of which the director is not a member.

(d) In this section, "family member" means a person's:

(1) spouse;

(2) minor child; or

(3) adult child who resides in the person's home.

Sec. 31.007. Exemption of Bank Directors and Personnel from Securities Law. (a) An officer, director, or employee of a bank that has its main office or a branch located in this state with fewer than 500 shareholders or of a bank holding company with fewer than 500 shareholders that controls a bank that has its main office or a branch located in this state is exempt from the registration and licensing provisions of The Securities Act (Article 581-1 et seq., Vernon's Texas Civil Statutes) with respect to that person's participation in a transaction, including a sale, involving securities issued by:

(1) the bank or bank holding company of which that person is an officer, director, or employee;

(2) a bank holding company that controls the bank of which that person is an officer, director, or employee; or

(3) a bank controlled by the bank holding company of which that person is an officer, director, or employee.

(b) A person may not be compensated for services performed under the exemption provided by this section.

Sec. 31.008. [Repealed][6]

Subchapter B. Regulation of Banking by Banking Commissioner

Sec. 31.101. General Duties of Banking Commissioner. The banking commissioner shall:

[6]Repealed eff. Sept. 1, 1999, by Acts 1999, 76th Leg., ch. 344, §9.002.

(1) supervise and regulate, as provided by this subtitle, Subtitles F and G, and Chapter 12, state banks, trust companies, and state-licensed foreign bank branches, agencies, and representative offices;

(2) administer and enforce this subtitle, Subtitles F and G, and Chapter 12 in person, through a deputy banking commissioner or another officer or employee of the department, or through a supervisor, conservator, or other agent; and

(3) administer and enforce laws other than this subtitle, Subtitles F and G, and Chapter 12 as directed by those other laws.

Sec. 31.102. Issuance of Interpretive Statements. (a) The banking commissioner may issue interpretive statements containing matters of general policy to guide the public and state banks, and may amend or repeal a published interpretive statement by issuing an amended statement or notice of repeal of a statement.

(b) An interpretive statement may be disseminated by newsletter, via an electronic medium such as the internet, in a volume of statutes or related materials published by the banking commissioner or others, or by other means reasonably calculated to notify persons affected by the interpretive statement. Notice of an amended or withdrawn statement must be disseminated in a substantially similar manner as the affected statement was originally disseminated.

Sec. 31.103. Issuance of Opinion. (a) In response to a specific request from a member of the public or the banking industry, the banking commissioner may issue an opinion directly or through a deputy banking commissioner or department attorney.

(b) If the banking commissioner determines that the opinion is useful for the general guidance of the public, state banks, or trust companies, the commissioner may disseminate the opinion by newsletter, via an electronic medium such as the internet, in a volume of statutes or related materials published by the banking commissioner or others, or by other means reasonably calculated to notify persons affected by the opinion. A published opinion must be redacted to preserve the confidentiality of the requesting party unless the requesting party consents to be identified in the published opinion.

(c) The banking commissioner may amend or repeal a published opinion by issuing an amended opinion or notice of repeal of an opinion and disseminating the opinion or notice in a substantially similar manner as the affected statement or opinion was originally disseminated. The requesting party, however, may rely on the original opinion if:

(1) all material facts were originally disclosed to the banking commissioner;

(2) the safety and soundness of the affected bank will not be affected by further reliance on the original opinion; and

(3) the text and interpretation of relevant, governing provisions of this subtitle or Chapter 12 have not been changed by legislative or judicial action.

Sec. 31.104. Effect of Interpretive Statement or Opinion. An interpretive statement or opinion issued under this subchapter does not have the force of law and is not a rule for the purposes of Chapter 2001, Government Code, unless adopted by the finance commission as provided by Chapter 2001, Government Code. An interpretive statement or opinion is an administrative construction of this subtitle or Chapter 12 entitled to great weight if the construction is reasonable and does not conflict with this subtitle or Chapter 12.

Sec. 31.105. Examination Required. (a) The banking commissioner shall examine each state bank annually, or on another periodic basis as may be required by rule or policy, or as the commissioner considers necessary to:

(1) safeguard the interests of depositors, creditors, and shareholders; and

(2) efficiently enforce applicable law.

(b) The banking commissioner may:

(1) accept an examination of a state bank by a federal or other governmental agency instead of an examination under this section; or

(2) conduct an examination of a state bank jointly with a federal or other governmental agency.

(c) The banking commissioner may:

(1) administer oaths and examine persons under oath on any subject that the commissioner considers pertinent to the financial condition or the safety and soundness of the activities of a state bank; and

(2) subpoena witnesses and require and compel by subpoena the production of documents not voluntarily produced.

(c-1) If a person refuses to obey a subpoena, a district court of Travis County, on application by the commissioner, may issue an order requiring the person to appear before the commissioner and produce documents or give evidence regarding the matter under examination or investigation.

(d) Disclosure of information to the banking commissioner pursuant to an examination request or a subpoena issued under this section does not constitute a waiver of or otherwise affect or diminish an evidentiary privilege to which the information is otherwise subject. A report of an examination under this section is confidential and may be disclosed only under the circumstances provided by this subtitle.

(e) A subpoena issued to a financial institution under this section is not subject to Section 59.006.

Sec. 31.106. Cost of Regulation. Each state bank shall pay, through the imposition and collection of fees established by the finance commission under Section 31.003(a)(4):[7]

(1) the cost of examination;

(2) the equitable or proportionate cost of maintenance and operation of the department; and

(3) the cost of enforcement of this subtitle and Chapter 12.

Sec. 31.107. Regulation and Examination of Related Entities. (a) The banking commissioner may regulate and examine, to the same extent as if the services or activities were performed by a state bank on its own premises:

(1) the activities of a state bank affiliate; and

(2) the performance of data processing, electronic fund transfers, or other bank services on behalf of a state bank by a third-party contractor, other than a national bank.

(b) The banking commissioner may collect a fee from an examined contractor or affiliate in connection with each examination to cover the cost of the examination or may collect that fee from the state banks that use the examined contractor.[8]

(c) For purposes of this section, a state bank affiliate does not include a company in which ownership or membership is limited to individuals and conditioned by law on the existence and maintenance of professional licensing.

Sec. 31.108. Call Report; Penalty. (a) A state bank shall file with the banking commissioner a copy of its call report stating the bank's financial condition and results of operation.

(b) The finance commission by rule may:[9]

(1) require call reports to be filed with the banking commissioner at the intervals the commission determines;

(2) specify the form of a call report, including the confidential and public information to be in the call report; and

(3) require public information in call reports of state banks to be published at the times and in the publications and locations the commission determines.

(c) A state bank that fails to timely file its call report as required by this section is subject to a penalty not exceeding $500 a day to be collected by suit by the attorney general on behalf of the banking commissioner.

Subchapter C. Administrative Procedure[10]

Sec. 31.201. Banking Commissioner Hearing; Informal Disposition. (a) The banking commissioner may convene a hearing to receive evidence and argument regarding any matter within the jurisdiction of and before the banking commissioner for decision or review. The hearing must be conducted under Chapter 2001, Government Code. A matter made confidential by law must be considered by the banking commissioner in a closed hearing.

[7] See 7 TAC §§3.36-3.38, relating to annual assessments and specialty examination fees.

[8] See 7 TAC §3.36(h), relating to specialty examination fees.

[9] See 7 TAC §3.21, relating to bank call reports.

[10] See 7 TAC Chapter 9, relating to rules of procedure.

(b) A hearing before the banking commissioner that is required or authorized by law may be conducted by a hearing officer on behalf of the banking commissioner.

(c) This section does not grant a right to hearing to a person that is not otherwise granted by governing law.

(d) The banking commissioner may informally dispose of a matter within the jurisdiction of and before the banking commissioner by consent order, agreed settlement, or default.

Sec. 31.202. Appeal of Banking Commissioner Decision or Order. Except as expressly provided otherwise by this subtitle, an appellant may appeal a decision or order of the banking commissioner made under this subtitle or Chapter 12 after hearing directly to the District Court of Travis County as provided by Section 31.204 or, at the option of the appellant, to the finance commission for review.

Sec. 31.203. Appeal to Finance Commission. (a) In an appeal to the finance commission, the finance commission shall consider the questions raised by the application for review and may also consider additional matters pertinent to the appeal.

(b) An order of the banking commissioner continues in effect pending review unless the order is stayed by the finance commission. The finance commission may impose any condition before granting a stay of the appealed order. The finance commission may not be required to accept additional evidence or hold an evidentiary hearing if a hearing was held and a record made before the banking commissioner. The finance commission shall remand the proceeding to the banking commissioner for the purpose of receiving any additional evidence the finance commission chooses to consider. A matter made confidential by law must be considered by the finance commission in a closed hearing.

(c) A hearing before the finance commission may be conducted by a hearing officer on behalf of the finance commission.

Sec. 31.204. Direct Appeal to Court or Appeal of Finance Commission Order. A person affected by a final order of the banking commissioner who elects to appeal directly to district court, or a person affected by a final order of the finance commission under this chapter, may appeal the final order by filing a petition for judicial review in the District Court of Travis County as provided by Chapter 2001, Government Code. A petition for judicial review filed in the district court does not stay or vacate the appealed order unless the court, after notice and hearing, expressly stays or vacates the order.

Subchapter D. Confidentiality of Information[11]

Sec. 31.301. Disclosure by Department Prohibited. (a) Except as expressly provided otherwise by this subtitle, Chapter 11 or 12, or a rule adopted under this subtitle, the following are confidential and may not be disclosed by the banking commissioner or an employee of the department:

(1) information directly or indirectly obtained by the department in any manner, including an application or examination, concerning the financial condition or business affairs of a financial institution or a present, former, or prospective shareholder, officer, director, affiliate, or service provider of a financial institution, other than information in a published statement or in the public portion of a call report or profit and loss statement; and

(2) all related files and records of the department.

(b) Information obtained by the department from a federal or state regulatory agency that is confidential under federal or state law may not be disclosed except as provided by federal or state law.

(c) The banking commissioner or an officer or employee of the department commits an offense if the person:

(1) discloses information or permits access to a file or record of the department; and

(2) knows at the time of disclosure or permission that the disclosure or permission violates this subchapter.

(d) An offense under this section is a Class A misdemeanor.

Sec. 31.302. Disclosure to Finance Commission. Confidential information may not be disclosed to a member of the finance commission, and a member of the commission may not be given access to the files and records of the department except that the banking commissioner may disclose to the commission

[11] See 7 TAC §3.111, relating to confidential information.

information, files, and records pertinent to a hearing or matter pending before the commission.

Sec. 31.303. Disclosure to Other Agencies. (a) For purposes of this section:

(1) "Affiliated group" means two or more persons affiliated through common ownership or a contractual common undertaking involving the sharing of customer information among those persons.

(2) "Agency" means a department or agency of this state, another state, the United States, or a foreign government with whom the United States currently maintains diplomatic relations, or any related agency or instrumentality.

(3) "Functional regulatory agency" means an agency that regulates and charters, licenses, or registers persons engaged in financial activities or activities incidental or complimentary to financial activities, including activities related to banking, insurance, or securities, within the jurisdiction of the agency.

(4) "Privilege" includes any work-product, attorney-client, or other privilege recognized under federal or state law.

(b) The banking commissioner may, as the commissioner considers necessary or proper to the enforcement of the laws of this state, another state, the United States, or a foreign sovereign state with whom the United States currently maintains diplomatic relations, or in the best interest of the public, disclose information in the possession of the department to another agency. The banking commissioner may not disclose information under this section that is confidential under applicable state or federal law unless:

(1) the recipient agency agrees to maintain the confidentiality and take all reasonable steps to oppose an effort to secure disclosure of the information from the agency; or

(2) the banking commissioner determines in the exercise of discretion that the interest of law enforcement outweighs and justifies the potential for disclosure of the information by the recipient agency.

(c) The banking commissioner by agreement may establish an information sharing and exchange program with a functional regulatory agency that has overlapping regulatory jurisdiction with the department, with respect to all or part of an affiliated group that includes a financial institution, to reduce the potential for duplicative and burdensome filings, examinations, and other regulatory activities. Each agency party to the agreement must agree to maintain confidentiality of information that is confidential under applicable state or federal law and take all reasonable steps to oppose any effort to secure disclosure of the information from the agency. An agreement may also specify procedures regarding use and handling of confidential information and identify types of information to be shared and procedures for sharing on a recurring basis.

(d) Disclosure of information by or to the banking commissioner under this section does not constitute a waiver of or otherwise affect or diminish an evidentiary privilege to which the information is otherwise subject, whether or not the disclosure is governed by a confidentiality agreement.

(e) Notwithstanding other law, an agency of this state:

(1) may execute, honor, and comply with an agreement to maintain confidentiality and oppose disclosure of information obtained from the banking commissioner as provided in this section; and

(2) shall treat as confidential any information obtained from the banking commissioner that is entitled to confidential treatment under applicable state or federal law and take all reasonable steps to oppose an effort to secure disclosure of the information from the agency.

Sec. 31.304. Other Disclosure Prohibited; Penalty. (a) Confidential information that is provided to a financial institution, affiliate, or service provider of a financial institution, whether in the form of a report of examination or otherwise, is the confidential property of the department. The information may not be made public or disclosed by the recipient or by an officer, director, manager, employee, or agent of the recipient to a person not officially connected to the recipient as officer, director, employee, attorney, auditor, or independent auditor except as authorized by rules adopted under this subtitle.

(b) A person commits an offense if the person discloses or uses information in violation of this section. An offense under this section is punishable as if it were an offense under Section 37.10, Penal Code.

Sec. 31.305. Civil Discovery. Civil discovery of confidential information from a person subject to Section 31.304 under subpoena or other legal process must comply with rules adopted under this subtitle and other applicable law. The rules may:

(1) restrict release of confidential information to the portion directly relevant to the legal dispute at issue; and

(2) require that a protective order, in form and under circumstances specified by the rules, be issued by a court before release of the confidential information.[12]

Sec. 31.306. Investigative Information. Notwithstanding any other law, the banking commissioner may refuse to release information or records in the custody of the department if, in the opinion of the commissioner, release of the information or records might jeopardize an ongoing investigation of potentially unlawful activities.

Sec. 31.307. Employment Information. (a) A person may provide employment information concerning the known or suspected involvement of a present or former employee, officer, or director of a financial institution in a violation of a state or federal law, rule, or regulation that has been reported to appropriate state or federal authorities to:

(1) the financial institution; or

(2) a person providing employment information to the financial institution.

(b) A person may not be held liable for providing information under Subsection (a) unless the information provided is false and the person provided the information with disregard for the truth.

Sec. 31.308. Shareholder Inspection Rights. (a) Notwithstanding Section 21.218 or 101.502, Business Organizations Code, a shareholder of a state bank may not examine:

(1) a report of examination or other confidential property of the department that is in the possession of the state bank; or

(2) a book or record of the state bank that directly or indirectly pertains to financial or other information maintained by the bank on behalf of its customers, including a specific item in the minutes of the board or a committee of the board regarding loan review and approval or a loan delinquency report that would tend to identify the bank's customer.

(B) This section does not affect a right of a shareholder of a state bank acting in another capacity.

[12] See 7 TAC §3.111(f), relating to discovery of confidential information, for form of protective order.

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CHAPTER 32. POWERS, ORGANIZATION, AND FINANCIAL REQUIREMENTS

Subchapter A. Organization and Powers in General

Subchapter B. Amendment of Certificate; Changes in Capital and Surplus

Subchapter C. Bank Offices

Subchapter D. Merger

Subchapter E. Purchase or Sale of Assets

Subchapter F. Exit of State Bank or Entry of Another Financial Institution

CHAPTER 32. POWERS, ORGANIZATION, AND FINANCIAL REQUIREMENTS

Subchapter A. Organization and Powers in General

Sec. 32.001. Organization and General Powers of State Bank. (a) One or more persons, a majority of whom are residents of this state, may organize a state bank as a banking association or a limited banking association.

(b) A state bank may:

(1) receive and pay deposits with or without interest, discount and negotiate promissory notes, borrow or lend money with or without security or interest, invest and deal in securities, buy and sell exchange, coin, and bullion, and exercise incidental powers as necessary to carry on the business of banking as provided by this subtitle;

(2) act as agent, or in a substantially similar capacity, with respect to a financial activity or an activity incidental or complementary to a financial activity;[1]

(3) act in a fiduciary capacity, without giving bond, as guardian, receiver, executor, administrator, or trustee, including a mortgage or indenture trustee;

(4) provide financial, investment, or economic advisory services;

(5) issue or sell instruments representing pools of assets in which a bank may invest directly;

(6) with prior written approval of the banking commissioner, engage in a financial activity or an activity that is incidental or complementary to a financial activity; and

(7) engage in any other activity, directly or through a subsidiary, authorized by this subtitle or rules adopted under this subtitle.[2]

(c) For purposes of other state law, a banking association is considered a corporation and a limited banking association is considered a limited liability company. To the extent consistent with this subtitle, a banking association may exercise the powers of a Texas business corporation and a limited banking association may exercise the powers of a Texas limited liability company as reasonably necessary to enable exercise of specific powers under this subtitle.

(d) A state bank may contribute to a community fund or to another charitable, philanthropic, or benevolent instrumentality conducive to public welfare an amount that the bank's board considers expedient and in the interests of the bank.

(e) A state bank may be organized or reorganized as a community development financial institution or may serve as a community development partner, as those terms are defined by the Riegle Community Development and Regulatory Improvement Act of 1994 (Pub. L. No. 103-325).

(f) In the exercise of discretion consistent with the purposes of this subtitle, the banking commissioner may require a state bank to conduct an otherwise authorized activity through a subsidiary.

Sec. 32.002. Certificate of Formation of State Bank. (a) The certificate of formation of a state bank must be signed and acknowledged by each organizer and must contain:

(1) the name of the bank, subject to Subsection (b);

(2) the period of the bank's duration, which may be perpetual, subject to Subsection (c);

(3) the powers of the bank, which may be stated as:

(A) all powers granted by law to a state bank; or

(B) a list of the specific powers under Section 32.001 that the bank chooses to exercise;

(4) the aggregate number of shares that the bank will be authorized to issue and the number of classes of shares, which may be one or more;

(5) if the shares are to be divided into classes:

[1] Also see Section 59.005, Finance Code, relating to agent activities for another financial institution.

[2] With respect to certain securities activities, see 7 TAC §3.1, relating to private placement of securities; 7 TAC §3.2, relating to investment and financial advisory services, 7 TAC §3.3, relating to securities activities of subsidiaries, and 7 TAC §3.5, relating to financial valuation and advisory services.

(A) the designation of each class and statement of the preferences, limitations, and relative rights of the shares of each class, which in the case of a limited banking association may be more fully set forth in the participation agreement;

(B) the number of shares of each class; and

(C) a statement of the par value of the shares of each class or that the shares are to be without par value;

(6) any provision limiting or denying to shareholders the preemptive right to acquire additional or treasury shares of the bank;

(7) any provision granting the right of shareholders to cumulative voting in the election of directors;

(8) the aggregate amount of consideration to be received for all shares initially issued by the bank and a statement that:

(A) all authorized shares have been subscribed; and

(B) all subscriptions received have been irrevocably paid in cash;[3]

(9) any provision that is otherwise required by this subtitle to be set forth in the certificate of formation;

(10) the street address of the bank's initial home office;

(11) the number of directors constituting the initial board and the names and street addresses of the persons who are to serve as directors until the first annual meeting of shareholders or until successor directors have been elected and qualified; and

(12) subject to Section 32.008, any provision consistent with law that organizers elect to set forth in the certificate of formation for the regulation of the internal affairs of the bank, including provisions permissible under the Business Organizations Code for:

(A) a for-profit corporation, in the case of a proposed banking association; or

(B) a limited liability company, in the case of a proposed limited banking association.

(b) The banking commissioner may determine that a proposed bank name is potentially misleading to the public and require the organizers to select a different name.

(c) A state bank, other than a private bank, organized before August 31, 1993, is considered to have perpetual existence, notwithstanding a contrary statement in its articles of association, unless after September 1, 1995, the bank amends its certificate of formation or articles of association to reaffirm its limited duration.

(d) [*Repealed eff. Sept. 1, 2007, by 80th Tex. Leg., ch. 237 (H.B. 1962), §80.*]

Sec. 32.003. Application for State Bank Charter; Standards for Approval. (a) An application for a state bank charter must be made under oath and in the form required by the banking commissioner, who shall inquire fully into the identity and character of each proposed director, officer, and principal shareholder. The application must be accompanied by all charter fees and deposits required by law.[4]

(b) The banking commissioner shall grant a state bank charter only if the commissioner determines that the organizers have established that public convenience and advantage will be promoted by the establishment of the state bank. In determining whether public convenience and advantage will be promoted, the banking commissioner shall consider the convenience of the public to be served and whether:

(1) the organizational and capital structure and amount of initial capitalization is adequate for the business plan;

(2) the anticipated volume and nature of business indicates a reasonable probability of success and profitability based on the market sought to be served;

(3) the officers and directors as a group have sufficient banking experience, ability, standing, competence, trustworthiness, and integrity to justify a belief that the bank will operate in compliance with law

[3] See Section 16(a), Article XVI, Texas Constitution.

[4] See 7 TAC §15.2 and 15.6, relating to application for state bank charter; also see 7 TAC §15.24, relating to option to withhold identity of officers. With respect to interim bank charters, see 7 TAC §15.23.

and that success of the bank is probable;

(4) each principal shareholder has sufficient experience, ability, standing, competence, trustworthiness, and integrity to justify a belief that the bank will be free from improper or unlawful influence or interference with respect to the bank's operation in compliance with law; and

(5) the organizers are acting in good faith.

Sec. 32.004. Notice and Investigation of Charter Application. (a) The organizers shall solicit comments and protests by publishing notice of the application, its date of filing, and the identity of the organizers, in the form and frequency specified by the banking commissioner, in a newspaper of general circulation in the county in which the bank is to be located, or in another publication or location as directed by the banking commissioner.

(b) At the expense of the organizers, the banking commissioner shall thoroughly investigate the application. The banking commissioner shall prepare a written report of the investigation.

(c) Rules adopted under this subtitle may specify the confidential or nonconfidential character of information obtained or prepared by the department under this chapter.[5] Except as provided by Subchapter D, Chapter 31, or in rules regarding confidential information, the business plan of the applicant and the financial statement of a proposed officer or director are confidential and not subject to public disclosure.

Sec. 32.005. Protest; Hearing; Decision on Charter Application. (a) A protest of a charter application must be received by the department before the 15th day after the date the organizers publish notice under Section 32.004(a) and must be accompanied by the fees and deposits required by law.[6] If the protest is untimely, the department shall return all submitted fees and deposits to the protesting party. If the protest is timely, the department shall notify the applicant of the protest and mail or deliver a complete copy of the nonconfidential sections of the charter application to the protesting party before the 15th day after the later of the date of receipt of the protest or receipt of the charter application.

(b) A protesting party must file a detailed protest responding to each contested statement contained in the nonconfidential portion of the application not later than the 20th day after the date the protesting party receives the application from the department, and relate each statement and response to the standards for approval set forth in Section 32.003(b)[7] The applicant must file a written reply to the protesting party's detailed response on or before the 10th day after the date the response is filed. The protesting party's response and the applicant's reply must be verified by affidavit and must certify that a copy was served on the opposing party. If applicable, statements in the response and in the reply may be supported by references to data available in sources of which official notice may properly be taken. Any comment received by the department and any reply of the applicant to the comment shall be made available to the protesting party.

(c) The banking commissioner may not be compelled to hold a hearing before granting or denying the charter application. In the exercise of discretion, the banking commissioner may consider granting a hearing on a charter application at the request of the applicant or a protesting party. The banking commissioner may order a hearing regardless of whether a hearing has been requested by a party. A party requesting a hearing must indicate with specificity the issues involved that cannot be determined on the basis of the record compiled under Subsection (b) and why the issues cannot be determined. A request for hearing and the banking commissioner's decision with regard to granting a hearing shall be made a part of the record. If the banking commissioner sets a hearing, the banking commissioner shall conduct a public hearing and one or more prehearing conferences and opportunities for discovery as the banking commissioner considers advisable and consistent with the applicable law, except that the banking commissioner may not permit discovery of confidential information in the charter application or the investigation report.

(d) Based on the record, the banking commissioner shall determine whether the application meets the requirements of Section 32.003(b) and shall enter an order granting or denying the charter.

(e) The banking commissioner may make approval of an application conditional. The banking commissioner shall include any conditions in the order approving the application.

[5] See 7 TAC §3.111, relating to confidential information.

[6] A protest fee may be required, see 7 TAC §15.2(c), relating to filing fees and cost deposits.

[7] See 7 TAC Chapter 9, relating to rules of procedure.

(f) Chapter 2001, Government Code, does not apply to a charter application filed for the purpose of assuming the assets and liabilities of a financial institution considered by the banking commissioner to be in hazardous condition.

Sec. 32.006. Issuance of Certificate of Authority. A state bank may not engage in the business of banking until it receives a certificate of authority from the banking commissioner. The banking commissioner may not deliver the certificate of authority until the bank has:

(1) received cash for the issuance of all authorized shares in the full amount subscribed;

(2) elected or qualified the initial officers and directors named in the application for charter or other officers and directors approved by the banking commissioner; and

(3) complied with all the other requirements of this subtitle relating to the organization of state banks.

Sec. 32.007. Deadline to Begin Business. If the state bank does not open and engage in the business of banking within six months after the date of the granting of its charter, the banking commissioner may forfeit the charter or cancel the conditional approval of application for charter without judicial action.

Sec. 32.008. Application of General Corporate Law. (a) The Business Organizations Code applies to a banking association as if it were a for-profit corporation, and to a limited banking association as if it were a limited liability company, to the extent not inconsistent with this subtitle or the proper business of a state bank, except that:

(1) a reference in the Business Organizations Code to the secretary of state means the banking commissioner unless the context requires otherwise; and

(2) the right of shareholders to cumulative voting in the election of directors exists only if granted by the bank's certificate of formation.

(b) The finance commission may adopt rules to limit or refine the applicability of the laws listed by Subsection (a) to a state bank or to alter or supplement the procedures and requirements of those laws applicable to an action taken under this chapter.[8]

(c) Unless expressly authorized by this subtitle or a rule adopted under this subtitle, a state bank may not take an action authorized by a law listed by Subsection (a) regarding its corporate status, its capital structure, or a matter of corporate governance, of the type for which those laws would require a filing with the secretary of state if the bank were a filing entity, without submitting the filing to the banking commissioner and obtaining the banking commissioner's prior written approval of the action.

(d) In this subtitle, a reference to a term or phrase listed in a subdivision of Section 1.006, Business Organizations Code, includes a synonymous term or phrase referenced by the same subdivision in Section 1.006 of that code.

Sec. 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

[8] See 7 TAC §15.9, relating to corporate filings.

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.[9]

(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.

Sec. 32.0095. [*Repealed eff. Sept. 1, 1999, by 76th Tex. Leg., ch. 344 (H.B. 2066), §9.002.*]

Sec. 32.010. Additional Powers. (a) Not withstanding 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

[9] See 7 TAC Chapter 9, relating to rules of procedure.

(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;

(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.[10]

(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.

Sec. 32.011. Financial Activities. (a) The finance commission by rule may determine that an activity not otherwise approved or authorized for a state bank under this subtitle or other law is:

(1) a financial activity;

(2) incidental to a financial activity; or

(3) complementary to a financial activity.

(b) In adopting a rule under Subsection (a), the finance commission shall consider:

(1) the purposes of this subtitle and the Gramm-Leach-Bliley Act (Pub. L. No. 106-102);

(2) changes or reasonably expected changes in the marketplace in which state banks compete;

(3) changes or reasonably expected changes in the technology for delivering financial services;

(4) whether the activity is necessary or appropriate to allow a state bank to:

[10] See 7 TAC Chapter 9, relating to rules of procedure.

(A) compete effectively with another company seeking to provide financial services;

(B) efficiently deliver information and services that are financial in nature through the use of technological means, including an application necessary to protect the security or efficacy of systems for the transmission of data or financial transactions; or

(C) offer customers available or emerging technological means for using financial services or for the document imaging of data;

(5) whether the activity would pose a substantial risk to the safety or soundness of a state bank or the financial system generally;

(6) if otherwise determined to be permissible, whether the conduct of the activity by a state bank should be qualified through the imposition of reasonable and necessary conditions to protect the public and require appropriate regard for safety and soundness of the bank and the financial system generally; and

(7) whether a state bank would be permitted to engage in the activity under applicable federal law, including 12 U.S.C. Section 1831a, and related regulations.

(c) A rule adopted by the finance commission under this section does not alter or negate applicable licensing and regulatory requirements administered by a functional regulatory agency of this state, as defined by Section 31.303, including licensing and regulatory requirements pertaining to:

(1) insurance activities;

(2) securities activities; and

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

Subchapter B. Amendment of Certificate; Changes in Capital and Surplus

Sec. 32.101. Amendment or Restatement of State Bank Certificate of Formation. (a) A state bank that has been granted a certificate of authority may amend or restate its certificate of formation for any lawful purpose, including the creation of authorized but unissued shares or participation shares in one or more classes or series.[11]

(b) An amendment authorizing the issuance of shares or participation shares in series must contain:

(1) the designation of each series and a statement of any variations in the preferences, limitations, and relative rights among series to the extent that the preferences, limitations, and relative rights are to be established in the certificate of formation; and

(2) a statement of any authority to be vested in the bank's board to establish series and determine the preferences, limitations, and relative rights of each series.

(c) Amendment or restatement of the certificate of formation of a state bank and approval of the bank's board and shareholders must be made or obtained as provided by the Business Organizations Code except as otherwise provided by this subtitle or rules adopted under this subtitle. The original and one copy of the certificate of amendment or restated certificate of formation must be filed with the banking commissioner for approval. Unless the submission presents novel or unusual questions, the banking commissioner shall approve or reject the amendment or restatement not later than the 31st day after the date the banking commissioner considers the submission informationally complete and accepted for filing. The banking commissioner may require the submission of additional information as considered necessary to an informed decision to approve or reject any amendment or restatement of a certificate of formation under this section. If the banking commissioner finds that the amendment or restatement conforms to law and any conditions imposed by the banking commissioner, and any required filing fee has been paid,[12] the banking commissioner shall:

(1) endorse the face of the original and copy of the amendment or restatement with the date of approval and the word "Approved";

(2) file the original of the amendment or restatement in the department's records; and

(3) deliver a certified copy of the amendment or restatement to the bank.

(d) Expired.

[11] See Section 16(a), Article XVI, Texas Constitution, for prohibition of authorized but unissued shares in initial articles of association.

[12] See 7 TAC §15.2, relating to filing fees and cost deposits.

(e) An amendment or restatement, if approved, takes effect on the date of approval unless the amendment or restatement provides for a different effective date.

Sec. 32.102. Establishing Series of Shares. (a) If the certificate of formation expressly gives the board of a state bank authority to establish shares in series and determine the preferences, limitations, and relative rights of each series, the board may do so only in compliance with this section and any rules adopted under this subtitle.

(b) A series of shares may be established in the manner provided by the Business Organizations Code, but the shares of the series may not be issued and sold without the prior written approval of the banking commissioner under Section 32.103. The bank shall file the original and one copy of the statement of action required by the Business Organizations Code with the banking commissioner.

(c) Unless the submission presents novel or unusual questions, the banking commissioner shall approve or reject the series not later than the 31st day after the date the banking commissioner considers the submission informationally complete and accepted for filing. The banking commissioner may require the submission of additional information as considered necessary to an informed decision to approve or reject a proposed series under this section.

(d) If the banking commissioner finds that the interests of depositors and creditors will not be adversely affected by the series, that the series conforms to law and any conditions imposed by the banking commissioner, and that any required filing fee has been paid, the banking commissioner shall:

(1) endorse the face of the original and copy of the statement with the date of approval and the word “Approved”;

(2) file the original of the statement in the department’s records; and

(3) deliver a certified copy of the statement to the state bank.

Sec. 32.103. Change in Outstanding Capital and Surplus. (a) A state bank may not reduce or increase its outstanding capital and surplus through dividend, redemption, issuance of shares, or otherwise, without the prior written approval of the banking commissioner, except as permitted by this section or rules adopted under this subtitle.[13]

(b) Unless restricted by rule, prior written approval is not required for an increase in capital and surplus accomplished through:

(1) issuance of shares of common stock for cash, or a cash contribution to surplus by shareholders that does not result in issuance of additional common stock or other securities;

(2) declaration and payment of pro rata share dividends as defined by the Business Organizations Code; or

(3) adoption by the board of a resolution directing that all or part of undivided profits be transferred to capital or surplus.

(c) Prior approval is not required for:

(1) a decrease in capital or surplus caused by losses in excess of undivided profits; or

(2) a change in capital and surplus resulting from accounting adjustments required by a transaction approved by the banking commissioner if the accounting adjustments are reasonably disclosed in the submitted application.

Sec. 32.104. Capital Notes or Debentures. (a) With the prior written approval of the banking commissioner, a state bank may at any time, through action of its board and without requiring action of its shareholders, issue and sell its capital notes or debentures. The capital notes or debentures must be subordinate to the claims of depositors and may be subordinate to other claims, including the claims of other creditors or the shareholders.

(b) Capital notes or debentures may be convertible into shares of any class or series. The issuance and sale of convertible capital notes or debentures are subject to satisfaction of preemptive rights, if any, to the extent provided by law.

(c) Without the prior written approval of the banking commissioner, a state bank may not pay interest due or principal repayable on outstanding capital notes or debentures when the bank is in hazardous condition or is insolvent, or to the extent that

[13] See 7 TAC §15.2, relating to filing fees and cost deposits.

payment will cause the bank to be in hazardous condition or insolvent, as determined by the banking commissioner.

(d) The amount of any outstanding capital notes or debentures that meet the requirements of this section and that are subordinated to unsecured creditors of the bank may be included in equity capital of the bank for purposes of determining hazardous condition or insolvency and for other purposes provided by rules adopted under this subtitle.

Subchapter C. Bank Offices

Sec. 32.201. Conduct of the Business of Banking. (a) A state bank may engage in the banking business at its home office, at an approved branch office location, and through electronic terminals. A drive-in facility must be approved as a branch if it is more than 2,000 feet from the nearest wall of the bank's home office or another approved branch office.

(b) A function of a state bank that does not involve banking contact with the public may be conducted at any location without prior written approval of the banking commissioner. The finance commission may adopt rules further defining functions of a state bank that are not required to be conducted at an approved location.

(c) The finance commission by rule under Section 32.009 may authorize a new form of banking facility. The banking commissioner may approve a new form of banking facility other than as provided by this subchapter if the banking commissioner does not have a significant supervisory or regulatory concern regarding the proposed facility.

Sec. 32.202. Home Office.(a) Each state bank must have and continuously maintain in this state a home office. The home office must be a location at which the bank does business with the public and keeps its corporate books and records. At least one officer of the bank must maintain an office at the home office.

(b) A state bank may change its home office to one of its previously established branch locations in this state, if the location that is the home office before the change is to remain as a branch of the bank, by filing a written notice with the banking commissioner. The notice must set forth the name of the bank, the street address of its home office before the change, the street address of the location to which the home office is to be changed, and a copy of the resolution adopted by the bank's board authorizing the change. The change of home office takes effect on the 31st day after the date the banking commissioner receives the notice unless the banking commissioner consents to a different effective date.[14]

(c) A state bank may change its home office to any location in this state, other than as permitted by Subsection (b), on prior written approval of the banking commissioner. The banking commissioner shall grant an application under this subsection if the banking commissioner does not have a significant supervisory or regulatory concern regarding the proposed banking facility, the applicant, or an affiliate of the applicant. Any standard established by the banking commissioner or the finance commission regarding the establishment of a branch under Section 32.203 applies to an application for a change of home office that is subject to this subsection, except as otherwise provided by rules adopted under this subtitle.[15]

(d) If the proposed relocation of the bank's home office would effect an abandonment of all or part of the community served by the bank, the bank must establish to the satisfaction of the banking commissioner that the abandonment is consistent with the original determination of public necessity for the establishment of a bank at that location.

Sec. 32.203. Branch Offices. (a) A state bank may establish and maintain a branch office at any location[16] on prior written approval of the banking commissioner. If the banking commissioner does not have a significant supervisory or regulatory concern regarding the proposed branch, the applicant, or an affiliate of the applicant, the banking commissioner shall approve the application.

(b) The finance commission may adopt rules establishing additional standards for the approval of branch offices.[17]

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[14] See 7 TAC §§15.2 and 15.41, relating to change of home office.

[15] See 7 TAC §§15.2 and 15.41. For standards applicable to establishing a branch office, see 7 TAC §15.42.

[16] With respect to a branch office in another state or foreign country (interstate branch), see Section 203.001, Finance Code. With respect to a branch in a foreign country, see 7 TAC §3.4, relating to foreign banking.

[17] See 7 TAC §§15.2 and 15.42, relating to establishing branch offices.

(c) A state bank may not establish or maintain a branch on the premises or property of an affiliate if the affiliate engages in a commercial activity.

Sec. 32.204. Deposit or Loan Production Offices.[18] (a) A state bank may establish one or more deposit or loan production offices for the purpose of:

(1) soliciting deposit accounts, applications for loans, or equivalent transactions;

(2) performing ministerial duties related to solicitations described by Subdivision (1); and

(3) conducting other activities as permitted by rules adopted under this subtitle.

(b) The bank shall notify the banking commissioner in writing of the location of and activities to be conducted at a proposed deposit or loan production office of the bank. The bank may establish the proposed office beginning on the 31st day after the date the banking commissioner receives the bank's notice unless the banking commissioner specifies that the proposed office be established on an earlier or later date.

(c) The banking commissioner may extend the 30-day period prescribed by Subsection (b) on a determination that the bank's notice raises issues that require additional information or time for analysis. If the period is extended, the bank may establish the proposed deposit or loan production office only with the prior written approval of the banking commissioner.

Subchapter D. Merger

Sec. 32.301. Merger Authority. (a) Two or more financial institutions, corporations, or other entities with the authority to participate in a merger, at least one of which is a state bank, may adopt and implement a plan of merger in accordance with this section.[19] The merger may not be made without the prior written approval of the banking commissioner if any surviving, new, or acquiring entity that is a party to the merger or created by the terms of the merger is a state bank or is not a financial institution.

(b) Implementation of the merger by the parties and approval of the board, shareholders, or owners of the parties must be made or obtained in accordance with the Business Organizations Code as if the state bank were a filing entity and all other parties to the merger were foreign entities, except as may be otherwise provided by applicable rules.

(c) A consummated merger has the effect provided by the Business Organizations Code. A separate application is not required to relocate the home office of a surviving state bank or to grant authority to a surviving bank to operate new branch offices that previously existed as part of a merging financial institution if the intent of the surviving bank is clearly stated as part of the plan of merger.

(d) A merger under this subchapter does not confer additional powers on a state bank beyond the powers conferred by other provisions of this subtitle.

Sec. 32.302. Approval of Banking Commissioner. (a) If the merger is subject to the prior written approval of the banking commissioner, the original certificate of merger and a number of copies of the certificate equal to the number of surviving, new, and acquiring entities must be filed with the banking commissioner. On this filing, the banking commissioner shall investigate the condition of the merging parties. The banking commissioner may require the submission of additional information the banking commissioner determines necessary to an informed decision to approve or reject a merger under this subchapter.[20]

(b) The banking commissioner shall approve the merger only if:

(1) each resulting state bank:

(A) has complied with the laws of this state relating to the organization and operation of state banks; and

(B) will be solvent and have adequate capitalization for its business and location;

(2) all deposit and other liabilities of each state bank that is a party to the merger have been properly discharged or otherwise assumed or retained by a financial institution;

[18] See 7 TAC §3.91, relating to loan production offices.

[19] For authority to establish an interstate branch by merger, see Section 203.001(b), Finance Code.

[20] See 7 TAC §§15.2 and 15.104, relating to application for merger or share exchange.

(3) each surviving, new, or acquiring entity that is not a depository institution will not be engaged in the unauthorized business of banking, and each state bank will not be engaged in a business other than banking or a business incidental to banking;

(4) the parties have complied with the laws of this state; and

(5) all conditions imposed by the banking commissioner have been satisfied or otherwise resolved.

(c) If the banking commissioner approves the merger and finds that all required filing fees and investigative costs have been paid, the banking commissioner shall:

(1) endorse the face of the original and each copy of the certificate of merger with the date of approval and the word "Approved";

(2) file the original of the certificate of merger in the department's records; and

(3) deliver a certified copy of the certificate of merger to each surviving, new, or acquiring entity.

(d) An approved merger takes effect on the date of approval unless the merger agreement provides for a different effective date.

Sec. 32.303. Rights of Dissenters from Merger. A shareholder may dissent from the merger to the extent, and by following the procedure provided, by the Business Organizations Code or any rules adopted under this subtitle.

Sec. 32.304. Limitation on Control of Deposits. (a) A merger is not permitted under this subchapter if, on consummation of the transaction, the resulting state bank, including all insured depository institution affiliates of the resulting state bank, would control 20 percent or more of the total amount of deposits in this state held by all insured depository institutions in this state.

(b) On request of the banking commissioner the applicant shall provide supplemental information to the banking commissioner to aid in a determination under this section, including information that is more current than or in addition to information in the most recently available summary of deposits, reports of condition, or similar reports filed with or produced by state or federal authorities.

(c) In this section, "deposit" and "insured depository institution" have the meanings assigned by Section 3, Federal Deposit Insurance Act (12 U.S.C. Section 1813), as amended.

Subchapter E. Purchase or Sale of Assets

Sec. 32.401. Authority to Purchase Assets.[21] (a) A state bank may purchase assets from another financial institution or other seller, except that the prior written approval of the banking commissioner is required if the purchase price exceeds an amount equal to three times the bank's unimpaired capital and surplus. The finance commission by rule may require a state bank to obtain the prior written approval of the banking commissioner for a transaction not otherwise subject to approval that involves potentially substantial risks to the safety and soundness of the purchasing bank.[22]

(b) Except as otherwise expressly provided by another statute, the purchase of all or part of the assets of the selling entity does not make the purchasing bank responsible for any liability or obligation of the selling entity that the purchasing bank does not expressly assume.

Sec. 32.402. Authority to Act as Disbursing Agent. (a) The purchasing bank may hold the purchase price and any additional money delivered to it by the selling institution in trust for, or as a deposit to the credit of, the selling institution and may act as agent of the selling institution in disbursing the money in trust or on deposit by paying the depositors and creditors of the selling institution.

(b) If the purchasing bank acts under written contract of agency approved by the banking commissioner that specifically names each depositor and creditor and the amount to be paid each, and if the agency is limited to the purely ministerial act of paying those depositors and creditors the amounts due them as determined by the selling institution and reflected in the contract of agency and does not involve discretionary duties or authority other than the identification of the depositors and creditors named, the purchasing bank:

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[21] An interstate purchase of assets is subject to Chapter 203, Finance Code, see Section 201.002(a)(27)(B), Finance Code.

[22] See 7 TAC §§15.2 and 15.105, relating to application for purchase of assets.

(1) may rely on the contract of agency and the instructions included in it; and

(2) is not responsible for:

(A) any error made by the selling institution in determining its liabilities, the depositors and creditors to whom the liabilities are due, or the amounts due the depositors and creditors; or

(B) any preference that results from the payments made under the contract of agency and the instructions included in it.

Sec. 32.403. Liquidation of Selling Institution. If the selling financial institution is at any time after the sale of assets voluntarily or involuntarily closed for liquidation by a state or federal regulatory agency, the purchasing bank shall pay to the receiver of the selling institution the balance of the money held by it in trust or on deposit for the selling institution and not yet paid to the depositors and creditors of the selling institution. Without further action the purchasing bank is discharged from all responsibilities to the selling institution and to the selling institution's receiver, depositors, creditors, and shareholders.

Sec. 32.404. Payment to Depositors and Creditors. The purchasing bank may pay a depositor or creditor of the selling institution the amount to be paid the person under the terms of the contract of agency by opening an account in the name of the depositor or creditor, crediting the account with the amount to be paid the depositor or creditor under the terms of the agency contract, and mailing or personally delivering a duplicate deposit ticket evidencing the credit to the depositor or creditor at the person's address shown in the records of the selling institution. The relationship between the purchasing bank and the depositor or creditor is that of debtor to creditor only to the extent of the credit reflected by the deposit ticket.

Sec. 32.405. Sale of Assets.[23] (a) A state bank may sell a portion of its assets to another financial institution or other buyer, except that the prior written approval of the banking commissioner is required if the sales price exceeds an amount equal to three times the bank's unimpaired capital and surplus. The finance commission by rule may require a state bank to obtain the prior written approval of the banking commissioner for a transaction not otherwise subject to approval that involves potentially substantial risks to the safety and soundness of the selling bank.

(b) If the prior approval of the banking commissioner for a sale of assets is not required under Subsection (a) and the sale involves the disposition of a branch office or another established location of the state bank, the state bank must provide written notice of the transaction to the banking commissioner at least 30 days before the expected closing date of the transaction.

(c) The board of a state bank, with the prior written approval of the banking commissioner, may cause the bank to sell all or substantially all of its assets without shareholder approval if:

(1) the banking commissioner finds the interests of depositors and creditors are jeopardized because of insolvency or imminent insolvency and that the sale is in their best interest;[24] and

(2) the Federal Deposit Insurance Corporation or its successor approves the transaction and agrees to provide assistance to the prospective buyer under 12 U.S.C. Section 1823(c) or a comparable law unless the deposits of the bank are not insured.

(d) A sale under Subsection (c) must include an assumption and promise by the buyer to pay or otherwise discharge:

(1) all of the bank's liabilities to depositors;

(2) all of the bank's liabilities for salaries of the bank's employees incurred before the date of the sale;

(3) obligations incurred by the banking commissioner arising out of the supervision or sale of the bank; and

(4) fees and assessments due the department.

(e) This section does not affect the banking commissioner's right to take action under another law. The sale by a state bank of all or substantially all of its assets with shareholder approval is considered a voluntary dissolution and liquidation and is governed by Subchapter B, Chapter 36.

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[23] An interstate sale of assets is subject to Chapter 203, Finance Code, see Section 201.002(a)(27)(B), Finance Code.

[24] See 7 TAC §§15.2 and 15.106, relating to application for sale of assets.

Sec. 32.406. Limitation on Control of Deposits. (a) A purchase of assets is not permitted under Section 32.401 if, on consummation of the transaction, the acquiring state bank, including all insured depository institution affiliates of the resulting state bank, would control 20 percent or more of the total amount of deposits in this state held by all insured depository institutions in this state.

(b) On request of the banking commissioner the applicant shall provide supplemental information to the banking commissioner to aid in a determination under this section, including information that is more current than or in addition to information in the most recently available summary of deposits, reports of condition, or similar reports filed with or produced by state or federal authorities.

(c) In this section, "deposit" and "insured depository institution" have the meanings assigned by Section 3, Federal Deposit Insurance Act (12 U.S.C. Section 1813), as amended.

Subchapter F. Exit of State Bank or Entry of Another Financial Institution

Sec. 32.501. Merger or Conversion of State Bank into Another Financial Institution. (a) Subject to Subtitle G, a state bank may act as necessary under and to the extent permitted by the laws of the United States, this state, another state, or another country to merge or convert into another financial institution, as that term is defined by Section 201.101.

(b) The merger or conversion by the state bank must be made and approval of its board and shareholders must be obtained in accordance with the Business Organizations Code as if the state bank were a filing entity and all other parties to the transaction, if any, were foreign entities, except as provided by rule. For purposes of this subsection, a conversion is considered a merger into the successor form of financial institution.

(c) The state bank does not cease to be a state bank subject to the supervision of the banking commissioner unless:

(1) the banking commissioner has been given written notice of the intention to merge or convert before the 31st day before the date of the proposed transaction;[25]

(2) the bank has filed with the banking commissioner:

(A) a copy of the application filed with the successor regulatory authority, including a copy of each contract evidencing or implementing the merger or conversion, or other documents sufficient to show compliance with applicable law; and

(B) a certified copy of all minutes of board meetings and shareholder meetings at which action was taken regarding the merger or conversion;

(3) the banking commissioner determines that:

(A) all deposit and other liabilities of the state bank are fully discharged, assumed, or otherwise retained by the successor form of financial institution;

(B) any conditions imposed by the banking commissioner for the protection of depositors and creditors have been met or otherwise resolved; and

(C) any required filing fees have been paid; and

(4) the bank has received a certificate of authority to do business as the successor financial institution.

(d) Section 32.304 applies to a proposed merger under this section.

Sec. 32.502. Conversion of Financial Institution into State Bank. (a) A financial institution, as that term is defined by Section 201.101, may apply to the banking commissioner for conversion into a state bank on a form prescribed by the banking commissioner and accompanied by any required fee if the institution follows the procedures prescribed by the laws of the United States, this state, another state, or another country governing the exit of the financial institution for the purpose of conversion into a state bank from the regulatory system applicable before the conversion.[26] A banking association or limited banking association may convert its organizational form under this section.

(b) A financial institution applying to convert into a state bank may receive a certificate of authority to do business as a state bank if the banking commissioner finds that:

[25] See 7 TAC §15.107, relating to notice of merger or conversion into another form of financial institution.

[26] See 7 TAC §§15.2 and 15.108, relating to conversion of financial institution into state bank.

(1) the financial institution is not engaging in a pattern or practice of unsafe and unsound banking practices;

(2) the financial institution has adequate capitalization for a state bank to engage in business at the same locations as the financial institution is engaged in business before the conversion;

(3) the financial institution can be expected to operate profitably after the conversion;

(4) the officers and directors of the financial institution as a group have sufficient banking experience, ability, standing, competence, trustworthiness, and integrity to justify a belief that the financial institution will operate as a state bank in compliance with law;

(5) each principal shareholder has sufficient experience, ability, standing, competence, trustworthiness, and integrity to justify a belief that the financial institution will be free from improper or unlawful influence or interference with respect to the financial institution's operation as a state bank in compliance with law; and

(6) if the converting financial institution did not have general depository powers and the state bank will have those powers, the factors set forth in Section 32.003(b) are satisfied.

(c) The banking commissioner may:

(1) request additional information considered necessary to an informed decision under this section;

(2) perform an examination of the converting financial institution at the expense of the converting financial institution; and

(3) require that examination fees be paid before a certificate of authority is issued.

(d) In connection with the application, the converting financial institution must:

(1) submit a statement of the law governing the exit of the financial institution from the regulatory system applicable before the conversion and the terms of the transition into a state bank; and

(2) demonstrate that all applicable law has been fully satisfied.

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CHAPTER 33. OWNERSHIP AND MANAGEMENT OF STATE BANK

Subchapter A. Transfer of Ownership Interest

Subchapter B. Board and Officers

Subchapter C. Limited Banking Association

CHAPTER 33. OWNERSHIP AND MANAGEMENT OF STATE BANK

Subchapter A. Transfer of Ownership Interest

Sec. 33.001. Acquisition of Control. (a) Except as otherwise expressly permitted by this subtitle, without the prior written approval of the banking commissioner a person may not directly or indirectly acquire a legal or beneficial interest in voting securities of a state bank or a corporation or other entity owning voting securities of a state bank if, after the acquisition, the person would control the bank.

(b) For purposes of this subchapter and except as otherwise provided by rules adopted under this subtitle, the principal shareholder of a state bank that directly or indirectly owns or has the power to vote a greater percentage of voting securities of the bank than any other shareholder is considered to control the bank.

(c) This subchapter does not prohibit a person from negotiating to acquire, but not acquiring, control of a state bank or a person that controls a state bank.

Sec. 33.002. Application Regarding Acquisition of Control. (a) The proposed transferee in an acquisition of control of a state bank or of a person that controls a state bank must file an application for approval of the acquisition. The application must:

(1) be under oath and in a form prescribed by the banking commissioner;

(2) contain all information that:

(A) is required by rules adopted under this subtitle;[1] or

(B) the banking commissioner requires in a particular application as necessary to an informed decision to approve or reject the proposed acquisition; and

(3) be accompanied by any filing fee required by law.

(b) If a person proposing to acquire voting securities in a transaction subject to this section includes any group of persons acting in concert, the information required by the banking commissioner may be required of each member of the group.

(c) Rules adopted under this subtitle may specify the confidential or nonconfidential character of information obtained by the banking commissioner under this section. In the absence of rules, information obtained by the banking commissioner under this section is confidential and may not be disclosed by the banking commissioner or any employee of the department except as provided by Subchapter D, Chapter 31.[2]

(d) The applicant shall publish notice of the application, its date of filing, and the identity of the applicant and, if the applicant includes a group, the identity of each group member. The notice must be published in the form and frequency specified by the banking commissioner and in a newspaper of general circulation in the county in which the bank's home office is located, or in another publication or location as directed by the banking commissioner.

(e) The applicant may defer publication of the notice until not later than the 34th day after the date the application is filed if:

(1) the application is filed in contemplation of a public tender offer subject to 15 U.S.C. Section 78n(d)(1);

(2) the applicant requests confidential treatment and represents that a public announcement of the tender offer and the filing of appropriate forms with the Securities and Exchange Commission or the appropriate federal banking agency, as applicable, will occur within the period of deferral; and

(3) the banking commissioner determines that the public interest will not be harmed by the requested confidential treatment.

(f) The banking commissioner may waive the requirement that a notice be published or permit delayed publication on a determination that waiver or delay is in the public interest. If publication of notice is waived under this subsection, the information that would be contained in a published notice becomes public information under Chapter 552, Government Code, on the 35th day after the date the application is filed.

Sec. 33.003. Hearing and Decision on Acquisition of Control. (a) Not later than the 60th day after the date the notice is published, the banking commissioner shall approve the application or set the application for hearing. If the banking commissioner sets a hearing, the department shall participate as the opposing party and the banking commissioner shall conduct the hearing and one or more prehearing conferences and opportunities for discovery as the banking commissioner considers advisable and consistent with governing law. A hearing held under this section is confidential and closed to the public.[3]

(b) Based on the record, the banking commissioner may issue an order denying an application if:

(1) the acquisition would substantially lessen competition, restrain trade, result in a monopoly, or further a combination or conspiracy to monopolize or attempt to monopolize the banking industry in any part of this state, unless:

(A) the anticompetitive effects of the proposed acquisition are clearly outweighed in the public interest by the probable effect of the acquisition in meeting the convenience and needs of the community to be served; and

(B) the proposed acquisition does not violate the law of this state or the United States;

(2) the financial condition of the proposed transferee, or any member of a group comprising the proposed transferee, might jeopardize the financial stability of the bank being acquired;

(3) plans or proposals to operate, liquidate, or sell the bank or its assets are not in the best interests of the bank;

[1] See 7 TAC §§15.2 and 15.81, relating to application for change of control.

[2] See 7 TAC §3.111, relating to confidential information.

[3] See 7 TAC Chapter 9, relating to rules of procedure.

(4) the experience, ability, standing, competence, trustworthiness, and integrity of the proposed transferee, or any member of a group comprising the proposed transferee, are insufficient to justify a belief that the bank will be free from improper or unlawful influence or interference with respect to the bank's operation in compliance with law;

(5) the bank will not be solvent, have adequate capitalization, or comply with the law of this state after the acquisition;

(6) the proposed transferee has not furnished all information pertinent to the application reasonably required by the banking commissioner; or

(7) the proposed transferee is not acting in good faith.

(c) If the banking commissioner approves the application, the transaction may be consummated. If the approval is conditioned on a written commitment from the proposed transferee offered to and accepted by the banking commissioner, the commitment is enforceable against the bank and the transferee and is considered for all purposes an agreement under this subtitle.

Sec. 33.004. Appeal from Adverse Decision. (a) If a hearing has been held, the banking commissioner has entered an order denying the application, and the order has become final, the proposed transferee may appeal the order by filing a petition for judicial review.

(b) The filing of an appeal under this section does not stay the order of the banking commissioner.

Sec. 33.005. Exemptions. The following acquisitions are exempt from Section 33.001:

(1) an acquisition of securities in connection with the exercise of a security interest or otherwise in full or partial satisfaction of a debt previously contracted for in good faith and the acquiring person files written notice of acquisition with the banking commissioner before the person votes the securities acquired;

(2) an acquisition of voting securities in any class or series by a controlling person who has previously complied with and received approval under this subchapter or who was identified as a controlling person in a prior application filed with and approved by the banking commissioner;

(3) an acquisition or transfer by operation of law, will, or intestate succession and the acquiring person files written notice of acquisition with the banking commissioner before the person votes the securities acquired;

(4) a transaction subject to Chapter 202; and

(5) a transaction exempted by the banking commissioner or by rules adopted under this subtitle because the transaction is not within the purposes of this subchapter or the regulation of the transaction is not necessary or appropriate to achieve the objectives of this subchapter.

Sec. 33.006. Objection to Other Transfer. This subchapter does not prevent the banking commissioner from investigating, commenting on, or seeking to enjoin or set aside a transfer of voting securities that evidence a direct or indirect interest in a state bank, regardless of whether the transfer is governed by this subchapter, if the banking commissioner considers the transfer to be against the public interest.

Sec. 33.007. Civil Enforcement; Criminal Penalty. (a) If the banking commissioner believes that a person has violated or is about to violate this subchapter or a rule of the finance commission or order of the banking commissioner pertaining to this subchapter, the attorney general on behalf of the banking commissioner may apply to a district court of Travis County for an order enjoining the violation and for other equitable relief the nature of the case requires.

(b) A person who knowingly fails or refuses to file the application required by Section 33.002 commits an offense. An offense under this subsection is a Class A misdemeanor.

Subchapter B. Board and Officers

Sec. 33.101. Voting Securities Held by Bank. (a) Voting securities of a state bank held by the bank in a fiduciary capacity under a will or trust, whether registered in the bank's name or in the name of its nominee, may not be voted in the election of directors or on a matter affecting the compensation of directors, officers, or employees of the bank in that capacity unless:

(1) under the terms of the will or trust, the manner in which the voting securities are to be voted may be determined by a donor or beneficiary of the will or trust and the donor or beneficiary makes the determination in the matter at issue;

(2) the terms of the will or trust expressly direct the manner in which the securities must be voted so that discretion is not vested in the bank as fiduciary; or

(3) the securities are voted solely by a cofiduciary that is not an affiliate of the bank, as if the cofiduciary were the sole fiduciary.

(b) Voting securities of a state bank that cannot be voted under this section are considered to be authorized but unissued for purposes of determining the procedures for and results of the affected vote.

Sec. 33.102. Bylaws. Each state bank shall adopt bylaws and may amend its bylaws for the purposes and according to the procedures provided by the Business Organizations Code.

Sec. 33.103. Board of Directors. (a) The board of a state bank must consist of not fewer than five but not more than 25 directors, a majority of whom are residents of this state. The principal executive officer of the bank is a member of the board. The principal executive officer acting in the capacity of a board member is the board's presiding officer unless the board elects a different presiding officer to perform the duties as designated by the board.

(b) Unless the banking commissioner consents otherwise in writing, a person may not serve as director of a state bank if:

(1) the bank incurs an unreimbursed loss attributable to a charged-off obligation of or holds a judgment against:

(A) the person; or

(B) an entity that was controlled by the person at the time of funding and at the time of default on the loan that gave rise to the judgment or charged-off obligation;

(2) the person is the subject of an order described by Section 35.007(a); or

(3) the person has been convicted of a felony.

(c) If a state bank does not elect directors before the 61st day after the date of its regular annual meeting, the banking commissioner may appoint a conservator under Chapter 35 to operate the bank and elect directors, as appropriate. If the conservator is unable to locate or elect persons willing and able to serve as directors, the banking commissioner may close the bank for liquidation.

(d) A vacancy on the board that reduces the number of directors to fewer than five must be filled not later than the 30th day after the date the vacancy occurs. If the vacancy is not timely filled, the banking commissioner may appoint a conservator under Chapter 35 to operate the bank and elect a board of not fewer than five persons to resolve the vacancy. If the conservator is unable to locate or elect five persons willing and able to serve as directors, the banking commissioner may close the bank for liquidation.

(e) Before each term to which a person is elected to serve as a director of a state bank, the person shall submit an affidavit for filing in the minutes of the bank stating that the person, to the extent applicable:

(1) accepts the position and is not disqualified from serving in the position;

(2) will not violate or knowingly permit an officer, director, or employee of the bank to violate any law applicable to the conduct of business of the bank; and

(3) will diligently perform the duties of the position.

(f) The banking commissioner in the exercise of discretion may waive or reduce the residency requirements for directors set forth in Subsection (a).

Sec. 33.104. Advisory Director. (a) An advisory director is not considered a director if the advisory director:

(1) is not elected by the shareholders of the bank;

(2) does not vote on matters before the board or a committee of the board;

(3) is not counted for purposes of determining a quorum of the board or committee; and

(4) provides solely general policy advice to the board.

(b) A state bank may not disclose to an advisory director confidential information pertaining to the bank or the bank's customers unless:

(1) the board adopts a resolution that designates the advisory director as a person who is officially connected to the bank and that describes the purpose for disclosure of the information, which must be a reasonable business purpose; and

(2) the disclosure is made under a written confidentiality agreement between the bank and the advisory director.

Sec. 33.105. Required Monthly Board Meeting. (a) Except as provided by Subsection (b), the board of a state bank shall hold at least one regular meeting each month.

(b) On application by the board, the banking commissioner may grant the board approval to hold regular meetings on a less frequent basis than the period prescribed by Subsection (a). The commissioner may revoke or modify a prior approval granted under this subsection if the commissioner determines that more frequent regular meetings of the board are necessary to promote the safety and soundness of the bank.

(c) At each regular meeting the board shall review and approve the minutes of the prior meeting and review the operations, activities, and financial condition of the bank. The board may designate a committee from among its members to perform those duties and approve or disapprove the committee's report at each regular meeting. Each action of the board must be recorded in its minutes.

Sec. 33.106. Officers. The board shall annually appoint the officers of the bank, who serve at the will of the board. The bank must have a principal executive officer primarily responsible for the execution of board policies and operation of the bank and an officer responsible for the maintenance and storage of all corporate books and records of the bank and for required attestation of signatures. Those positions may not be held by the same person. The board may appoint other officers of the bank as the board considers necessary.

Sec. 33.107. Limitation on Action of Officer or Employee in Relation to Asset or Liability. Unless expressly authorized by a resolution of the board recorded in its minutes, an officer or employee may not create or dispose of a bank asset or create or incur a liability on behalf of the bank.

Sec. 33.108. Criminal Offenses. (a) An officer, director, employee, or shareholder of a state bank commits an offense if the person knowingly:

(1) conceals information or a fact, or removes, destroys, or conceals a book or record of the bank for the purpose of concealing information or a fact, from the banking commissioner or an agent of the banking commissioner; or

(2) removes, destroys, or conceals any book or record of the bank that is material to a pending or anticipated legal or administrative proceeding.

(b) An officer, director, or employee of a state bank commits an offense if the person:

(1) knowingly makes a false entry in a book, record, report, or statement of the bank; or

(2) violates or knowingly participates in a violation of, or permits another of the bank's officers, directors, or employees to violate, the prohibition on lending trust funds under Section 113.052, Property Code.

(c) An offense under this section is a felony of the third degree.

Sec. 33.109. Transactions with Management and Affiliates. (a) Without the prior approval of a disinterested majority of the board recorded in the minutes or, if a disinterested majority cannot be obtained, the prior written approval of the banking commissioner,[4] a state bank may not directly or indirectly:

(1) sell or lease an asset of the bank to an officer, director, or principal shareholder of the bank or of an affiliate of the bank; or

(2) purchase or lease an asset in which an officer, director, or principal shareholder of the bank or of an affiliate of the bank has an interest.

(b) An officer or director of the bank who knowingly participates in or permits a violation of this section commits an offense. An offense under this subsection is a felony of the third degree.

Subchapter C. Limited Banking Association

Sec. 33.201. Liability of Participants and Managers. (a) A participant or manager of a limited banking association is not liable for a debt, obligation, or liability of the limited banking association, including a debt, obligation, or liability under a judgment, decree, or order of court. A participant or a manager of a limited banking association is not a proper party to a proceeding by or against a limited banking association unless the object of the proceeding is to enforce a participant's or manager's right against or liability to a limited banking association.

(b) [*Repealed eff. Sept. 1, 2007, by 80th Tex. Leg., ch. 237 (H.B. 1962), §80.*]

Sec. 33.202. [*Repealed eff. Sept. 1, 2007, by 80th Tex. Leg., ch. 237 (H.B. 1962), §80.*]

[4] See 7 TAC §3.22, relating to sale or lease agreements with officer, director, principal shareholder, or affiliate.

Sec. 33.203. [*Repealed eff. Sept. 1, 2007, by 80th Tex. Leg., ch. 237 (H.B. 1962), §80.*]

Sec. 33.204. Management of Limited Banking Association. (a) Management of a limited banking association is vested in a board of managers elected by the participants as prescribed by the bylaws.

(b) A board of managers operates in substantially the same manner as, and has substantially the same rights, powers, privileges, duties, and responsibilities, as a board of directors of a banking association, and a manager must meet the qualifications for a director under Section 33.103.

(c) The certificate of formation, bylaws, and participation agreement of a limited banking association may use "director" instead of "manager" and "board" instead of "board of managers."

Sec. 33.205. [*Repealed eff. Sept. 1, 2007, by 80th Tex. Leg., ch. 237 (H.B. 1962), §80.*]

Sec. 33.206. Interest in Limited Banking Association; Transferability of Interest. (a) The interest of a participant in a limited banking association is the personal property of the participant and may be transferred as provided by the bylaws or the participation agreement.

(b) The bylaws or the participation agreement may not require the consent of any other participant in order for a participant to transfer participation shares, including voting rights.

Sec. 33.207. [*Repealed eff. Sept. 1, 2007, by 80th Tex. Leg., ch. 237 (H.B. 1962), §80.*]

Sec. 33.208. Dissolution. The bylaws or the participation agreement may not require automatic termination, dissolution, or suspension of the limited banking association on the death, disability, bankruptcy, expulsion, or withdrawal of a participant, or on the happening of any other event than the passage of time.

Sec. 33.209. Allocation of Profits and Losses. The profits and losses of a limited banking association may be allocated among the participants and among classes of participants as provided by the participation agreement. Without the prior written approval of the banking commissioner to use a different allocation method, the profits and losses must be allocated according to the relative interests of the participants as reflected in the certificate of formation and related documents filed with and approved by the banking commissioner.

Sec. 33.210. Distributions. Subject to Section 32.103, distributions of cash or other assets of a limited banking association may be made to the participants as provided by the participation agreement. Without the prior written approval of the banking commissioner to use a different distribution method, distributions must be made to the participants according to the relative interests of the participants as reflected in the certificate of formation and related documents filed with and approved by the banking commissioner.

Sec. 33.211. Application of Other Provisions to Limited Banking Associations. For purposes of the provisions of Subtitle A and this subtitle other than this subchapter, as the context requires:

(1) a manager is considered to be a director and the board of managers is considered to be the board of directors;

(2) a participant is considered to be a shareholder;

(3) a participation share is considered to be a share; and

(4) a distribution is considered to be a dividend.

CHAPTER 34. INVESTMENTS, LOANS, AND DEPOSITS

Subchapter A. Acquisition and Ownership of Bank Facilities and Other Real Property

Subchapter B. Investments

Subchapter C. Loans

Subchapter D. Deposits

CHAPTER 34. INVESTMENTS, LOANS, AND DEPOSITS

Subchapter A. Acquisition and Ownership of Bank Facilities and Other Real Property

Sec. 34.001. Definition. In this subchapter, “bank facility” means real property, including an improvement, that a state bank owns or leases, to the extent the lease or the leasehold improvement is capitalized, for the purpose of:

(1) providing space for bank employees to perform their duties and for bank employees and customers to park;

(2) conducting bank business, including meeting the reasonable needs and convenience of the public and the bank’s customers, computer operations, document and other item processing, maintenance and storage of foreclosed collateral pending disposal, and record retention and storage;

(3) holding, improving, and occupying as an incident to future expansion of the bank’s facilities; or

(4) conducting another activity authorized by rules adopted under this subtitle.

Sec. 34.002. Investment in Bank Facilities. (a) Without the prior written approval of the banking commissioner, a state bank may not directly or indirectly invest an amount in excess of its unimpaired capital and surplus in bank facilities, furniture, fixtures, and equipment. Except as otherwise provided by rules adopted under this subtitle, in computing this limitation the bank:

(1) shall include:

(A) its direct investment in bank facilities;

(B) an investment in equity or investment securities of a company holding title to a facility used by the bank for a purpose specified by Section 34.001;

(C) a loan made by the bank to or on the security of equity or investment securities issued by a company holding title to a facility used by the bank; and

(D) any indebtedness incurred on bank facilities by a company:

(i) that holds title to the facility;

(ii) that is an affiliate of the bank; and

(iii) in which the bank is invested in the manner described by Paragraph (B) or (C); and

(2) may exclude an amount included under Subdivisions (1)(B)-(D) to the extent a lease of a facility from the company holding title to the facility is capitalized on the books of the bank.

(b) Real property acquired for the purposes described by Section 34.001(3) and not improved and occupied by the bank ceases to be a bank facility on the third anniversary of the date of its acquisition unless the banking commissioner on application grants written approval to further delay in the improvement and occupation of the property by the bank.

(c) A bank shall comply with regulatory accounting principles in accounting for its investment in and depreciation of bank facilities, furniture, fixtures, and equipment.

Sec. 34.003. Other Real Property.[1] (a) A state bank may not acquire real property except:

(1) as permitted by this subtitle or rules adopted under this subtitle;

(2) with the prior written approval of the banking commissioner; or

(3) as necessary to avoid or minimize a loss on a loan or investment previously made in good faith.

(b) With the prior written approval of the banking commissioner, a state bank may:

(1) exchange real property for other real property or personal property;

(2) invest additional money in or improve real property acquired under this subsection or Subsection (a); or

(3) acquire additional real property to avoid or minimize loss on real property acquired as permitted by Subsection (a).

(c) A state bank shall dispose of real property subject to this section not later than the fifth anniversary of the date the real property:

(1) was acquired except as otherwise provided by rules adopted under this subtitle;

(2) ceases to be used as a bank facility; or

(3) ceases to be a bank facility as provided by Section 34.002(b).

(d) The banking commissioner on application may grant one or more extensions of time for disposing of real property if the banking commissioner determines that:

(1) the bank has made a good faith effort to dispose of the real property; or

(2) disposal of the real property would be detrimental to the bank.

Sec. 34.004. Retention of Nonparticipating Royalty Interests. (a) Notwithstanding Section 34.003(a), a state bank may hold nonparticipating royalty interests if:

(1) the state bank acquires the interest pursuant to Section 34.003(a)(3) or retains the interest in a sale of property acquired under that section;

(2) the interest is nonparticipating due to the fact the interest:

(A) is nonpossessory;

[1] See 7 TAC §12.91, relating to other real estate owned;, also see Policy Memorandum (Interpretive Statement) No. 1008.

(B) does not bear executive rights, the right of ingress and egress, the right to receive bonus payments, or the right to receive delay rentals; and

(C) is accordingly not subject to expenses of exploration, development, production, operation, maintenance, or abandonment, or other expenses associated with extracting and marketing the minerals subject to the interest;

(3) the interest is reasonably valued on the books of the state bank for not more than a nominal amount, and the aggregate amount of earnings from such interests is separately disclosed in the annual financial statements of the state bank;

(4) the state bank does not make any new investments relating to the interests without the approval of the banking commissioner; and

(5) the banking commissioner determines that the possession of such interests is not inconsistent with the safety and soundness of the state bank.

(b) The banking commissioner may order a state bank that holds nonparticipating royalty interests to divest such interests at any time if the banking commissioner determines that continued ownership of such interests is detrimental to the state bank.

(c) Subject to compliance with this section, nonparticipating royalty interests are not considered to be real property for purposes of this subtitle.[2]

Subchapter B. Investments

Sec. 34.101. Securities. (a) A state bank may purchase and sell securities without recourse solely on the order and for the account of a customer.[3]

(b) Except as otherwise provided by this subtitle or rules adopted under this subtitle, a state bank may not:

(1) underwrite an issue of securities;[4] or

(2) invest its money in equity securities except as necessary to avoid or minimize a loss on a loan or investment previously made in good faith.

(c) A state bank may purchase investment securities for its own account under limitations and restrictions prescribed by rules adopted under this subtitle. Except as otherwise provided by this section, the amount of the investment securities of any one obligor or maker held by the bank for its own account may not exceed an amount equal to 15 percent of the bank's unimpaired capital and surplus. The banking commissioner may authorize investments in excess of this limitation on written application if the banking commissioner determines that:

(1) the excess investment is not prohibited by other applicable law; and

(2) the safety and soundness of the requesting state bank is not adversely affected.

(d) Notwithstanding Subsections (a)-(c), a state bank may, without limit and subject to the exercise of prudent banking judgment, deal in, underwrite, or purchase for its own account:

(1) bonds and other legally created general obligations of a state, an agency or political subdivision of a state, the United States, or an instrumentality of the United States;

(2) obligations that this state, an agency or political subdivision of this state, the United States, or an instrumentality of the United States has unconditionally agreed to purchase, insure, or guarantee;

(3) securities that are offered and sold under 15 U.S.C. Section 77d(5);

(4) mortgage related securities or small business related securities, as those terms are defined by 15 U.S.C. Section 78c(a);

(5) mortgages, obligations, or other securities that are or ever have been sold by the Federal Home Loan Mortgage Corporation under 12 U.S.C. Sections 1434 and 1455;

[2] A state bank that seeks to retain direct ownership of royalty interests beyond 10 years after acquisition must apply to and obtain approval of both the banking commissioner under this section the Federal Deposit Insurance Corporation under 12 C.F.R. §362.3(b)(2)(i).

[3] See 7 TAC §3.1, relating to private placement of securities; 7 TAC §3.2, relating to investment and financial advisory services, 7 TAC §3.3, relating to securities activities of subsidiaries, and 7 TAC §3.5, relating to financial valuation and advisory services.

[4] See 7 TAC §§3.2-3.3, relating to investment and financial advisory services, and securities activities of subsidiaries.

(6) obligations, participation, or other instruments of or issued by the Federal National Mortgage Association or the Government National Mortgage Association;

(7) obligations issued by the Federal Agricultural Mortgage Corporation, the Federal Farm Credit Banks Funding Corporation, or a Federal Home Loan Bank;

(8) obligations of the Federal Financing Bank or the Environmental Financing Authority;

(9) obligations or other instruments or securities of the Student Loan Marketing Association;

(10) qualified Canadian government obligations, as defined by 12 U.S.C. Section 24; or

(11) if the state bank is well capitalized, as defined by Section 38, Federal Deposit Insurance Act (12 U.S.C. Section 1831o), obligations, including limited obligation bonds, revenue bonds, and obligations that satisfy the requirements of 26 U.S.C. Section 142(b)(1), issued by or on behalf of a state or a political subdivision of a state, including a municipal corporate instrumentality of one or more states or a public agency or authority of a state or political subdivision of a state.

(e) Notwithstanding Subsections (a) and (b), subject to the exercise of prudent banking judgment, a state bank may deal in, underwrite, or purchase for its own account, including for purposes of Subsection (c) obligations as to which the bank is under commitment, the following:

(1) obligations issued by a development bank, corporation, or other entity created by international agreement if the United States is a member and a capital stock shareholder;

(2) obligations issued by a state or political subdivision or an agency of a state or political subdivision for housing, university, or dormitory purposes, that are at the time eligible for purchase by a state bank for its own account; or

(3) bonds, notes, and other obligations issued by the Tennessee Valley Authority or by the United States Postal Service.

(f) A state bank may not invest more than an amount equal to 25 percent of the bank's unimpaired capital and surplus in investment grade adjustable rate preferred stock and money market (auction rate) preferred stock.

(g) A state bank may deposit money in a federally insured financial institution, a Federal Reserve Bank, or a Federal Home Loan Bank without limitation.

(h) The finance commission may adopt rules to administer and carry out this section, including rules to:

(1) define or further define terms used by this section;

(2) establish limits, requirements, or exemptions other than those specified by this section for particular classes or categories of securities; and

(3) limit or expand investment authority for state banks for particular classes or categories of securities.

Sec. 34.102. Transaction in Bank Shares. (a) A state bank may not acquire a lien by pledge or otherwise on its own shares, or otherwise purchase or acquire title to its own shares, except:

(1) as necessary to avoid or minimize a loss on a loan or investment previously made in good faith; or

(2) as provided by Subsection (b).

(b) With the prior written approval of the banking commissioner or as permitted by rules adopted under this subtitle, a state bank may acquire title to its own shares and hold those shares as treasury stock. Treasury stock acquired under this subsection is not considered an equity investment.[5]

(c) If a state bank acquires a lien on or title to its own shares under this section, the lien may not by its original terms extend for more than two years. Except with the prior written approval of the banking commissioner, the bank may not hold title to its own shares for more than one year.

(d) A state bank may make loans on the collateral security of securities issued by an affiliate, if the loan is subject to and in compliance with the provisions of Sections 23A and 23B, Federal Reserve Act (12 U.S.C. Sections 371c and 371c-1), as amended,

[5] See 7 TAC §§15.2 and 15.121, relating to acquisition and retention of treasury stock.

applicable to nonmember insured state banks by virtue of Section 18(j)(1), Federal Deposit Insurance Act (12 U.S.C. Section 1828(j)(1)), as amended.

Sec. 34.103. Bank Subsidiaries. (a) Subject to this section and except as otherwise provided by this subtitle or rules adopted under this subtitle, a state bank may conduct any activity or make any investment through an operating subsidiary that a state bank or a bank holding company, including a financial holding company, is authorized to conduct or make under state or federal law if the operating subsidiary is adequately empowered and appropriately licensed to conduct its business.[6]

(b) Except for investment in a subsidiary engaging solely in activities that may be engaged in directly by the bank and that are conducted on the same terms and conditions that govern the conduct of the activities by the bank, a state bank without the prior written approval of the banking commissioner may not invest more than an amount equal to 10 percent of its unimpaired capital and surplus in a single subsidiary. For purposes of this subsection, the amount of a state bank's investment in a subsidiary is the sum of the amount of the bank's investment in securities issued by the subsidiary and any loans and extensions of credit from the bank to the subsidiary.

(c) A state bank may not establish or acquire a subsidiary or a controlling interest in a subsidiary that engages in activities as principal in which the bank is prohibited from engaging directly unless:

(1) the state bank's investment in the subsidiary has been approved by the Federal Deposit Insurance Corporation under Section 24, Federal Deposit Insurance Act (12 U.S.C. Section 1831a); or

(2) with respect to a subsidiary engaged in activities as principal that a national bank may conduct only through a financial subsidiary, including firm underwriting of equity securities other than as permitted by Section 34.101, and not otherwise engaged in activities as principal that are impermissible for a state bank or a financial subsidiary of a national bank, the subsidiary's activities and the bank's investment are in compliance with the restrictions and requirements of Section 46, Federal Deposit Insurance Act (12 U.S.C. Section 1831w).

(d) Except as otherwise provided by this subtitle or a rule adopted under this subtitle, a state bank may not make a non-controlling minority investment in equity securities of a company unless:

(1) the investment or company is described by Subsection (c)(2) or Section 34.104 or 34.105;

(2) the company engages solely in activities that are part of or incidental to the permissible business of a state bank under this subtitle and:

(A) the state bank is adequately empowered to prevent the company from engaging in activities not part of or incidental to the permissible business of a state bank or, as a practical matter, is otherwise enabled to withdraw or liquidate its investment in the company in such an event;

(B) as a legal and accounting matter, the loss exposure of the state bank with respect to the activities of the company is limited and does not include any open-ended liability for an obligation of the company; and

(C) the investment is convenient or useful to the state bank in carrying out its business and is not a mere passive investment unrelated to the bank's banking business; or

(3) the investment is made indirectly through an operating subsidiary in equity securities issued by:

(A) another bank;

(B) a company that engages solely in an activity that is permissible for a bank service corporation or a bank holding company subsidiary; or

(C) a company that engages solely in activities as agent or trustee or in a brokerage, custodial, advisory, or administrative capacity, or in a substantially similar capacity.

(e) A state bank that intends to acquire, establish, or perform new activities through a subsidiary shall submit a letter to the banking commissioner describing in detail the proposed activities of the subsidiary.[7] The bank may acquire or establish a subsidiary or perform new activities in an existing subsidiary beginning on the 31st day after the date the banking commissioner receives the bank's letter unless the banking commissioner specifies an earlier or later date. The

[6] With respect to foreign bank subsidiaries, see 7 TAC §3.4, relating to foreign banking.

[7] See 7 TAC §15.2, relating to filing fees and cost deposits.

banking commissioner may extend the 30-day period on a determination that the bank's letter raises issues that require additional information or additional time for analysis. If the period is extended, the bank may acquire or establish a subsidiary, or may perform new activities in an existing subsidiary, only on prior written approval of the banking commissioner.

(f) A subsidiary of a state bank is subject to regulation by the banking commissioner to the extent provided by Chapter 11 or 12, this subtitle, or rules adopted under this subtitle. In the absence of limiting rules, the banking commissioner may regulate a subsidiary as if it were a state bank.

Sec. 34.104. Mutual Funds. (a) A state bank may invest for its own account in equity securities of an investment company registered under the Investment Company Act of 1940 (15 U.S.C. Section 80a-1 et seq.) and the Securities Act of 1933 (15 U.S.C. Section 77a et seq.) if the portfolio of the investment company consists wholly of investments in which the bank could invest directly for its own account.

(b) If the portfolio of an investment company described by Subsection (a) consists wholly of investments in which the bank could invest directly without limitation, the bank may invest in the investment company without limitation.

(c) The bank may invest not more than an amount equal to 15 percent of the bank's unimpaired capital and surplus in an investment company described by Subsection (a) the portfolio of which contains an investment or obligation in which the bank could not invest directly without limitation under this chapter.

(d) A state bank that invests in an investment company as provided by Subsection (c) shall periodically determine that its pro rata share of any security in the portfolio of the investment company combined with the bank's pro rata share of that security held by all other investment companies in which the bank has invested and with the bank's own direct investment and loan holdings is not in excess of applicable investment and lending limitations.

Sec. 34.105. Other Direct Equity Investments. (a) A state bank may purchase for its own account equity securities of any class issued by:

(1) a bank service corporation, except that the bank may not invest more than an amount equal to 15 percent of the bank's unimpaired capital and surplus in a single bank service corporation or more than an amount equal to five percent of its assets in all bank service corporations;

(2) an agricultural credit corporation, except that the bank may not invest more than an amount equal to 30 percent of the bank's unimpaired capital and surplus in the agricultural credit corporation unless the bank owns at least 80 percent of the equity securities of the agricultural credit corporation;

(3) a small business investment company if the aggregate investment does not exceed an amount equal to 10 percent of the bank's unimpaired capital and surplus;

(4) a banker's bank if the aggregate investment does not exceed an amount equal to 15 percent of the bank's unimpaired capital and surplus or result in the bank acquiring or retaining ownership, control, or power to vote more than five percent of any class of voting securities of the banker's bank; or

(5) a housing corporation if the sum of the amount of investment and the amount of loans and commitments for loans to the housing corporation does not exceed an amount equal to 10 percent of the bank's unimpaired capital and surplus.

(b) On written application, the banking commissioner may authorize investments in excess of a limitation of Subsection (a) if the banking commissioner concludes that:

(1) the excess investment is not precluded by other applicable law; and

(2) the safety and soundness of the requesting bank would not be adversely affected.

(c) For purposes of this section:

(1) "Agricultural credit corporation" means a company organized solely to make loans to farmers and ranchers for agricultural purposes, including the breeding, raising, fattening, or marketing of livestock.

(2) "Banker's bank" means a bank insured by the Federal Deposit Insurance Corporation or a bank holding company that owns or controls such an insured bank if:

(A) all equity securities of the bank or bank holding company, other than director's qualifying shares or shares issued under an employee compensation plan, are owned by depository institutions or depository institution holding companies; and

(B) the bank or bank holding company and all its subsidiaries are engaged exclusively in providing:

(i) services to or for other depository institutions, depository institution holding companies, and the directors, officers, and employees of other depository institutions and depository institution holding companies; and

(ii) correspondent banking services at the request of other depository institutions, depository institution holding companies, or their subsidiaries.

(3) "Bank service corporation" has the meaning assigned by the Bank Service Corporation Act (12 U.S.C. Section 1861 et seq.) or a successor to that Act.

(4) "Housing corporation" means a corporation organized under Title IX of the Housing and Urban Development Act of 1968 (42 U.S.C. Section 3931 et seq.), a partnership, limited partnership, or joint venture organized under Section 907(a) or (c) of that Act (42 U.S.C. Section 3937(a) or (c)), or a housing corporation organized under the laws of this state to engage in or finance low-income and moderate-income housing developments or projects.

Sec. 34.106. Investments for Public Welfare. (a) A state bank may make investments of a predominantly civic, community, or public nature, including investments providing housing, services, or jobs or promoting the welfare of low-income and moderate-income communities or families.

(b) The bank may make the investments directly or by purchasing equity securities in an entity primarily engaged in making those investments. The bank may not make an investment that would expose the bank to unlimited liability.

(c) A bank may serve as a community partner and make investments in a community partnership, as those terms are defined by the Riegle Community Development and Regulatory Improvement Act of 1994 (Pub. L. 103-325).

(d) A bank's aggregate investments under this section, including loans and commitments for loans, may not exceed an amount equal to 10 percent of the bank's unimpaired capital and surplus. The banking commissioner may authorize investments in excess of this limitation in response to a written application if the banking commissioner concludes that:

(1) the excess investment is not precluded by other applicable law; and

(2) the safety and soundness of the requesting bank would not be adversely affected.

Sec. 34.107. Engaging in Commerce Prohibited. (a) A state bank may not buy, sell, or otherwise deal in goods in trade or commerce or own or operate a business not part of the business of banking except:

(1) as necessary to avoid or minimize a loss on a loan or investment previously made in good faith; or

(2) as otherwise provided by this subtitle or rules adopted under this subtitle.

(b) Engaging in an approved activity, directly or through a subsidiary, that is a financial activity or incidental or complementary to a financial activity, whether as principal or agent, is not considered to be engaging in commerce.

Subchapter C. Loans

Sec. 34.201. Lending Limits. (a) Without the prior written approval of the banking commissioner, the total loans and extensions of credit by a state bank to a person outstanding at one time may not exceed an amount equal to 25 percent of the bank's unimpaired capital and surplus.[8] This limitation does not apply to:

(1) liability as endorser or guarantor of commercial or business paper discounted by or assigned to the bank by its owner who has acquired it in the ordinary course of business;

(2) indebtedness evidenced by bankers' acceptances as described by 12 U.S.C. Section 372 and issued by other banks;

(3) indebtedness secured by a bill of lading, warehouse receipt, or similar document transferring or securing title to readily marketable goods, except that:

(A) the goods must be insured if it is customary to insure those goods; and

[8] See 7 TAC §§12.1-12.12, relating to legal lending limits; also see Policy Memorandum Nos. 1010 and 1011.

(B) the aggregate indebtedness of a person under this subdivision may not exceed an amount equal to 50 percent of the bank's unimpaired capital and surplus;

(4) indebtedness evidenced by notes or other paper secured by liens on agricultural products in secure and properly documented storage in bonded warehouses or elevators if the value of the collateral is not less than 125 percent of the amount of the indebtedness and the bank's interest in the collateral is adequately insured against loss, except that the aggregate indebtedness of a person under this subdivision may not exceed an amount equal to 50 percent of the bank's unimpaired capital and surplus;

(5) indebtedness of another depository institution arising out of loans with settlement periods of less than one week;

(6) indebtedness arising out of the daily transaction of the business of a clearinghouse association in this state;

(7) liability under an agreement by a third party to repurchase from the bank an investment security listed in Section 34.101(d) to the extent that the agreed repurchase price does not exceed the original purchase price to the bank or the market value of the investment security;

(8) the portion of an indebtedness that this state, an agency or political subdivision of this state, the United States, or an instrumentality of the United States has unconditionally agreed to repay, purchase, insure, or guarantee;

(9) indebtedness secured by securities listed in Section 34.101(d) to the extent that the market value of the securities equals or exceeds the indebtedness;

(10) the portion of an indebtedness that is fully secured by a segregated deposit account in the lending bank;

(11) loans and extensions of credit arising from the purchase of negotiable or nonnegotiable installment consumer paper that carries a full recourse endorsement or unconditional guarantee by the person transferring the paper if:

(A) the bank's files or the knowledge of its officers of the financial condition of each maker of the consumer paper is reasonably adequate; and

(B) an officer of the bank designated for that purpose by the board certifies in writing that the bank is relying primarily on the responsibility of each maker for payment of the loans or extensions of credit and not on a full or partial recourse endorsement or guarantee by the transferor;

(12) the portion of an indebtedness in excess of the limitation of this subsection that is fully secured by marketable securities or bullion with a market value at least equal to the amount of the overage, as determined by reliable and continuously available price quotations, except that the exempted indebtedness or overage of a person under this subdivision may not exceed an amount equal to 15 percent of the bank's unimpaired capital and surplus;

(13) indebtedness of an affiliate of the bank if the transaction with the affiliate is subject to the restrictions and limitations of 12 U.S.C. Section 371c;

(14) indebtedness of an operating subsidiary of the bank other than a subsidiary described by Section 34.103(c)(2); and

(15) the portion of the indebtedness of a person secured in good faith by a purchase money lien taken by the bank in exchange for the sale of real or personal property owned by the bank if the sale is in the best interest of the bank.

(b) The finance commission may adopt rules to administer this section, including rules to:

(1) define or further define terms used by this section;

(2) establish limits, requirements, or exemptions other than those specified by this section for particular classes or categories of loans or extensions of credit; and

(3) establish collective lending and investment limits.

(c) The banking commissioner may determine whether a loan or extension of credit putatively made to a person will be attributed to another person for purposes of this section.

Sec. 34.202. Violation of Lending Limit. (a) An officer, director, or employee of a state bank who approves or participates in the approval of a loan with actual knowledge that the loan violates Section 34.201 is jointly and severally liable to the bank for the lesser of the amount by which the loan exceeded applicable lending limits or the bank's actual loss. The person remains liable for that amount until the loan and all prior indebtedness of the borrower to the bank have been fully repaid.

(b) The bank may initiate a proceeding to collect an amount due under this section at any time before the fourth anniversary of the date the borrower defaults on the subject loan or any prior indebtedness.

(c) A person who is liable for and pays amounts to the bank under this section is entitled to an assignment of the bank's claim against the borrower to the extent of the payments.

(d) For purposes of this section, an officer, director, or employee of a state bank is presumed to know the amount of the bank's lending limit under Section 34.201(a) and the amount of the borrower's aggregate outstanding indebtedness to the bank immediately before a new loan or extension of credit to that borrower.

Sec. 34.203. Loan Expenses and Fees.[9] (a) A bank may require a borrower to pay all reasonable expenses and fees incurred in connection with the making, closing, disbursing, extending, readjusting, or renewing of a loan, regardless of whether those expenses or fees are paid to third parties. A fee charged by the bank under this section may not exceed the cost the bank reasonably expects to incur in connection with the transaction to which the fee relates. Payment for those expenses may be:

(1) collected by the bank from the borrower and:

(A) retained by the bank; or

(B) paid to a person rendering services for which a charge has been made; or

(2) paid directly by the borrower to a third party to whom they are payable.

(b) This section does not authorize the bank to charge its borrower for payment of fees and expenses to an officer or director of the bank for services rendered in the person's capacity as an officer or director.

(c) A bank may charge a penalty for prepayment or late payment. Only one penalty may be charged by the bank on each past due payment. Unless otherwise agreed in writing, prepayment of principal must be applied on the final installment of the note or other obligation until that installment is fully paid, and further prepayments must be applied on installments in the inverse order of their maturity.

(d) Fees and expenses charged and collected as provided by this section are not considered a part of the interest or compensation charged by the bank for the use, forbearance, or detention of money.

(e) To the extent of any conflict between this section and a provision of Subtitle B, Title 4, the provision of Subtitle B, Title 4, prevails.

Sec. 34.204. Lease Financing Transaction. (a) Subject to rules adopted under this subtitle, a state bank may, directly or indirectly through an operating subsidiary, provide the equivalent of a financing transaction by acting as lessor under a lease for the benefit of a customer.

(b) Without the written approval of the banking commissioner to continue holding property acquired for leasing purposes under this subsection, the bank may not hold personal property more than six months or real property more than two years after the date of expiration of the original or any extended or renewed lease period agreed to by the customer for whom the property was acquired or by a subsequent lessee.

(c) A rental payment received by the bank in a lease financing transaction under this section is considered to be rent and not interest or compensation for the use, forbearance, or detention of money. However, a lease financing transaction is considered to be a loan or extension of credit for purposes of Sections 34.201 and 34.202.

Subchapter D. Deposits

Sec. 34.301. Nature of Deposit Contract. (a) A deposit contract between a bank and an account holder is considered a contract in writing for all purposes and may be evidenced by one or more agreements, deposit tickets, signature cards, or notices as provided by Section 34.302, or by other documentation as provided by law.

(b) A cause of action for denial of deposit liability on a deposit contract without a maturity date does not accrue until the bank has denied liability and given notice of the denial to the account holder. A bank that

[9] See 7 TAC §12.32, relating to loan fees, subject to Section 34.203(e), Finance Code.

provides an account statement or passbook to the account holder is considered to have denied liability and given the notice as to any amount not shown on the statement or passbook.

(c) To the extent provided by Section 4.102(c), Business & Commerce Code, the laws of this state govern a deposit contract between a bank and a consumer account holder if the branch or separate office of the bank that accepts the deposit contract is located in this state.

Sec. 34.302. Amendment of Deposit Contract. (a) A bank and its account holder may amend the deposit contract by agreement or as permitted by Subsection (b) or other law.

(b) A bank may amend a deposit contract by mailing a written notice of the amendment to the account holder, separately or as an enclosure with or part of the account holder's statement of account or passbook. The notice must include the text and effective date of the amendment. The bank is required to deliver the notice to only one of the account holders of a deposit account that has more than one account holder. The effective date may not be earlier than the 30th day after the date of mailing the notice unless the amendment:

(1) is made to comply with a statute or rule that authorizes an earlier effective date;

(2) does not reduce the interest rate on the account or otherwise adversely affect the account holder; or

(3) is made for a reason relating to security of an account.

(c) Except for a disclosure required to be made under Section 34.303 or the Truth in Savings Act (12 U.S.C. Section 4301 et seq.) or other federal law, before renewal of an account a notice of amendment is not required under Subsection (b) for:

(1) a change in the interest rate on a variable-rate account, including a money market or negotiable order of withdrawal account;

(2) a change in a term for a time account with a maturity of one month or less if the deposit contract authorizes the change in the term; or

(3) a change contemplated and permitted by the original contract.

(d) An amendment under Subsection (b) may reduce the rate of interest or eliminate interest on an account without a maturity date.

(e) Amendment of a deposit contract made in compliance with this section is not a violation of the Deceptive Trade Practices-Consumer Protection Act (Section 17.41 et seq., Business & Commerce Code).

Sec. 34.303. Fees; Disclosures. (a) Except as otherwise provided by law, a bank may charge an account holder a fee, service charge, or penalty relating to service or activity of a deposit account, including a fee for an overdraft, insufficient fund check, or stop payment order.

(b) Except as otherwise provided by the Truth in Savings Act (12 U.S.C. Section 4301 et seq.) or other federal law, a bank shall disclose the amount of each fee, charge, or penalty related to an account or, if the amount of a fee, charge, or penalty cannot be stated, the method of computing the fee, charge, or penalty. The disclosure must be made by written notice delivered or mailed to each customer opening an account not later than the 10th business day after the date the account is opened. A bank that increases or adds a new fee, charge, or penalty shall give notice of the change to each affected account holder in the manner provided by Section 34.302(b) for notice of an amendment of a deposit contract.

Sec. 34.304. Securing Deposits. (a) A state bank may not create a lien on its assets or secure the repayment of a deposit except as authorized or required by this section, rules adopted under this subtitle, or other law.

(b) A state bank may pledge its assets to secure a deposit of:

(1) any state or an agency, political subdivision, or instrumentality of any state;

(2) the United States or an agency or instrumentality of the United States;

(3) any federally recognized Indian tribe; or

(4) another entity to the same extent and subject to the same limitations as may be authorized by the law of this state or of the United States for any other depository institution doing business in this state.

(c) This section does not prohibit the pledge of assets to secure the repayment of money borrowed or the purchase of excess deposit insurance from a private insurance company.

(d) An act, deed, conveyance, pledge, or contract in violation of this section is void.

Sec. 34.305. Deposit Account of Minor. (a) Except as otherwise provided by this section, a bank lawfully doing business in this state may enter into a deposit account with a minor as the sole and absolute owner of the account and may pay checks and withdrawals and otherwise act with respect to the account on the order of the minor. A payment or delivery of rights to a minor who holds a deposit account evidenced by an acquittance signed by the minor discharges the bank to the extent of the payment made or rights delivered.

(b) The disabilities of minority of a minor who is the sole and absolute owner of the deposit account are removed for the limited purpose of enabling:

(1) the minor to enter into a depository contract with the bank; and

(2) the bank to enforce the contract against the minor, including collection of an overdraft or account fee and submission of account history to an account reporting agency or credit reporting bureau.

(c) A parent or legal guardian of a minor may deny the minor's authority to control, transfer, draft on, or make a withdrawal from the minor's deposit account by notifying the bank in writing. On receipt of the notice by the bank, the minor may not control, transfer, draft on, or make a withdrawal from the account during minority except with the joinder of a parent or legal guardian of the minor.

(d) If a minor with a deposit account dies, the acquittance of the minor's parent or legal guardian discharges the liability of the bank to the extent of the acquittance, except that the aggregate discharges under this subsection may not exceed $3,000.

(e) Subsection (a) does not authorize a loan to the minor by the bank, whether on pledge of the minor's savings account or otherwise, or bind the minor to repay a loan made except as provided by Subsection (b) or other law or unless the depository institution has obtained the express consent and joinder of a parent or legal guardian of the minor. This subsection does not apply to an inadvertent extension of credit because of an overdraft from insufficient funds, a returned check or deposit, or another shortage in a depository account resulting from normal banking operations.

Sec. 34.306. Trust Account with Limited Documentation. (a) Subject to Subchapter B, Chapter 111, and Chapters 112 and 113, Estates Code, a bank may accept and administer a deposit account:

(1) that is opened with the bank by one or more persons expressly as a trustee for one or more other named persons; and

(2) for which further notice of the existence and terms of a trust is not given in writing to the bank.

(b) For a deposit account that is opened with a bank by one or more persons expressly as a trustee for one or more other named persons under or purporting to be under a written trust agreement, the trustee may provide the bank with a certificate of trust to evidence the trust relationship. The certificate must be an affidavit of the trustee and must include the effective date of the trust, the name of the trustee, the name of or method for choosing successor trustees, the name and address of each beneficiary, the authority granted to the trustee, the disposition of the account on the death of the trustee or the survivor of two or more trustees, other information required by the bank, and an indemnification of the bank. The bank may accept and administer the account, subject to Subchapter B, Chapter 111, and Chapters 112 and 113, Estates Code, in accordance with the certificate of trust without requiring a copy of the trust agreement. The bank is not liable for administering the account as provided by the certificate of trust, even if the certificate of trust is contrary to the terms of the trust agreement, unless the bank has actual knowledge of the terms of the trust agreement.

(c) On the death of the trustee or of the survivor of two or more trustees, the bank may pay all or part of the withdrawal value of the account with interest as provided by the certificate of trust. If the trustee did not deliver a certificate of trust, the bank's right to treat the account as owned by a trustee ceases on the death of the trustee. On the death of the trustee or of the survivor of two or more trustees, the bank, unless the certificate of trust provides otherwise, shall pay the withdrawal value of the account with interest in equal shares to the persons who survived the trustee, are named as beneficiaries in the certificate of trust, and can be located by the bank from its own records. If there is not a certificate of trust, payment of the withdrawal value and interest shall be made as provided by Subchapter B, Chapter 111, and Chapters 112 and 113, Estates Code. Any payment made under this section for all or part of the withdrawal value and interest discharges any liability of the bank to the extent of the payment. The bank may pay all or part of the withdrawal value and interest in the manner provided by this section, regardless of whether it has knowledge of a competing claim, unless the bank receives actual knowledge that payment has been restrained by court order.

(d) This section does not obligate a bank to accept a deposit account from a trustee who does not furnish a copy of the trust agreement or to search beyond its own records for the location of a named beneficiary.

(e) This section does not affect a contractual provision to the contrary that otherwise complies with the laws of this state.

Sec. 34.307. Right of Set-off. (a) Except as otherwise provided by the Truth in Lending Act (15 U.S.C. Section 1601 et seq.) or other federal law, a bank has a right of set-off, without further agreement or action, against all accounts owned by a depositor to whom or on whose behalf the bank has made an advance of money by loan, overdraft, or otherwise if the bank has previously disclosed this right to the depositor. If the depositor defaults in the repayment or satisfaction of the obligation, the bank, without notice to or consent of the depositor, may set off or cancel on its books all or part of the accounts owned by the depositor and apply the value of the accounts in payment of and to the extent of the obligation.

(b) For purposes of this section, a default occurs when an obligor has failed to make a payment as provided by the terms of the loan or other credit obligation and a grace period provided for by the agreement or law has expired. An obligation is not required to be accelerated or matured for a default to authorize set-off of the depositor’s obligation against the defaulted payment.

(c) A bank may not exercise its right of set-off under this section against an account unless the account is due the depositor in the same capacity as the defaulted credit obligation. A trust account for which a depositor is trustee, including a trustee under a certificate of trust delivered under Section 34.306(b), is not subject to the right of set-off under this section unless the trust relationship is solely evidenced by the account card as provided by Subchapter B, Chapter 111, and Chapters 112 and 113, Estates Code.

(d) This section does not limit the exercise of another right of set-off, including a right under contract or common law.

CHAPTER 35. ENFORCEMENT ACTIONS

Subchapter A. Enforcement Orders: Banks and Management

Subchapter B. Supervision and Conservatorship

Subchapter C. Unauthorized Activity: Investigation and Enforcement

CHAPTER 35. ENFORCEMENT ACTIONS

Subchapter A. Enforcement Orders: Banks and Management

Sec. 35.0001. Applicability to Bank Subsidiaries. This subchapter applies to a subsidiary of a state bank, a present or former officer, director, or employee of a subsidiary, or a controlling shareholder or other person participating in the affairs of a subsidiary in the same manner as the subchapter applies to a state bank, a present or former officer, director, or employee of a state bank, or a controlling shareholder or other person participating in the affairs of a state bank.

Sec. 35.001. Determination Letter. (a) If the banking commissioner determines from examination or other credible evidence that a state bank is in a condition that may warrant the issuance of an enforcement order under this chapter, the banking commissioner may notify the bank in writing of the determination, the requirements the bank must satisfy to abate the determination, and the time in which the requirements must be satisfied to avert further administrative action. The determination letter must be delivered by personal delivery or by registered or certified mail, return receipt requested.

(b) The determination letter may be issued in connection with the issuance of a cease and desist, removal, or prohibition order under this subchapter or an order of supervision or conservatorship under Subchapter B.

Sec. 35.002. Cease and Desist Order. (a) The banking commissioner has grounds to issue a cease and desist order to an officer, employee, or director of a state bank, or the bank itself acting through an authorized person, if the banking commissioner determines from examination or other credible evidence that the bank or person directly or indirectly has:

(1) violated this subtitle or another applicable law;

(2) engaged in a breach of trust or other fiduciary duty;

(3) refused to submit to examination or examination under oath;

(4) conducted business in an unsafe or unsound manner; or

(5) violated a condition of the bank's charter or an agreement between the bank or the person and the banking commissioner or the department.

(b) If the banking commissioner has grounds for action under Subsection (a) and finds that an order to cease and desist from a violation appears to be necessary and in the best interest of the bank involved and its depositors, creditors, and shareholders, the banking commissioner may serve a proposed cease and desist order on the bank and each person who committed or participated in the action. The proposed order must:

(1) be delivered by personal delivery or by registered or certified mail, return receipt requested;

(2) state with reasonable certainty the grounds for the proposed order; and

(3) state the effective date of the order, which may not be before the 21st day after the date the proposed order is delivered or mailed.

(b-1) A proposed cease and desist order may require an officer, employee, or director of a state bank, or the bank itself acting through an authorized person, to cease or desist from a violation or other practice or to take affirmative action to correct the conditions resulting from a violation or other practice, including the payment of restitution or other action that the banking commissioner determines is appropriate.

(c) The order takes effect if the bank or person against whom the proposed order is directed does not request a hearing in writing before the effective date. After taking effect, the order is final and nonappealable as to that bank or person.

Sec. 35.003. Removal or Prohibition Order. (a) The banking commissioner has grounds to remove or prohibit a present or former officer, director, or employee of a state bank from office or employment in, or prohibit a controlling shareholder or other person participating in the affairs of a state bank from further participation in the affairs of, a state bank or any other entity chartered, registered, permitted, or licensed by the banking commissioner if the banking commissioner determines from examination or other credible evidence that:

(1) the person:

(A) intentionally committed or participated in the commission of an act described by Section 35.002(a) with regard to the affairs of a financial institution, as defined by Section 201.101;

(B) violated a final cease and desist order issued by a state or federal regulatory agency against the person or an entity in which the person is or was an officer, director, or employee; or

(C) made, or caused to be made, false entries in the records of a financial institution;

(2) because of this action by the person:

(A) the financial institution has suffered or will probably suffer financial loss or expense, or other damage;

(B) the interests of the depositors, creditors, or shareholders of the financial institution have been or could be prejudiced; or

(C) the person has received financial gain or other benefit by reason of the action, or likely would have if the action had not been discovered; and

(3) the action:

(A) involves personal dishonesty on the part of the person; or

(B) demonstrates wilful or continuing disregard for the safety or soundness of the financial institution.

(b) If the banking commissioner has grounds for action under Subsection (a) and finds that a removal or prohibition order appears to be necessary and in the best interest of the public, the banking commissioner may serve a proposed removal or prohibition order, as appropriate, on a person alleged to have committed or participated in the action. The proposed order must:

(1) be delivered by personal delivery or by registered or certified mail, return receipt requested;

(2) state with reasonable certainty the grounds for removal or prohibition; and

(3) state the effective date of the order, which may not be before the 21st day after the date the proposed order is delivered or mailed; and

(4) state the duration of the order, including whether the duration of the order is perpetual.

(b-1) The banking commissioner may make a removal or prohibition order perpetual or effective for a specific period of time, may probate the order, or may impose other conditions on the order.

(c) The order takes effect if the person against whom the proposed order is directed does not request a hearing in writing before the effective date. After taking effect, the order is final and nonappealable as to that person.

Sec. 35.0035. Removal or Prohibition Orders in Response to Certain Criminal Offenses. (a) For purposes of this section, a person is considered to have been finally convicted of an offense if the person's case is not subject to further appellate review and:

(1) a sentence was imposed on the person;

(2) the person received probation or community supervision, including deferred adjudication community supervision; or

(3) the court deferred final disposition of the person's case.

(b) The banking commissioner has grounds to remove or prohibit a present or former officer, director, or employee of a state bank from office or employment in, or prohibit a controlling shareholder or other person participating in the affairs of a state bank from further participation in the affairs of, a state bank or any other entity chartered, registered, permitted, or licensed by the banking commissioner if the person has been finally convicted of a felony offense involving:

(1) a bank or other financial institution;

(2) dishonesty; or

(3) breach of trust.

(c) If the banking commissioner has grounds for action under Subsection (b), the banking commissioner may serve a removal or prohibition order, as appropriate, on the person who has been finally convicted of a felony offense. The banking commissioner shall also serve a copy of the order on any state bank that the person is affiliated with at the time of service of the order.

(d) An order issued under this section becomes effective immediately on service and continues in effect unless the order is:

(1) stayed or terminated by the banking commissioner;

(2) set aside by the banking commissioner after a hearing; or

(3) stayed or vacated on appeal.

(e) Not later than the 30th day after the date an order is served under this section, the person against whom the order is issued may request in writing a hearing before the banking commissioner to show that the person's continued service to a state bank or participation in the affairs of a state bank does not, or is unlikely to, threaten the interests of the depositors, creditors, or shareholders of the state bank or the public confidence in the state bank.

(f) Not later than the 30th day after the date the request for a hearing is received under this section, the banking commissioner shall hold the hearing, unless the party requesting the hearing requests a later date. At the hearing, the party requesting the hearing has the burden of proof.

(g) After the hearing, the banking commissioner may affirm, modify, or set aside, in whole or in part, the order. An order affirming or modifying the order is immediately final for purposes of enforcement and appeal. The order may be appealed as provided by Sections 31.202, 31.203, and 31.204.

Sec. 35.004. Hearing on Proposed Order.[1] (a) A requested hearing on a proposed order shall be held not later than the 30th day after the date the first request for a hearing on the order was received by the department unless the parties agree to a later hearing date. Not later than the 11th day before the date of the hearing, each party shall be given written notice by personal delivery or by registered or certified mail, return receipt requested, of the date set by the banking commissioner for the hearing. At the hearing, the department has the burden of proof and each person against whom the proposed order is directed may cross-examine and present evidence to show why the proposed order should not be issued.

(b) After the hearing, the banking commissioner shall issue or decline to issue the proposed order. The proposed order may be modified as necessary to conform to the findings at the hearing and to require the board to take necessary affirmative action to correct the conditions cited in the order.

(c) An order issued under this section is immediately final for purposes of enforcement and appeal. The order may be appealed as provided by Sections 31.202, 31.203, and 31.204.[2]

[1] See 7 TAC §§9.11-9.39, relating to contested case hearings.

[2] See 7 TAC §§9.51-9.57, relating to appeals to the finance commission.

Sec. 35.005. Emergency Order. (a) If the banking commissioner believes that immediate action is necessary to prevent immediate and irreparable harm to the bank and its depositors, creditors, and shareholders, the banking commissioner may issue one or more cease and desist, removal, or prohibition orders as emergency orders to become effective immediately on service without prior notice or hearing. Service must be by personal delivery or by registered or certified mail, return receipt requested.

(b) In each emergency order the banking commissioner shall notify the bank and any person against whom the emergency order is directed of:

(1) the specific conduct requiring the order;

(2) the citation of each law alleged to have been violated;

(3) the immediate and irreparable harm alleged to be threatened;

(4) the duration of the order, including whether the duration of the order is perpetual; and

(5) the right to a hearing.

(c) Unless a person against whom the emergency order is directed requests a hearing in writing before the 11th day after the date it is served on the person, the emergency order is final and nonappealable as to that person.

(d) A hearing requested under Subsection (c) must be:

(1) given priority over all other matters pending before the banking commissioner; and

(2) held not later than the 20th day after the date that it is requested unless the parties agree to a later hearing date.[3]

(e) After the hearing, the banking commissioner may affirm, modify, or set aside in whole or part the emergency order. An order affirming or modifying the emergency order is immediately final for purposes of enforcement and appeal. The order may be appealed as provided by Sections 31.202, 31.203, and 31.204.[4]

[3] See 7 TAC §§9.11-9.39, relating to contested case hearings.

[4] See 7 TAC §§9.51-9.57, relating to appeals to the finance commission.

(f) An emergency order continues in effect unless the order is stayed by the banking commissioner. The banking commissioner may impose any condition before granting a stay of the emergency order.

Sec. 35.006. Copy of Letter or Order in Bank Records. A copy of a determination letter, proposed order, emergency order, or final order issued by the banking commissioner under this subchapter shall be immediately brought to the attention of the board of the affected bank, regardless of whether the bank is a party, and filed in the minutes of the board. Each director shall immediately certify to the banking commissioner in writing that the certifying person has read and understood the determination letter, proposed order, emergency order, or final order. The required certification may not be considered an admission of a person in a subsequent legal or administrative proceeding.

Sec. 35.007. Effect of Final Removal or Prohibition Order. (a) Except as otherwise provided by law, without the prior written approval of the banking commissioner, a person subject to a final and enforceable removal or prohibition order issued by the banking commissioner, or by another state, federal, or foreign financial institution regulatory agency, may not:

(1) serve as a director, officer, or employee of a state bank or trust company, or as a director, officer, or employee with financial responsibility of any other entity chartered, registered, permitted, or licensed by the banking commissioner under the laws of this state;

(2) directly or indirectly participate in any manner in the management of such an entity;

(3) directly or indirectly vote for a director of such an entity; or

(4) solicit, procure, transfer, attempt to transfer, vote, or attempt to vote a proxy, consent, or authorization with respect to voting rights in such an entity.

(b) The person subject to the order remains entitled to receive dividends or a share of profits, return of contribution, or other distributive benefit from such an entity with respect to voting securities owned by the person.

(c) If voting securities of an entity identified in Subsection (a)(1) cannot be voted under this section, the voting securities are considered to be authorized but unissued for purposes of determining the procedures for and results of an affected vote.

(d) [Repealed][5]

(e) This section and Section 35.008 do not prohibit a removal or prohibition order that has indefinite duration or that by its terms is perpetual.

Sec. 35.0071. Application for Release from Final Removal or Prohibition Order. (a) After the expiration of 10 years from date of issuance, a person who is subject to a prohibition or removal order issued under this subchapter, regardless of the order's stated duration or date of issuance, may apply to the banking commissioner to be released from the order.

(b) The application must be made under oath and in the form required by the banking commissioner. The application must be accompanied by any required fees.

(c) The banking commissioner, in the exercise of discretion, may approve or deny an application filed under this section.

(d) The banking commissioner's decision under Subsection (c) is final and not appealable.

Sec. 35.008. Limitation on Action. The banking commissioner may not initiate an enforcement action under this subchapter later than the fifth anniversary of the date the banking commissioner discovered or reasonably should have discovered the conduct involved.

Sec. 35.009. Enforcement by Commissioner. (a) If the banking commissioner reasonably believes that a bank or other person has violated any of the following, the banking commissioner may take any action authorized under Subsection (a-1):

(1) this subtitle or rules enacted under this subtitle and, as a result of that violation, exposed or could have exposed the bank or the bank's depositors, creditors, or shareholders to harm;

(2) other applicable law of this state and, as a result of that violation, exposed or could have exposed the bank or the bank's depositors, creditors, or shareholders to harm; or

(3) a final order issued by the banking commissioner.

(a-1) The banking commissioner may:

[5] Repealed eff. Sept. 1, 2007, by 80th Tex. Leg., ch. 237 (H.B. 1962), §80.

(1) initiate an administrative penalty proceeding against the bank or other person, in accordance with Sections 35.010 and 35.011;

(2) refer the matter to the attorney general for enforcement by injunction or other available remedy; or

(3) pursue any other action the banking commissioner considers appropriate under applicable law.

(b) If the attorney general prevails in an action brought under Subsection (a-1)(2), the attorney general is entitled to recover reasonable attorney's fees from the bank or person committing the violation.

Sec. 35.010. Administrative Penalty. (a) The banking commissioner may initiate a proceeding for an administrative penalty against a bank or other person by serving on the bank or other person, as applicable, notice of the time and place of a hearing on the penalty. The hearing may not be held earlier than the 20th day after the date the notice is served.[6] The notice must:

(1) be served by personal delivery or by registered or certified mail, return receipt requested;

(2) contain a statement of the conduct alleged to constitute a violation; and

(3) if the alleged violation is described by Section 35.009(a)(1) or (2), identify corrective action that the bank or other person must take to avoid or reduce the amount of a penalty that would otherwise be imposed under this section.

(b) In determining the amount of any penalty to be imposed, the banking commissioner shall consider the following factors:

(1) the financial resources of the bank or other person;

(2) the good faith of the bank or other person, including any corrective action taken;

(3) the gravity of the violation;

(4) the history of previous violations;

(5) an offset of the amount of the penalty by the amount of any penalty imposed by another state or federal agency for the same conduct; and

(6) any other matter that justice may require.

(c) If the banking commissioner determines after the hearing that the alleged conduct occurred and that the conduct constitutes a violation, the banking commissioner may impose an administrative penalty against a bank or other person, as applicable, in an amount:

(1) if imposed against a bank, not less than $500 and not more than $10,000 for each violation for each day the violation continues, except that the maximum administrative penalty that may be imposed is the lesser of $500,000 or one percent of the bank's assets; or

(2) if imposed against a person other than a bank, not less than $500 and not more than $5,000 for each violation for each day the violation continues, except that the maximum administrative penalty that may be imposed is $250,000.

Sec. 35.011. Payment or Appeal of Administrative Penalty. (a) When a penalty order under Section 35.010 becomes final, the bank or other person, as applicable, shall pay the penalty or appeal by filing a petition for judicial review.

(b) The petition for judicial review stays the penalty order during the period preceding the decision of the court. If the court sustains the order, the court shall order the bank or other person, as applicable, to pay the full amount of the penalty or a lower amount determined by the court. If the court does not sustain the order, a penalty is not owed. If the final judgment of the court requires payment of a penalty, interest accrues on the penalty, at the rate charged on loans to depository institutions by the Federal Reserve Bank of New York, beginning on the date the judgment is final and ending on the date the penalty and interest are paid.

(c) If the bank or other person, as applicable, does not pay the penalty imposed under a final and nonappealable penalty order, the banking commissioner shall refer the matter to the attorney general for enforcement. The attorney general is entitled to recover reasonable attorney's fees from the bank or other person, as applicable, if the attorney general prevails in judicial action necessary for collection of the penalty.

Sec. 35.012. Confidentiality of Records. A copy of a notice, correspondence, transcript, pleading, or other document in the records of the department relating to an order issued under this subchapter is confidential and may be released only as provided by Subchapter D, Chapter

[6] See 7 TAC §§9.11-9.39, relating to contested case hearings.

31,[7] except that the banking commissioner periodically shall publish all final removal and prohibition orders. The banking commissioner may release a final cease and desist order, a final order imposing an administrative penalty, or information regarding the existence of any of those orders to the public if the banking commissioner concludes that the release would enhance effective enforcement of the order.

Sec. 35.013. Collection of Fees. The department may sue to enforce the collection of a fee owed to the department under a law administered by the department. In the suit a certificate by the banking commissioner showing the delinquency is prima facie evidence of:

(1) the levy of the fee or the delinquency of the stated fee amount; and

(2) compliance by the department with the law relating to the computation and levy of the fee.

Subchapter B. Supervision and Conservatorship[8]

Sec. 35.1001. Applicability to Bank Subsidiaries. This subchapter applies to a subsidiary of a state bank, a present or former officer, director, or employee of a subsidiary, or a controlling shareholder or other person participating in the affairs of a subsidiary in the same manner as the subchapter applies to a state bank, a present or former officer, director, or employee of a state bank, or a controlling shareholder or other person participating in the affairs of a state bank.

Sec. 35.101. Order of Supervision. (a) The banking commissioner by order may appoint a supervisor over a state bank if the banking commissioner determines from examination or other credible evidence that the bank is in hazardous condition and that an order of supervision appears to be necessary and in the best interest of the bank and its depositors, creditors, and shareholders, or the public.

(b) The banking commissioner may issue the order without prior notice.

(c) A supervisor serves until the earlier of:

(1) the expiration of the period stated in the order of supervision; or

(2) the date the banking commissioner determines that the requirements for abatement of the order have been satisfied.

Sec. 35.102. Order of Conservatorship. (a) The banking commissioner by order may appoint a conservator for a state bank if the banking commissioner determines from examination or other credible evidence that the bank is in hazardous condition and immediate and irreparable harm is threatened to the bank, its depositors, creditors, or shareholders, or the public.

(b) The banking commissioner may issue the order without prior notice at any time before, during, or after the period of supervision.

(c) An order of conservatorship issued under this section must specifically state the basis for the order.

Sec. 35.103. Notice and Hearing.[9] (a) An order issued under Section 35.101 or 35.102 must contain or be accompanied by a notice that, at the request of the bank, a hearing before the banking commissioner will be held at which the bank may cross-examine and present evidence to contest the order or show that the bank has satisfied all requirements for abatement of the order. The department has the burden of proof for any continuation of the order or the issuance of a new order.

(b) To contest or modify the order or demonstrate that the bank has satisfied all requirements for abatement of the order, the bank must submit to the banking commissioner a written request for a hearing. The request must state the grounds for the request to set aside or modify the order. On receiving a request for hearing, the banking commissioner shall serve notice of the place and time of the hearing, which must be not later than the 10th day after the date the banking commissioner receives the request for a hearing unless the parties agree to a later hearing date. The notice must be delivered by personal delivery or by registered or certified mail, return receipt requested.

(c) The banking commissioner may:

(1) delay a decision for a prompt examination of the bank; and

(2) reopen the record as necessary to allow presentation of the results of the examination and

[7] See 7 TAC §3.111, relating to confidential information.

[8] See generally Policy Memorandum (Interpretive Statement) No. 1005, relating to policy on administrative and enforcement actions. With respect to administrative procedure regarding contested case hearings and appeals, see 7 TAC Chapter 9.

[9] See 7 TAC §§9.11-9.39, relating to contested case hearings.

appropriate opportunity for cross-examination and presentation of other relevant evidence.

Sec. 35.104. Post-hearing Order. (a) If after the hearing the banking commissioner finds that the bank has been rehabilitated, that its hazardous condition has been remedied, that irreparable harm is no longer threatened, or that the bank should otherwise be released from the order, the banking commissioner shall release the bank from the order, subject to conditions the banking commissioner from the evidence believes are warranted to preserve the safety and soundness of the bank.

(b) If after the hearing the banking commissioner finds that the bank has failed to comply with the lawful requirements of the banking commissioner, has not been rehabilitated, is insolvent, or otherwise continues in hazardous condition, the banking commissioner by order shall:

(1) appoint or reappoint a supervisor under Section 35.101;

(2) appoint or reappoint a conservator under Section 35.102; or

(3) take other appropriate action authorized by law.

(c) An order issued under Subsection (b) is immediately final for purposes of appeal. The order may be appealed as provided by Sections 31.202, 31.203, and 31.204.[10]

Sec. 35.105. Confidentiality of Records. An order issued under this subchapter and a copy of a notice, correspondence, transcript, pleading, or other document in the records of the department relating to the order are confidential and may be released only as provided by Subchapter D, Chapter 31,[11] except that the banking commissioner may release to the public an order or information regarding the existence of an order if the banking commissioner concludes that the release would enhance effective enforcement of the order.

Sec. 35.106. Authority of Supervisor. During a period of supervision, a bank, without the prior approval of the banking commissioner or the supervisor or as otherwise permitted or restricted by the order of supervision, may not:

(1) dispose of, sell, transfer, convey, or encumber the bank's assets;

(2) lend or invest the bank's money;

(3) incur a debt, obligation, or liability;

(4) pay a cash dividend to the bank's shareholders; or

(5) remove an executive officer or director, change the number of executive officers or directors, or have any other change in the position of executive officer or director.

Sec. 35.107. Authority of Conservator. (a) A conservator appointed under this subchapter shall immediately take charge of the bank and all of its property, books, records, and affairs on behalf and at the direction and control of the banking commissioner.

(b) Subject to any limitation in the order of appointment or other direction of the banking commissioner, the conservator has all the powers of the directors, officers, and shareholders of the bank and shall conduct the business of the bank and take all steps the conservator considers appropriate to remove the conditions causing the conservatorship. During the conservatorship, the board may not direct or participate in the affairs of the bank.

(c) Except as otherwise provided by this subchapter, by rules adopted under this subtitle, or by Section 12.106, the conservator has the rights and privileges and is subject to the duties, restrictions, penalties, conditions, and limitations of the directors, officers, and employees of state banks.

Sec. 35.108. Qualifications of Appointee. The banking commissioner may appoint as a supervisor or conservator any person who in the judgment of the banking commissioner is qualified to serve. The banking commissioner may serve as, or may appoint an employee of the department to serve as, supervisor or conservator.

Sec. 35.109. Expenses. (a) The banking commissioner shall determine and approve the reasonable expenses attributable to the service of a supervisor or conservator, including costs incurred by the department and the compensation and expenses of the supervisor or conservator and any professional employees appointed to represent or assist the supervisor or conservator. The banking commissioner or an employee of the department may not receive compensation in addition to salary for serving as supervisor or conservator, but the department

[10] See 7 TAC §§9.51-9.57, relating to appeals to the finance commission.

[11] See 7 TAC §3.111, relating to confidential information.

may receive reimbursement for the fully allocated personnel cost associated with service of the banking commissioner or an employee of the department as supervisor or conservator.

(b) All approved expenses shall be paid by the bank as the banking commissioner determines. The banking commissioner has a lien against the assets and money of the bank to secure payment of approved expenses. The lien has a higher priority than any other lien against the bank.

(c) Notwithstanding any other provision of this subchapter, the bank may employ an attorney and other persons the bank selects to assist the bank in contesting or satisfying the requirements of an order of supervision or conservatorship. The banking commissioner shall authorize the payment of reasonable fees and expenses from the bank for the attorney and other persons as expenses of the supervision or conservatorship.

(d) The banking commissioner may defer collection of assessment and examination fees by the department from the bank during a period of supervision or conservatorship if deferral would appear to aid prospects for rehabilitation. As a condition of release from supervision or conservatorship, the banking commissioner may require the rehabilitated bank to pay or develop a reasonable plan for payment of deferred fees.

Sec. 35.110. Review of Supervisor or Conservator Decision. (a) Notwithstanding Section 35.107(b), a majority of the bank's board, acting directly or through counsel who affirmatively represents that the requisite majority has been obtained, may request in writing that the banking commissioner review an action taken or proposed by the supervisor or conservator. The request must specify why the action would not be in the best interest of the bank. The banking commissioner shall investigate to the extent necessary and make a prompt written ruling on the request. If the action has not yet been taken or if the effect of the action can be postponed, the banking commissioner may stay the action on request pending review.

(b) If a majority of the bank's board objects to the banking commissioner's ruling, the majority may request a hearing before the banking commissioner. The request must be made not later than the 10th day after the date the bank is notified of the ruling.

(c) The banking commissioner shall give the board notice of the time and place of the hearing by personal delivery or by registered or certified mail, return receipt requested. The hearing may not be held later than the 10th day after the date the banking commissioner receives the request for a hearing unless the parties agree to a later hearing date. At the hearing the board has the burden of proof to demonstrate that the action is not in the best interest of the bank.[12]

(d) After the hearing, the banking commissioner may affirm, modify, or set aside in whole or part the prior ruling. An order supporting the action contested by the board is immediately final for purposes of appeal. The order may be appealed as provided by Sections 31.202, 31.203, and 31.204.[13] If the order is appealed to the finance commission, the finance commission may:

(1) affirm, terminate, or modify the order;

(2) continue or end supervision or conservatorship; and

(3) order further relief as justice, equity, and protection of depositors, creditors, and the public require.

Sec. 35.111. Venue. (a) A suit filed against a bank while the bank is under conservatorship, or against a person in connection with an action taken or decision made by that person as a supervisor or conservator of a bank, must be brought in Travis County regardless of whether the bank remains under supervision or conservatorship.

(b) A conservator may sue a person on the bank's behalf to preserve, protect, or recover a bank asset, including a claim or cause of action. Venue is in:

(1) Travis County; or

(2) another location provided by law.

Sec. 35.112. Duration. A supervisor or conservator serves for the period necessary to accomplish the purposes of the supervision or conservatorship as intended by this subchapter. A rehabilitated bank shall be returned to its former or new management under conditions reasonable and necessary to prevent recurrence of the conditions causing the supervision or conservatorship.

Sec. 35.113. Administrative Election of Remedies. The banking commissioner may take any action authorized by Chapter 36 regardless of the existence of supervision or conservatorship. A period of

[12] See 7 TAC §§9.11-9.39, relating to contested case hearings.

[13] See 7 TAC §§9.51-9.57, relating to appeals to the finance commission.

supervision or conservatorship is not required before a bank is closed for liquidation or other remedial action is taken.

Sec. 35.114. Release Before Hearing. This subchapter does not prevent release of the bank from supervision or conservatorship before a hearing if the banking commissioner is satisfied that requirements for abatement have been adequately satisfied.

Subchapter C. Unauthorized Activity: Investigation and Enforcement

Sec. 35.201. Inapplicability. This subchapter does not apply to a financial institution, as that term is defined by Section 201.101, that lawfully maintains its main office or a branch in this state.

Sec. 35.202. Investigation of Unauthorized Activity. (a) If the banking commissioner has reason to believe that a person has engaged, is engaging, or is likely to engage in an unauthorized activity, the banking commissioner may:

(1) investigate as necessary within or outside this state to:

(A) determine whether the unauthorized activity has occurred or is likely to occur; or

(B) aid in the enforcement of the laws administered by the banking commissioner;

(2) initiate appropriate disciplinary action as provided by this subchapter; and

(3) report unauthorized activity to a law enforcement agency or another regulatory agency with appropriate jurisdiction.

(b) The banking commissioner may:

(1) on written request furnish to a law enforcement agency evidence the banking commissioner has compiled in connection with the unauthorized activity, including materials, documents, reports, and complaints; and

(2) assist the law enforcement agency or other regulatory agency as requested.

(c) A person acting without malice, fraudulent intent, or bad faith is not subject to liability, including liability for libel, slander, or another relevant tort, because the person files a report or furnishes, orally or in writing, information concerning a suspected, anticipated, or completed unauthorized activity to a law enforcement agency, the banking commissioner, another regulatory agency with appropriate jurisdiction, or an agent or employee of a law enforcement agency, the banking commissioner, or other regulatory agency. The person is entitled to attorney's fees and court costs if the person prevails in an action for libel, slander, or another relevant tort based on the report or other information the person furnished as provided by this subchapter.

(d) This section does not:

(1) affect a common law or statutory privilege or immunity;

(2) preempt the authority or relieve the duty of a law enforcement agency or other regulatory agency with appropriate jurisdiction to investigate and prosecute suspected criminal acts;

(3) prohibit a person from voluntarily disclosing information to a law enforcement agency or other regulatory agency; or

(4) limit a power or duty granted to the banking commissioner under this subtitle or other law.

Sec. 35.203. Subpoena Authority. (a) This section applies only to an investigation of an unauthorized activity as provided by Section 35.202 and does not affect the conduct of a contested case under Chapter 2001, Government Code.

(b) The banking commissioner may issue a subpoena to compel the attendance and testimony of a witness or the production of a book, account, record, paper, or correspondence relating to a matter that the banking commissioner has authority to consider or investigate at the department's offices in Austin or at another place the banking commissioner designates.

(c) The subpoena must be signed and issued by the banking commissioner or a deputy banking commissioner.

(d) A person who is required by subpoena to attend a proceeding before the banking commissioner is entitled to receive:

(1) reimbursement for mileage, in the amount provided for travel by a state employee, for traveling to or returning from a proceeding that is more than 25 miles from the witness's residence; and

(2) a fee for each day or part of a day the witness is necessarily present as a witness in an amount equal to the per diem travel allowance of a state employee.

(e) The banking commissioner may serve the subpoena or have it served by an authorized agent of the banking commissioner, a sheriff, or a constable. The sheriff's or constable's fee for serving the subpoena is the same as the fee paid the sheriff or constable for similar services.

(f) A person possessing materials located outside this state that are requested by the banking commissioner may make the materials available to the banking commissioner or a representative of the banking commissioner for examination at the place where the materials are located. The banking commissioner may:

(1) designate a representative, including an official of the state in which the materials are located, to examine the materials; and

(2) respond to a similar request from an official of another state, the United States, or a foreign country.

(g) A subpoena issued under this section to a financial institution is not subject to Section 59.006.

Sec. 35.204. Enforcement of Subpoena. (a) If necessary, the banking commissioner may apply to a district court of Travis County or of the county in which the subpoena was served for enforcement of the subpoena, and the court may issue an order compelling compliance.

(b) If the court orders compliance with the subpoena or finds the person in contempt for failure to obey the order, the banking commissioner, or the attorney general if representing the banking commissioner, may recover reasonable court costs, attorney's fees, and investigative costs incurred in the proceeding.

Sec. 35.205. Confidentiality of Subpoenaed Records. (a) A book, account, record, paper, correspondence, or other document subpoenaed and produced under Section 35.203 that is otherwise made privileged or confidential by law remains privileged or confidential unless admitted into evidence at an administrative hearing or in a court. The banking commissioner may issue an order protecting the confidentiality or privilege of the document and restricting its use or distribution by any person or in any proceeding, other than a proceeding before the banking commissioner.

(b) Subject to Subchapter D, Chapter 31,[14] and confidentiality provisions of other law administered by the banking commissioner, information or material acquired under Section 35.203 under a subpoena is not a public record for the period the banking commissioner considers reasonably necessary to complete the investigation, to protect the person being investigated from unwarranted injury, or to serve the public interest. The information or material is not subject to a subpoena, except a grand jury subpoena, until released for public inspection by the banking commissioner or until, after notice and a hearing, a district court determines that the public interest and any investigation by the banking commissioner would not be jeopardized by obeying the subpoena. The district court order may not apply to:

(1) a record or communication received from another law enforcement or regulatory agency except on compliance with the confidentiality laws governing the records of the other agency; or

(2) an internal note, memorandum, report, or communication made in connection with a matter that the banking commissioner has the authority to consider or investigate, except on good cause and in compliance with applicable confidentiality laws.

Sec. 35.206. Evidence. (a) On certification by the banking commissioner, a book, record, paper, or document produced or testimony taken as provided by Section 35.204 and held by the department is admissible as evidence in any case without prior proof of its correctness and without other proof. The certified book, record, document, or paper, or a certified copy, is prima facie evidence of the facts it contains.

(b) This section does not limit another provision of this subtitle or a law that provides for the admission of evidence or its evidentiary value.

Sec. 35.207. Cease and Desist Order. (a) The banking commissioner may serve a proposed cease and desist order on a person that the banking commissioner believes is engaging or is likely to engage in an unauthorized activity. The order must:

(1) be delivered by personal delivery or registered or certified mail, return receipt requested, to the person's last known address;

(2) state each act or practice alleged to be an unauthorized activity; and

[14] See 7 TAC §3.111, relating to confidential information.

(3) state the effective date of the order, which may not be before the 21st day after the date the proposed order is delivered or mailed.

(b) Unless the person against whom the proposed order is directed requests a hearing in writing before the effective date of the proposed order, the order takes effect and is final and nonappealable as to that person.

(c) A requested hearing on a proposed order shall be held not later than the 30th day after the date the first written request for a hearing on the order is received by the department unless the parties agree to a later hearing date. At the hearing, the department has the burden of proof and must present evidence in support of the order. Each person against whom the order is directed may cross-examine and show cause why the order should not be issued.[15]

(d) After the hearing, the banking commissioner shall issue or decline to issue a cease and desist order. The proposed order may be modified as necessary to conform to the findings at the hearing. An order issued under this subsection:

(1) is immediately final for purposes of enforcement and appeal; and

(2) must require the person to immediately cease and desist from the unauthorized activity.

Sec. 35.208. Emergency Cease and Desist Order. (a) The banking commissioner may issue an emergency cease and desist order to a person whom the banking commissioner reasonably believes is engaging in a continuing unauthorized activity that is fraudulent or threatens immediate and irreparable public harm.

(b) The order must:

(1) be delivered on issuance to each person affected by the order by personal delivery or registered or certified mail, return receipt requested, to the person's last known address;

(2) state the specific charges and require the person immediately to cease and desist from the unauthorized activity; and

(3) contain a notice that a request for hearing may be filed under this section.

[15] See 7 TAC §§9.11-9.39, relating to contested case hearings.

(c) Unless a person against whom the order is directed requests a hearing in writing before the 11th day after the date it is served on the person, the emergency order is final and nonappealable as to that person. A request for a hearing must:

(1) be in writing and directed to the banking commissioner; and

(2) state the grounds for the request to set aside or modify the order.

(d) On receiving a request for a hearing, the banking commissioner shall serve notice of the time and place of the hearing by personal delivery or registered or certified mail, return receipt requested. The hearing must be held not later than the 10th day after the date the banking commissioner receives the request for a hearing unless the parties agree to a later hearing date. At the hearing, the department has the burden of proof and must present evidence in support of the order. The person requesting the hearing may cross-examine witnesses and show cause why the order should not be affirmed.[16]

(e) After the hearing, the banking commissioner shall affirm, modify, or set aside in whole or part the emergency cease and desist order. An order affirming or modifying the emergency cease and desist order is immediately final for purposes of enforcement and appeal.

(f) An order continues in effect unless the order is stayed by the banking commissioner. The banking commissioner may impose any condition before granting a stay of the order.

Sec. 35.209. Judicial Review of Cease and Desist Order. (a) A person affected by a cease and desist order issued, affirmed, or modified after a hearing may file a petition for judicial review.

(b) A filed petition for judicial review does not stay or vacate the order unless the court, after hearing, specifically stays or vacates the order.

Sec. 35.210. Violation of Final Cease and Desist Order. (a) If the banking commissioner reasonably believes that a person has violated a final and enforceable cease and desist order, the banking commissioner may:

(1) initiate an administrative penalty proceeding under Section 35.211;

[16] See 7 TAC §§9.11-9.39, relating to contested case hearings.

(2) refer the matter to the attorney general for enforcement by injunction and any other available remedy; or

(3) pursue any other action the banking commissioner considers appropriate under applicable law.

(b) If the attorney general prevails in an action brought under Subsection (a)(2), the attorney general is entitled to reasonable attorney's fees.

Sec. 35.211. Administrative Penalty. (a) The banking commissioner may initiate an action for an administrative penalty against a person for violation of a cease and desist order by serving on the person notice of the time and place of a hearing on the penalty. The notice must be delivered by personal delivery or certified mail, return receipt requested, to the person's last known address. The hearing may not be held earlier than the 20th day after the date the notice is served.[17] The notice must contain a statement of the facts or conduct alleged to violate the cease and desist order.

(b) In determining whether a cease and desist order has been violated, the banking commissioner shall consider the maintenance of procedures reasonably adopted to ensure compliance with the order.

(c) If the banking commissioner after the hearing determines that a cease and desist order has been violated, the banking commissioner may:

(1) impose an administrative penalty in an amount not to exceed $25,000 for each discrete unauthorized act;

(2) direct the person against whom the order was issued to make complete restitution, in the form and amount and within the period determined by the banking commissioner, to each resident of this state and entity operating in this state damaged by the violation; or

(3) both impose the penalty and direct restitution.

(d) In determining the amount of the penalty and whether to impose restitution, the banking commissioner shall consider:

(1) the seriousness of the violation, including the nature, circumstances, extent, and gravity of any prohibited act;

(2) the economic harm caused by the violation;

(3) the history of previous violations;

(4) the amount necessary to deter future violations;

(5) efforts to correct the violation;

(6) whether the violation was intentional or unintentional;

(7) the financial ability of the person against whom the penalty is to be assessed; and

(8) any other matter that justice may require.

Sec. 35.212. Payment and Appeal of Administrative Penalty. (a) When an administrative penalty order under Section 35.211 becomes final, a person affected by the order, within the time permitted by law for appeal, shall:

(1) pay the amount of the penalty;

(2) pay the amount of the penalty and file a petition for judicial review contesting the occurrence of the violation, the amount of the penalty, or both; or

(3) without paying the amount of the penalty, file a petition for judicial review contesting the occurrence of the violation, the amount of the penalty, or both.

(b) Within the time permitted by law for appeal, a person who acts under Subsection (a)(3) may:

(1) stay enforcement of the penalty by:

(A) paying the amount of the penalty to the court for placement in an escrow account; or

(B) giving the court a supersedeas bond that is approved by the court for the amount of the penalty and that is effective until all judicial review of the order is final; or

(2) request the court to stay enforcement of the penalty by:

(A) filing with the court a sworn affidavit of the person stating that the person is financially unable to pay the amount of the penalty and is financially unable to give the supersedeas bond; and

(B) giving a copy of the affidavit to the banking commissioner by certified mail.

[17] See 7 TAC §§9.11-9.39, relating to contested case hearings.

(c) Not later than the fifth day after the date the banking commissioner receives a copy of an affidavit under Subsection (b)(2), the banking commissioner may file with the court a contest to the affidavit. The court shall hold a hearing on the facts alleged in the affidavit as soon as practicable and shall stay the enforcement of the penalty on finding that the alleged facts are true. The person who files an affidavit has the burden of proving that the person is financially unable to pay the amount of the penalty and to give a supersedeas bond.

(d) If the person does not pay the amount of the penalty and the enforcement of the penalty is not stayed, the banking commissioner may refer the matter to the attorney general for collection of the amount of the penalty.

Sec. 35.213. Judicial Review of Administrative Penalty. (a) If on judicial review the court sustains the penalty order, the court shall order the person to pay the full amount of the penalty or a lower amount determined by the court. If the court does not sustain the order, a penalty is not owed.

(b) When the judgment of the court becomes final, if the person paid the amount of the penalty and if that amount is reduced or is not upheld by the court, the court shall order that the appropriate amount plus accrued interest computed at the annual rate of 10 percent be remitted by the department. The interest shall be paid for the period beginning on the date the penalty was paid and ending on the date the penalty is remitted. If the person gave a supersedeas bond and if the amount of the penalty is not upheld by the court, the court shall order the release of the bond. If the person gave a supersedeas bond and if the amount of the penalty is reduced, the court shall order the release of the bond after the person pays the amount owed.

(c) If the judgment of the court requires payment of a penalty that has not previously been paid, the court shall order as part of its judgment that interest accrues on the penalty at the annual rate of 10 percent, beginning on the date the judgment is final and ending on the date the penalty and interest are paid.

CHAPTER 36. DISSOLUTION AND RECEIVERSHIP

Subchapter A. General Provisions

Subchapter B. Voluntary Dissolution

Subchapter C. Involuntary Dissolution and Liquidation

Subchapter D. Claims Against Receivership Estate

CHAPTER 36. DISSOLUTION AND RECEIVERSHIP

Subchapter A. General Provisions

Sec. 36.001. Definition. In this chapter, "administrative expense" means:

(1) an expense designated as an administrative expense by Subchapter C or D;

(2) court costs and expenses of operation and liquidation of a bank estate;

(3) wages owed to an employee of a bank for services rendered within three months before the date the bank was closed for liquidation and not exceeding:

(A) $2,000 to each employee; or

(B) another amount set by rules adopted under this subtitle;

(4) current wages owed to a bank employee whose services are retained by the receiver for services rendered after the date the bank is closed for liquidation;

(5) an unpaid expense of supervision or conservatorship of the bank before its closing for liquidation; and

(6) any unpaid fees or assessments owed to the department.

Sec. 36.002. Remedies Exclusive. (a) Unless the banking commissioner so requests, a court may not:

(1) order the closing or suspension of operation of a state bank; or

(2) appoint for a state bank a receiver, supervisor, conservator, liquidator, or other person with similar responsibility.

(b) A person may not be designated a receiver, supervisor, conservator, or liquidator without the voluntary approval of the banking commissioner.

(c) This chapter prevails over any conflicting law of this state.

Sec. 36.003. Federal Deposit Insurance Corporation as Liquidator. (a) The banking commissioner without court action may tender a state bank that has been closed for liquidation to the Federal Deposit Insurance Corporation or its successor as receiver and liquidating agent if the deposits of the bank were insured by the Federal Deposit Insurance Corporation or its successor on the date of closing.

(b) After acceptance of tender of the bank, the Federal Deposit Insurance Corporation or its successor shall perform the acts and duties as receiver of the bank that it considers necessary or desirable and that are permitted or required by federal law or this chapter.

(c) If the Federal Deposit Insurance Corporation or its successor refuses to accept tender of the bank, the banking commissioner shall act as receiver.

Sec. 36.004. Appointment of Independent Receiver. (a) On request of the banking commissioner, the court in which a liquidation proceeding is pending may:

(1) appoint an independent receiver; and

(2) require a suitable bond of the independent receiver.

(b) On appointment of an independent receiver, the banking commissioner is discharged as receiver and remains a party to the liquidation proceeding with standing to initiate or contest any motion. The views of the banking commissioner are entitled to deference unless they are inconsistent with the plain meaning of this chapter.

Sec. 36.005. Succession of Trust Powers. (a) If a state bank in the process of voluntary or involuntary dissolution and liquidation is acting as trustee, guardian, executor, administrator, or escrow agent, or in another fiduciary or custodial capacity, the banking commissioner may authorize the sale of the bank's administration of fiduciary accounts to a successor entity with fiduciary powers.

(b) The successor entity, without the necessity of action by a court or the creator or a beneficiary of the fiduciary relationship, shall:

(1) continue the office, trust, or fiduciary relationship; and

(2) perform all the duties and exercise all the powers connected with or incidental to the fiduciary relationship as if the successor entity had been originally designated as the fiduciary.

(c) This section applies to all fiduciary relationships, including a trust established for the benefit of a minor by court order under Section 142.005, Property Code. This section does not affect any right of a court or a party to the instrument governing the fiduciary relationship to subsequently designate another trustee as the successor fiduciary.

Subchapter B. Voluntary Dissolution

Sec. 36.101. Initiating Voluntary Dissolution. (a) A state bank may initiate voluntary dissolution and surrender its charter as provided by this subchapter:

(1) with the approval of the banking commissioner;

(2) after complying with the provisions of the Business Organizations Code regarding board and shareholder approval for voluntary dissolution; and

(3) by filing the documents as provided by Section 36.102.

(b) The shareholders of a state bank initiating voluntary dissolution by resolution shall appoint one or more persons to act as the liquidating agent or committee. The liquidating agent or committee shall conduct the liquidation as provided by law and under the supervision of the bank's board. The board, in consultation with the banking commissioner, shall require the liquidating agent or committee to give a suitable bond.

Sec. 36.102. Filing Resolutions with Banking Commissioner. After resolutions to dissolve and liquidate a state bank have been adopted by the bank's board and shareholders, a majority of the directors shall verify and file with the banking commissioner certified copies of:

(1) the resolutions of the shareholders that:

(A) are adopted at a meeting for which proper notice was given or by unanimous written consent; and

(B) approve the dissolution and liquidation of the bank;

(2) the resolutions of the board approving the dissolution and liquidation of the bank; and

(3) the notice to the shareholders informing them of the meeting.

Sec. 36.103. Banking Commissioner Investigation and Consent. The banking commissioner shall review the documentation submitted under Section 36.102 and conduct any necessary investigation or examination. If the proceedings appear to have been properly conducted and the bond to be given by the liquidating agent or committee is adequate for its purposes, the banking commissioner shall consent to dissolution and direct the bank to publish notice of its pending dissolution.

Sec. 36.104. Notice of Pending Dissolution. (a) A state bank initiating voluntary dissolution shall publish notice of its pending dissolution in a newspaper of general circulation in each community where its home office or a branch is located:

(1) at least once each week for eight consecutive weeks; or

(2) at other times specified by the banking commissioner or rules adopted under this subtitle.

(b) The notice must:

(1) be in the form and include the information required by the banking commissioner; and

(2) state that:

(A) the bank is liquidating;

(B) depositors and creditors must present their claims for payment on or before a specified date; and

(C) all safe deposit box holders and bailors of property left with the bank should remove their property on or before a specified date.

(c) The dates selected by the bank under Subsection (b) must:

(1) be approved by the banking commissioner; and

(2) allow:

(A) the affairs of the bank to be wound up as quickly as feasible; and

(B) creditors, depositors, and owners of property adequate time for presentation of claims, withdrawal of accounts, and redemption of property.

(d) The banking commissioner may adjust the dates under Subsection (b) with or without republication of notice if additional time appears needed for the activities to which the dates pertain.

(e) At the time of or promptly after publication of the notice, the bank shall mail to each of the bank's known depositors, creditors, safe deposit box holders, and bailors of property left with the bank, at the mailing address shown on the bank's records, an individual notice containing:

(1) the information required in a notice under Subsection (b); and

(2) specific information pertinent to the account or property of the addressee.

Sec. 36.105. Safe Deposits and Other Bailments. (a) A contract between the bank and a person for bailment, of deposit for hire, or for lease of a safe, vault, or box ceases on the date specified in the notice as the date for removal of property or a later date approved by the banking commissioner. A person who has paid rental or storage charges for a period extending beyond the date designated for removal of property has an unsecured claim against the bank for a refund of the unearned amount paid.

(b) If the property is not removed by the date the contract ceases, an officer of the bank shall inventory the property. In making the inventory the officer may open a safe, vault, or box, or any package, parcel, or receptacle, in the custody or possession of the bank. The inventory must be made in the presence of a notary public who is not an officer or employee of the bank and who is bonded in an amount and by sureties approved by the banking commissioner. The property shall be marked to identify, to the extent possible, its owner or the person who left it with the bank. After all property belonging to others that is in the bank's custody and control has been inventoried, a master list certified by the bank officer and the notary public shall be furnished to the banking commissioner. The master list shall be kept in a place and dealt with in a manner the banking commissioner specifies pending delivery of the property to its owner or to the comptroller as unclaimed property.

Sec. 36.106. Offices to Remain Open. Unless the banking commissioner directs or consents otherwise, the home office and all branch offices of a state bank initiating voluntary dissolution shall remain open for business during normal business hours until the last date specified in published notices for presentation of claims, withdrawal of accounts, and redemption of property.

Sec. 36.107. Fiduciary Activities. (a) As soon after publication of the notice of dissolution as is practicable, the bank shall:

(1) terminate all fiduciary positions it holds;

(2) surrender all property held by it as a fiduciary; and

(3) settle its fiduciary accounts.

(b) Unless all fiduciary accounts are settled and transferred by the last date specified in published notices or by the banking commissioner and unless the banking commissioner directs otherwise, the bank shall mail a notice to each trustor and beneficiary of any remaining trust, escrow arrangement, or other fiduciary relationship. The notice must state:

(1) the location of an office open during normal business hours where administration of the remaining fiduciary accounts will continue until settled or transferred; and

(2) a telephone number at that office.

Sec. 36.108. Final Liquidation. (a) After the bank has taken all of the actions specified by Sections 36.102, 36.105, and 36.107, paid all its debts and obligations, and transferred all property for which a legal claimant has been found after the time for presentation of claims has expired, the bank shall make a list from its books of the names of each depositor, creditor, owner of personal property in the bank's possession or custody, or lessee of any safe, vault, or box, who has not claimed or has not received a deposit, debt, dividend, interest, balance, or other amount or property due to the person. The list must be sworn to or affirmed by a majority of the bank's board.

(b) The bank shall:

(1) file the list and any necessary identifying information with the banking commissioner;

(2) pay any unclaimed money and deliver any unclaimed property to the comptroller as provided by Chapter 74, Property Code; and

(3) certify to the banking commissioner that the unclaimed money has been paid and unclaimed property has been delivered to the comptroller.

(c) After the banking commissioner has reviewed the list and has reconciled the unclaimed cash and property with the amounts of money and property reported and transferred to the comptroller, the banking commissioner shall allow the bank to distribute the bank's remaining assets, if any, among its shareholders as their ownership interests appear.

(d) After distribution of all remaining assets under Subsection (c), the bank shall file with the department:

(1) an affidavit and schedules, sworn to or affirmed by a majority of the bank's board, showing the distribution to each shareholder;

(2) all copies of reports of examination of the bank in its possession; and

(3) its original charter or an affidavit stating that the original charter is lost.

(e) After verifying the submitted information and documents, the banking commissioner shall issue a certificate canceling the charter of the bank.

Sec. 36.109. Application of Law to Bank in Dissolution. A state bank in the process of voluntary dissolution and liquidation remains subject to this subtitle and Chapters 11 and 12, including provisions for examination by the banking commissioner, and the bank shall furnish reports required by the banking commissioner.

Sec. 36.110. Authorization of Deviation from Procedures. The banking commissioner may authorize a deviation from the procedures for voluntary dissolution in this subchapter if the banking commissioner determines that the interests of claimants are not jeopardized by the deviation.

Sec. 36.111. Closure by Banking Commissioner for Involuntary Dissolution and Liquidation. The banking commissioner may close a state bank for involuntary dissolution and liquidation under this chapter if the banking commissioner determines that:

(1) the voluntary liquidation is:

(A) being conducted in an improper or illegal manner; or

(B) not in the best interests of the bank's depositors and creditors; or

(2) the bank is insolvent or imminently insolvent.

Sec. 36.112. Application for New Charter. After a state bank's charter has been voluntarily surrendered and canceled, the bank may not resume business or reopen except on application for and approval of a new charter.

Subchapter C. Involuntary Dissolution and Liquidation

Sec. 36.201. Action to Close State Bank. (a) The banking commissioner may close and liquidate a state bank on finding that:

(1) the interests of the bank's depositors and creditors are jeopardized by the bank's insolvency or imminent insolvency; and

(2) the best interests of depositors and creditors would be served by requiring that the bank be closed and its assets liquidated.

(b) A majority of the bank's directors may voluntarily close the bank and place it with the banking commissioner for liquidation.

Sec. 36.202. Notice and Effect of Closure; Appointment of Receiver. (a) After closing a state bank under Section 36.201, the banking commissioner shall place a sign at its main entrance stating that the bank has been closed and the findings on which the closing of the bank is based. A correspondent bank of the closed bank may not pay an item drawn on the account of the closed bank that is presented for payment after the correspondent has received actual notice of closing unless it previously certified the item for payment.

(b) As soon as practicable after posting the sign at the bank's main entrance, the banking commissioner shall tender the bank to the Federal Deposit Insurance Corporation as provided by Section 36.003 or initiate a receivership proceeding by filing a copy of the notice contained on the sign in a district court in the county where the bank's home office is located. The court in which the notice is filed shall docket it as a case styled, "In re liquidation of ____" (inserting the name of the bank). When this notice is filed, the court has constructive custody of all the bank's assets and any action that seeks to directly or indirectly affect bank assets is considered an intervention in the receivership proceeding and is subject to this subchapter and Subchapter D.

Sec. 36.203. Nature and Duration of Receivership. (a) The court may not require a bond from the banking commissioner as receiver.

(b) A reference in this chapter to the receiver is a reference to the banking commissioner as receiver and to any successor in office, the Federal Deposit Insurance Corporation if acting as receiver as provided by Section 36.003 and federal law, or an independent receiver appointed at the request of the banking commissioner as provided by Section 36.004.

(c) The receiver has all the powers of the directors, officers, and shareholders of the bank as necessary to support an action taken on behalf of the bank.

(d) The receiver and all employees and agents acting on behalf of the receiver are acting in an official capacity and are protected by Section 12.106. An act of the receiver is an act of the bank in liquidation. This state or a political subdivision of this state is not liable and may not be held accountable for any debt or obligation of a state bank in receivership.

(e) Section 64.072, Civil Practice and Remedies Code, applies to the receivership of a bank except as provided by this subsection. A bank receivership shall be administered continuously for the length of time necessary to complete its purposes, and a period prescribed by other law limiting the time for the administration of a receivership or of corporate affairs generally, including Section 64.072(d), Civil Practice and Remedies Code, does not apply.

Sec. 36.204. Contest of Liquidation. (a) A state bank, acting through a majority of its directors, may intervene in an action filed by the banking commissioner closing a state bank to challenge the banking commissioner's closing of the bank and to enjoin the banking commissioner or other receiver from liquidating its assets. The bank must file the intervention not later than the second business day after the closing of the bank, excluding legal holidays. The court may issue an ex parte order restraining the receiver from liquidating bank assets pending a hearing on the injunction. The receiver shall comply with the restraining order but may petition the court for permission to liquidate an asset as necessary to prevent its loss or diminution pending the outcome of the injunction.

(b) The court shall hear an action as quickly as possible and shall give it priority over other business.

(c) The bank or receiver may appeal the court's judgment as in other civil cases, except that the receiver shall retain all bank assets pending a final appellate court order even if the banking commissioner does not prevail in the trial court. If the banking commissioner prevails in the trial court, liquidation of the bank may proceed unless the trial court or appellate court orders otherwise. If liquidation is enjoined or stayed pending appeal, the trial court retains jurisdiction to permit liquidation of an asset as necessary to prevent its loss or diminution pending the outcome of the appeal.

Sec. 36.205. Notice of Bank Closing. (a) As soon as reasonably practicable after initiation of the receivership proceeding, the receiver shall publish notice in a newspaper of general circulation in each community where the bank's home office or a branch is located. The notice must state that:

(1) the bank has been closed for liquidation;

(2) depositors and creditors must present their claims for payment on or before a specified date; and

(3) all safe deposit box holders and bailors of property left with the bank should remove their property not later than a specified date.

(b) A date that the receiver selects under Subsection (a):

(1) may not be earlier than the 121st day after the date of the notice; and

(2) must allow:

(A) the affairs of the bank to be wound up as quickly as feasible; and

(B) creditors, depositors, and owners of property adequate time for presentation of claims, withdrawal of accounts, and redemption of property.

(c) The receiver may adjust the dates under Subsection (a) with the approval of the court and with or without republication of notice if additional time appears needed for those activities.

(d) As soon as reasonably practicable given the state of bank records and the adequacy of staffing, the receiver shall mail to each of the bank's known depositors, creditors, safe deposit box holders, and bailors of property left with the bank, at the mailing address shown on the bank's records, an individual notice containing the information required in a notice under Subsection (a) and specific information pertinent to the account or property of the addressee.

(e) The receiver may determine the form and content of notices under this section.

Sec. 36.206. Inventory. As soon as reasonably practicable given the state of bank records and the adequacy of staffing, the receiver shall prepare a comprehensive inventory of the bank's assets for filing with the court. The inventory is open to inspection.

Sec. 36.207. Receiver's Title and Priority. (a) The receiver has the title to all the bank's property, contracts, and rights of action, wherever located, beginning on the date the bank is closed for liquidation.

(b) The rights of the receiver have priority over a contractual lien or statutory landlord's lien under Chapter 54, Property Code, judgment lien, attachment lien, or voluntary lien that arises after the date of the closing of the bank for liquidation.

(c) The filing or recording of a receivership order in a record office of this state gives the same notice that would be given by a deed, bill of sale, or other evidence of title filed or recorded by the bank in liquidation. The recording clerk shall index a recorded receivership order in the records to which the order relates.

Sec. 36.208. Rights Fixed. The rights and liabilities of the bank in liquidation and of a depositor, creditor, officer, director, employee, shareholder, agent, or other person interested in the bank's estate are fixed on the date of closing of the bank for liquidation except as otherwise directed by the court or as expressly provided otherwise by this subchapter or Subchapter D.

Sec. 36.209. Depositories. (a) The receiver may deposit money collected on behalf of the bank estate in:

(1) the Texas Treasury Safekeeping Trust Company in accordance with procedures established by the comptroller; or

(2) one or more state banks in this state, the deposits of which are insured by the Federal Deposit Insurance Corporation or its successor, if the receiver, using sound financial judgment, determines that it would be advantageous to do so.

(b) If receivership money deposited in an account at a state bank exceeds the maximum insured amount, the receiver shall require the excess deposit to be adequately secured through a pledge of securities or otherwise, without approval of the court. The depository bank may secure the deposits of the bank in liquidation on behalf of the receiver, notwithstanding any other provision of Chapter 11 or 12 or this subtitle.

Sec. 36.210. Pending Lawsuit. (a) A judgment or order of a court of this state or of another jurisdiction in an action pending by or against the bank, rendered after the date the bank was closed for liquidation, is not binding on the receiver unless the receiver was made a party to the suit.

(b) Before the first anniversary of the date the bank was closed for liquidation, the receiver may not be required to plead to any suit pending against the bank in a court in this state on the date the bank was closed for liquidation and in which the receiver is a proper plaintiff or defendant.

(c) Sections 64.052, 64.053, and 64.056, Civil Practice and Remedies Code, do not apply to a bank estate being administered under this subchapter and Subchapter D.

Sec. 36.211. New Lawsuit. (a) Except as otherwise provided by this section, the court in which the receivership proceeding is pending under this subchapter has exclusive jurisdiction to hear and determine all actions or proceedings instituted by or against the bank or receiver after the receivership proceeding begins.

(b) The receiver may file in any jurisdiction an ancillary suit that may be helpful to obtain jurisdiction or venue over a person or property.

(c) Exclusive venue lies in Travis County for an action or proceeding instituted against the receiver or the receiver's employee, including an employee of the department, that asserts personal liability on the part of the receiver or employee.

Sec. 36.212. Requiring Record or Other Property in Possession of Other Person. (a) Each bank affiliate, officer, director, shareholder, trustee, agent, servant, employee, attorney, attorney-in-fact, or correspondent shall immediately deliver to the receiver, without cost to the receiver, any record or other property of the bank or that relates to the business of the bank.

(b) If by contract or otherwise a record or other property that can be copied is the property of a person listed in Subsection (a), it shall be copied and the copy shall be delivered to the receiver. The owner shall retain the original until notification by the receiver that it is no longer required in the administration of the bank's estate or until another time the court, after notice and hearing, directs. A copy is considered to be a record of the bank in liquidation under Section 36.225.

Sec. 36.213. Injunction in Aid of Liquidation. (a) On application by the receiver, the court with or without notice may issue an injunction:

(1) restraining a bank officer, director, shareholder, trustee, agent, servant, employee, attorney, attorney-in-fact, correspondent, or other person from transacting the bank's business or wasting or disposing of its property; or

(2) requiring the delivery of the bank's property or assets to the receiver subject to the further order of the court.

(b) At any time during a proceeding under this subchapter, the court may issue another injunction or order considered necessary or desirable to prevent:

(1) interference with the receiver or the proceeding;

(2) waste of the assets of the bank;

(3) the beginning or prosecution of an action;

(4) the obtaining of a preference, judgment, attachment, garnishment, or other lien; or

(5) the making of a levy against the bank or its assets.

Sec. 36.214. Subpoena. (a) The receiver may request the court ex parte to issue a subpoena to compel the attendance and testimony of a witness before the receiver and the production of a record relating to the receivership estate. For this purpose the receiver or the receiver's designated representative may administer an oath or affirmation, examine a witness, or receive evidence. The court has statewide subpoena power and may compel attendance and production of a record before the receiver at the bank, the office of the receiver, or another location.

(b) A person served with a subpoena under this section may file a motion with the court for a protective order as provided by Rule 166b, Texas Rules of Civil Procedure. In a case of disobedience of a subpoena or the contumacy of a witness appearing before the receiver or the receiver's designated representative, the receiver may request and the court may issue an order requiring the person subpoenaed to obey the subpoena, give evidence, or produce a record relating to the matter in question.

(c) A witness who is required to appear before the receiver is entitled to receive:

(1) reimbursement for mileage, in the amount for travel by a state employee, for traveling to or returning from a proceeding that is more than 25 miles from the witness's residence; and

(2) a fee for each day or part of a day the witness is necessarily present as a witness in an amount set by the receiver with the approval of the court of not less than $10 a day and not more than an amount equal to the per diem travel allowance of a state employee.

(d) A payment of fees under Subsection (c) is an administrative expense.

(e) The receiver may serve the subpoena or have it served by the receiver's authorized agent, a sheriff, or a constable. The sheriff's or constable's fee for serving a subpoena must be the same as the fee paid the sheriff or constable for similar services.

(f) A subpoena issued under this section to a financial institution is not subject to Section 59.006.

(g) On certification by the receiver under official seal, a record produced or testimony taken as provided by this section and held by the receiver is admissible in evidence in any case without proof of its correctness or other proof, except the certificate of the receiver that the record or testimony was received from the person producing the record or testifying. The certified record or a certified copy of the record is prima facie evidence of the facts it contains. This section does not limit another provision of this subchapter, Subchapter D, or another law that provides for the admission of evidence or its evidentiary value.

Sec. 36.215. Executory Contract; Oral Agreement. (a) Not later than six months after the date the receivership proceeding begins, the receiver may terminate any executory contract to which the bank is a party or any obligation of the bank as a lessee. A lessor who receives notice of the receiver's election to terminate the lease before the 60th day before the termination date is not entitled to rent or damages for termination, other than rent accrued to the date of termination.

(b) An agreement that tends to diminish or defeat the interest of the estate in a bank asset is not valid against the receiver unless the agreement:

(1) is in writing;

(2) was executed by the bank and any person claiming an adverse interest under the agreement, including the obligor, when the bank acquired the asset;

(3) was approved by the board of the bank or its loan committee, and the approval is reflected in the minutes of the board or committee; and

(4) has been continuously since its execution an official record of the bank.

Sec. 36.216. Preferences. (a) A transfer of or lien on the property or assets of a state bank is voidable by the receiver if the transfer or lien:

(1) was made or created less than:

(A) four months before the date the bank is closed for liquidation; or

(B) one year before the date the bank is closed for liquidation if the receiving creditor was at the time an affiliate, officer, director, or principal shareholder of the bank or an affiliate of the bank;

(2) was made or created with the intent of giving to a creditor or depositor, or enabling a creditor or depositor to obtain, a greater percentage of the claimant's debt than is given or obtained by another claimant of the same class; and

(3) is accepted by a creditor or depositor having reasonable cause to believe that a preference will occur.

(b) Each bank officer, director, shareholder, trustee, agent, servant, employee, attorney-in-fact, or correspondent, or other person acting on behalf of the bank, who has participated in implementing a voidable transfer or lien, and each person receiving property or the benefit of property of the bank as a result of the voidable transfer or lien, are personally liable for the property or benefit received and shall account to the receiver for the benefit of the depositors and creditors of the bank.

(c) The receiver may avoid a transfer of or lien on the property or assets of a bank that a depositor, creditor, or shareholder of the bank could have avoided and may recover the property transferred or its value from the person to whom it was transferred or from a person who has received it unless the transferee or recipient was a bona fide holder for value before the date the bank was closed for liquidation.

Sec. 36.217. Employees of Receiver. The receiver may employ agents, legal counsel, accountants, appraisers, consultants, and other personnel the receiver considers necessary to assist in the performance of the receiver's duties. The receiver may use personnel of the department if the receiver considers the use to be advantageous or desirable. The expense of employing those persons is an administrative expense.

Sec. 36.218. Disposal of Property; Settling of Claim. (a) In liquidating a bank, the receiver on order of the court entered with or without hearing may:

(1) sell all or part of the property of the bank;

(2) borrow money and pledge all or part of the assets of the bank to secure the debt created, except that the receiver may not be held personally liable to repay borrowed money;

(3) compromise or compound a doubtful or uncollectible debt or claim owed by or owing to the bank; and

(4) enter another agreement on behalf of the bank that the receiver considers necessary or proper to the management, conservation, or liquidation of its assets.

(b) If the amount of a debt or claim owed by or owing to the bank or the value of an item of property of the bank does not exceed $20,000, excluding interest, the receiver may compromise or compound the debt or claim or sell the property on terms the receiver considers to be in the best interests of the bank estate without obtaining the approval of the court.

(c) The receiver may with the approval of the court sell or offer or agree to sell an asset of the bank, other than a fiduciary asset, to a depositor or creditor of the bank. Payment may be in whole or part out of distributions payable to the purchasing depositor or creditor on account of an approved claim against the bank's estate. On application by the receiver, the court may designate one or more representatives to act for certain depositors or creditors as a class in the purchase, holding, and management of assets purchased by the class under this section, and the receiver may with the approval of the court advance the expenses of the appointed representative against the security of the claims of the class.

Sec. 36.219. Court Order; Notice and Hearing. If the court requires notice and hearing before entering an order, the court shall set the time and place of the hearing and prescribe whether the notice is to be given by service on specific parties, by publication, or by a combination of those methods. The court may not enter an order requested by a person other than the receiver without notice to the receiver and an opportunity for the receiver to be heard.

Sec. 36.220. Receiver's Report; Expenses. (a) The receiver shall file with the court:

(1) a quarterly report showing the operation, receipts, expenditures, and general condition of the bank in liquidation; and

(2) a final report regarding the liquidated bank showing all receipts and expenditures and giving a full explanation and a statement of the disposition of all assets of the bank.

(b) The receiver shall pay all administrative expenses out of money or other assets of the bank. Each quarter the receiver shall swear to and submit an itemized report of those expenses. The court shall approve the report unless an objection is filed before the 11th day after the date it is submitted. An objection may be made only by a party in interest and must specify each item objected to and the ground for the objection. The court shall set the objection for hearing and notify the parties of this action. The objecting party has the burden of proof to show that the item objected to is improper, unnecessary, or excessive.

(c) The court may prescribe whether the notice of the receiver's report is to be given by service on specific parties, by publication, or by a combination of those methods.

Sec. 36.221. Court-ordered Audit. The court may order an audit of the books and records of the receiver that relate to the receivership. A report of an audit ordered under this section shall be filed with the court. The receiver shall make the books and records relating to the receivership available to the auditor as required by the court order. The receiver shall pay the expenses of an audit ordered under this section as an administrative expense.

Sec. 36.222. Safe Deposits and Other Bailments. (a) A contract between the bank and another person for bailment, of deposit for hire, or for lease of a safe, vault, or box ceases on the date specified for removal of property in the notices that were published and mailed or a later date approved by the receiver or the court. A person who has paid rental or storage charges for a period extending beyond the date designated for removal of property has a claim against the bank estate for a refund of the unearned amount paid.

(b) If the property is not removed by the date the contract ceases, the receiver shall inventory the property. In making the inventory the receiver may open a safe, vault, or box, or any package, parcel, or receptacle, in the custody or possession of the receiver. The property shall be marked to identify, to the extent possible, its owner or the person who left it with the bank. After all property belonging to others that is in the receiver's custody and control has been inventoried, the receiver shall compile a master list that is divided for each office of the bank that received property that remains unclaimed. The receiver shall publish, in a newspaper of general circulation in each community in which the bank had an office that received property that remains unclaimed, the list and the names of the owners of the property as shown in the bank's records. The published notice must specify a procedure for claiming the property unless the court, on application of the receiver, approves an alternate procedure.

Sec. 36.223. Fiduciary Activities. (a) As soon after beginning the receivership proceeding as is practicable, the receiver shall:

(1) terminate all fiduciary positions the bank holds;

(2) surrender all property held by the bank as a fiduciary; and

(3) settle the bank's fiduciary accounts.

(b) The receiver shall release all segregated and identifiable fiduciary property held by the bank to successor fiduciaries.

(c) With the approval of the court, the receiver may sell the administration of all or substantially all remaining fiduciary accounts to one or more successor fiduciaries on terms that appear to be in the best interests of the bank's estate and the persons interested in the fiduciary accounts.

(d) If commingled fiduciary money held by the bank as trustee is insufficient to satisfy all fiduciary claims to the commingled money, the receiver shall distribute commingled money pro rata to all fiduciary claimants of commingled money based on their proportionate interests after payment of administrative expenses related solely to the fiduciary claims. The fictional tracing rule does not apply. To the extent of any unsatisfied fiduciary claim to commingled money, a claimant to commingled trust money is entitled to the same priority as a depositor of the bank.

(e) Subject to Subsection (d), if the bank has lost fiduciary money or property through misappropriation or otherwise, a claimant to the missing fiduciary money or property is entitled to the same priority as a depositor of the bank.

(f) The receiver may require a fiduciary claimant to file a proof of claim if the records of the bank are insufficient to identify the claimant's interest.

Sec. 36.224. Disposition and Maintenance of Records. (a) On approval by the court, the receiver may dispose of records of the bank in liquidation that are obsolete and unnecessary to the continued administration of the receivership proceeding.

(b) The receiver may devise a method for the effective, efficient, and economical maintenance of the records of the bank and of the receiver's office. The method may include maintaining those records on any medium approved by the records management division of the Texas State Library.

(c) To maintain the records of the liquidated bank after the closing of the receivership proceeding, the receiver may reserve assets of an estate, deposit them in an account, and use them for maintenance, storage, and disposal of records in closed receivership estates.

(d) Records of a liquidated bank are not government records for any purpose, including Chapter 552, Government Code, but shall be preserved and disposed of as if they were records of the department under Chapter 441, Government Code. Those records are confidential as provided by:

(1) Subchapter D, Chapter 31;

(2) Section 59.006; and

(3) rules adopted under this subtitle.

Sec. 36.225. Records Admitted. (a) A record of a bank in liquidation obtained by the receiver and held in the course of the receivership proceeding or a certified copy of the record under the official seal of the receiver is admissible in evidence in all cases without proof of correctness or other proof, except the certificate of the receiver that the record was received from the custody of the bank or found among its effects.

(b) The receiver may certify the correctness of a record of the receiver's office, including a record described by Subsection (a), and may certify any fact contained in the record. The record shall be received in evidence in all cases in which the original would be evidence.

(c) The original record or a certified copy of the record is prima facie evidence of the facts it contains.

(d) A copy of an original record or another record that is maintained on a medium approved by the records management division of the Texas State Library, within the scope of this section, and produced by the receiver or the receiver's authorized representative under this section:

(1) has the same effect as the original record; and

(2) may be used the same as the original record in a judicial or administrative proceeding in this state.

Sec. 36.226. Resumption of Business. (a) A state bank closed under Section 36.201 may not be reopened without the approval of the banking commissioner unless a contest of liquidation under Section 36.204 is finally resolved adversely to the banking commissioner and the court authorizes the bank's reopening.

(b) The banking commissioner may place temporary limits on the right of withdrawals by or payments to individual depositors and creditors of a bank reopened under this section. The limits:

(1) must apply equally to all unsecured depositors and creditors;

(2) may not defer a withdrawal by or payment to a secured depositor or creditor without the person's written consent; and

(3) may not postpone the right of full withdrawal or payment of unsecured depositors or creditors for more than 18 months after the date that the bank reopens.

(c) As a depositor or creditor of a reopened bank, this state or a political subdivision of this state may agree to temporary limits that the banking commissioner places on payments or withdrawals.

Sec. 36.227. Assets Discovered after Close of Receivership. (a) The banking commissioner shall report to the court discovery of an asset having value that:

(1) the banking commissioner discovers after the receivership was closed by final order of the court; and

(2) was abandoned as worthless or unknown during the receivership.

(b) The court may reopen the receivership proceeding for continued liquidation if the value of the asset justifies the reopening.

(c) If the banking commissioner suspects that the information may have been intentionally or fraudulently concealed, the banking commissioner shall notify appropriate civil and criminal authorities to determine any applicable penalties.

Subchapter D. Claims Against Receivership Estate

Sec. 36.301. Filing Claim. (a) This section applies only to a claim by a person, other than a shareholder acting in that capacity, who has a claim against a state bank in liquidation, including a claimant with a secured claim and a claimant under a fiduciary relationship who has been ordered by the receiver to file a proof of claim under Section 36.223.

(b) To receive payment of a claim, the person must present proof of the claim to the receiver:

(1) at a place specified by the receiver; and

(2) within the period specified by the receiver under Section 36.205.

(c) A claim that is not filed within the period specified by the receiver may not participate in a distribution of the assets by the receiver, except that, subject to court approval, the receiver may accept a claim filed not later than the 180th day after the date notice of the claimant's right to file a proof of claim is mailed to the claimant.

(d) A claim accepted and approved under Subsection (c) is subordinate to an approved claim of a general creditor.

(e) Interest does not accrue on a claim after the date the bank is closed for liquidation.

Sec. 36.302. Proof of Claim. (a) A proof of claim must be in writing, be signed by the claimant, and include:

(1) a statement of the claim;

(2) a description of the consideration for the claim;

(3) a statement of whether collateral is held or a security interest is asserted against the claim and, if so, a description of the collateral or security interest;

(4) a statement of any right of priority of payment for the claim or other specific right asserted by the claimant;

(5) a statement of whether a payment has been made on the claim and, if so, the amount and source of the payment, to the extent known by the claimant;

(6) a statement that the amount claimed is justly owed by the bank in liquidation to the claimant; and

(7) any other matter that is required by the court.

(b) The receiver may designate the form of the proof of claim. A proof of claim must be filed under oath unless the oath is waived by the receiver. A proof of claim filed with the receiver is considered filed in an official proceeding for purposes of Chapter 37, Penal Code.

(c) If a claim is founded on a written instrument, the original instrument, unless lost or destroyed, must be filed with the proof of claim. After the instrument is filed, the receiver may permit the claimant to substitute a copy of the instrument until the final disposition of the claim. If the instrument is lost or destroyed, a statement of that fact and of the circumstances of the loss or destruction must be filed under oath with the claim.

Sec. 36.303. Judgment as Proof of Claim. (a) A judgment entered against a state bank in liquidation before the date the bank was closed for liquidation may not be given higher priority than a claim of an unsecured creditor unless the judgment creditor in a proof of claim proves the allegations supporting the judgment to the receiver's satisfaction.

(b) A judgment against the bank taken by default or by collusion before the date the bank was closed for liquidation may not be considered as conclusive evidence of the liability of the bank to the judgment creditor or of the amount of damages to which the judgment creditor is entitled.

(c) A judgment against the bank entered after the date the bank was closed for liquidation may not be considered as evidence of liability or of the amount of damages.

Sec. 36.304. Secured Claim. (a) The owner of a secured claim against a bank in liquidation may:

(1) surrender the security and file a claim as a general creditor; or

(2) apply the security to the claim and discharge the claim.

(b) If the owner applies the security and discharges the claim, any deficiency shall be treated as a claim against the general assets of the bank on the same basis as a claim of an unsecured creditor. The amount of the deficiency shall be determined as provided by Section 36.305, except that if the amount of the deficiency has been adjudicated by a court in a proceeding in which the receiver has had notice and an opportunity to be heard, the court's decision is conclusive as to the amount.

(c) The value of security held by a secured creditor shall be determined under supervision of the court by:

(1) converting the security into money according to the terms of the agreement under which the security was delivered to the creditor; or

(2) agreement, arbitration, compromise, or litigation between the creditor and the receiver.

Sec. 36.305. Unliquidated or Undetermined Claim. (a) A claim based on an unliquidated or undetermined demand shall be filed within the period provided by Subchapter C for the filing of a claim. The claim may not share in any distribution to claimants until the claim is definitely liquidated, determined, and allowed. After the claim is liquidated, determined, and allowed, the claim shares ratably with the claims of the same class in all subsequent distributions.

(b) For purposes of this section, a demand is considered unliquidated or undetermined if the right of action on the demand accrued while the bank was closed for liquidation and the liability on the demand has not been determined or the amount of the demand has not been liquidated.

(c) If the receiver in all other respects is in a position to close the receivership proceeding, the proposed closing is sufficient grounds for the rejection of any remaining claim based on an unliquidated or undetermined demand. The receiver shall notify the claimant of the intention to close the proceeding. If the demand is not liquidated or determined before the 61st day after the date of the notice, the receiver may reject the claim.

Sec. 36.306. Set-off. (a) Mutual credits and mutual debts shall be set off and only the balance allowed or paid, except that a set-off may not be allowed in favor of a person if:

(1) the obligation of the bank to the person on the date the bank was closed for liquidation did not entitle the person to share as a claimant in the assets of the bank;

(2) the obligation of the bank to the person was purchased by or transferred to the person after the date the bank was closed for liquidation or for the purpose of increasing set-off rights; or

(3) the obligation of the person or the bank is as a trustee or fiduciary.

(b) On request, the receiver shall provide a person with an accounting statement identifying each debt that is due and payable. A person who owes the bank an amount that is due and payable against which the person asserts a set-off of mutual credits that may become due and payable from the bank in the future shall promptly pay to the receiver the amount due and payable. The receiver shall promptly refund, to the extent of the person's prior payment, mutual credits that become due and payable to the person by the bank in liquidation.

Sec. 36.307. Action on Claim. (a) Not later than six months after the last day permitted for the filing of claims or a later date allowed by the court, the receiver shall accept or reject in whole or in part each filed claim against the bank in liquidation, except for an unliquidated or undetermined claim governed by Section 36.305. The receiver shall reject a claim if the receiver doubts its validity.

(b) The receiver shall mail written notice to each claimant specifying the disposition of the person's claim. If a claim is rejected in whole or in part, the receiver in the notice shall specify the basis for rejection and advise the claimant of the procedures and deadline for appeal.

(c) The receiver shall send each claimant a summary schedule of approved and rejected claims by priority class and notify the claimant:

(1) that a copy of a schedule of claims disposition including only the name of the claimant, the amount of the claim allowed, and the amount of the claim rejected is available on request; and

(2) of the procedure and deadline for filing an objection to an approved claim.

(d) The receiver or an agent or employee of the receiver, including an employee of the department, is not liable, and a cause of action may not be brought against the person, for an action taken or not taken by the person relating to the adjustment, negotiation, or settlement of a claim.

Sec. 36.308. Objection to Approved Claim. The receiver with court approval shall set a date for objection to an approved claim. On or before that date a depositor, creditor, other claimant, or shareholder of the bank may file an objection to an approved claim. The objection shall be heard and determined by the court. If the objection is sustained, the court shall direct an appropriate modification of the schedule of claims.

Sec. 36.309. Appeal of Rejected Claim. (a) The receiver's rejection of a claim may be appealed in the court in which the receivership proceeding is pending. The appeal must be brought within three months after the date of service of notice of the rejection.

(b) If the action is timely brought, review is de novo as if originally filed in the court and subject to the rules of procedure and appeal applicable to civil cases. This action is separate from the receivership proceeding and is not initiated by a claimant's attempt to appeal the action of the receiver by intervening in the receivership proceeding.

(c) If the action is not timely brought, the action of the receiver is final and not subject to review.

Sec. 36.310. Payment of Claim. (a) Except as expressly provided otherwise by this subchapter or Subchapter C, without the approval of the court the receiver may not make a payment on a claim, other than a claim for an obligation incurred by the receiver for administrative expenses.

(b) The receiver may periodically make partial distribution to the holders of approved claims if:

(1) all objections have been heard and decided as provided by Section 36.308;

(2) the time for filing appeals has expired as provided by Section 36.309; and

(3) a proper reserve is established for the pro rata payment of:

(A) rejected claims that have been appealed; and

(B) any claims based on unliquidated or undetermined demands governed by Section 36.305.

(c) As soon as practicable after the determination of all objections, appeals, and claims based on previously unliquidated or undetermined demands governed by Section 36.305, the receiver shall distribute the assets of the bank in satisfaction of approved claims other than claims asserted in a person's capacity as a shareholder.

Sec. 36.311. Priority of Claims Against Insured Bank. The distribution of assets from the estate of a bank the deposits of which are insured by the Federal Deposit Insurance Corporation or its successor shall be made in the same order of priority as assets would be distributed on liquidation or purchase of assets and assumption of liabilities of a national bank under federal law.

Sec. 36.312. Priority of Claims Against Uninsured Bank. (a) The priority of distribution of assets from the estate of a bank the deposits of which are not insured by the Federal Deposit Insurance Corporation or its successor shall be in accordance with the order of each class as provided by this section. Every claim in each class shall be paid in full, or adequate money shall be retained for that payment, before a member of the next class receives any payment. A subclass may not be established within a class, except for a preference or subordination within a class expressly created by contract or other instrument or in the certificate of formation.

(b) Assets shall be distributed in the following order of priority:

(1) administrative expenses;

(2) approved claims of secured creditors to the extent of the value of the security as provided by Section 36.304;

(3) approved claims of beneficiaries of insufficient commingled fiduciary money or missing fiduciary property and approved claims of depositors of the bank;

(4) other approved claims of general creditors not falling within a higher priority under this section, including unsecured claims for taxes and debts due the federal government or a state or local government;

(5) approved claims of a type described by Subdivisions (1)-(4) that were not filed within the period prescribed by this subchapter; and

(6) claims of capital note or debenture holders or holders of similar obligations and proprietary claims of shareholders or other owners according to the terms established by issue, class, or series.

Sec. 36.313. Excess Assets. (a) If bank assets remain after the receiver has provided for unclaimed distributions and all of the liabilities of the bank in liquidation, the receiver shall distribute the remaining assets to the shareholders of the bank.

(b) If the remaining assets are not liquid or if they otherwise require continuing administration, the receiver may call a meeting of the shareholders of the bank. The receiver shall give notice of the meeting:

(1) in a newspaper of general circulation in the county where the home office of the bank was located; and

(2) by written notice to the shareholders of record at their last known addresses.

(c) At the meeting, the shareholders shall appoint one or more agents to take over the affairs to continue the liquidation for the benefit of the shareholders. Voting privileges are governed by the bank's bylaws and certificate of formation. If a quorum cannot be obtained at the meeting, the banking commissioner shall appoint an agent. An agent appointed under this subsection shall execute and file with the court a bond approved by the court, conditioned on the faithful performance of all the duties of the trust.

(d) Under order of the court the receiver shall transfer and deliver to the agent or agents for continued liquidation under the court's supervision all assets of the bank remaining in the receiver's hands. The court shall discharge the receiver from further liability to the bank and its depositors, creditors, and shareholders.

(e) The bank may not resume business and the charter of the bank is void on the date the court issues the order directing the receiver to transfer and deliver the remaining assets of the bank to the agent or agents.

Sec. 36.314. Unclaimed Property. After completion of the liquidation, any unclaimed property remaining in the hands of the receiver shall be tendered to the comptroller as provided by Chapter 74, Property Code.

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CHAPTER 37. EMERGENCIES

CHAPTER 37. EMERGENCIES

Sec. 37.001. Definition. In this chapter, “emergency” means a condition or occurrence that may interfere physically with the conduct of normal business at the offices of a bank[1] or with the conduct of a particular bank operation, or that poses an imminent or existing threat to the safety or security of persons or property, including:

(1) fire, flood, earthquake, hurricane, tornado, or wind, rain, or snow storm;

(2) labor dispute or strike;

(3) power failure, transportation failure, or interruption of communication facilities;

(4) shortage of fuel, housing, food, transportation, or labor;

(5) robbery, burglary, or attempted robbery or burglary;

(6) epidemic or other catastrophe; or

(7) riot, civil commotion, enemy attack, or other actual or threatened act of lawlessness or violence.

Sec. 37.002. Emergency Closing of Office or Operation by Bank. (a) If the officers of a bank located in this state determine that an emergency that affects or may affect the bank’s offices or a particular bank operation exists or is impending, the officers may determine:

(1) not to open the bank’s offices or conduct the particular bank operation; or

(2) if the bank’s offices have opened or the particular bank operation has begun, to close the bank’s offices or suspend and close the particular bank operation during the emergency, regardless of whether the banking commissioner has issued a proclamation of emergency.

(b) Subject to Subsection (c), the office or operation closed may remain closed until the officers determine that the emergency has ended and for additional time reasonably required to reopen.

(c) An office or operation may not remain closed for more than three consecutive days, excluding days on which the bank is customarily closed, without the banking commissioner’s approval.

(d) A bank closing an office or operation under this section shall give notice of its action to the banking commissioner as promptly as possible and by any means available.

Sec. 37.003. Emergency Closing of Office or Operation by Banking Commissioner. (a) If the banking commissioner determines that an emergency exists or is impending in all or part of this state, the banking commissioner by proclamation may authorize banks located in the affected area to close all or part of their offices or operations.

(b) If the banking commissioner determines that an emergency exists or is impending that affects or may affect one or more particular banks or a particular bank operation, but not banks located in the area generally, the banking commissioner may authorize the bank or banks affected to close their offices or a particular bank operation.

(c) A bank office or bank operation closed under this section may remain closed until the banking commissioner proclaims that the emergency has ended, or until an earlier time that the officers of the bank determine that the closed

[1] As used in this chapter, the term “bank” is as defined in Section 31.002(a)(2), including a bank as defined by Section 201.002(a)(4) that is organized under the laws of another state or country and maintains an interstate branch office in this state.

bank office or bank operation should reopen, except that the affected bank office or operation may remain closed for additional time reasonably required to reopen.

Sec. 37.004. Effect of Closing.[2] (a) A day on which a bank or one or more of its operations is closed during its normal banking hours as provided by this chapter is a legal holiday for all purposes with respect to any banking business affected by the closed bank or bank operation.

(b) A bank or a director, officer, or employee of a bank does not incur liability or loss of rights because of a closing authorized by this chapter.

Sec. 37.005. Limitations on Withdrawals from State Bank. (a) At the request of a state bank that is experiencing or threatened with unusual and excessive withdrawals because of financial conditions, panic, or crisis, the banking commissioner, to prevent unnecessary loss to or preference among the depositors and creditors of the bank and to preserve the financial structure of the bank and its usefulness to the community, may issue an order limiting the right of withdrawal by or payment to depositors, creditors, and other persons to whom the bank is liable.

(b) The order:

(1) must expire not later than the 10th day after the date it is issued;

(2) must be uniform in application to each class of liability; and

(3) is not subject to judicial review.

Sec. 37.006. Financial Moratorium. (a) The banking commissioner, with the approval of a majority of the finance commission and the governor, may proclaim a financial moratorium for, and invoke a uniform limitation on, withdrawal of deposits of every character from all banks within this state. A bank refusing to comply with a written proclamation of the banking commissioner under this section, signed by a majority of the members of the finance commission and the governor:

(1) forfeits its charter if it is a state bank; or

(2) may not act as reserve agent for a state bank or as depository of state, county, municipal, or other public money if it is a national bank.

(b) On order of the banking commissioner after refusal of a national bank to comply with the proclamation, a depositor of public money with the bank:

(1) shall immediately withdraw the public money from the bank; and

(2) may not redeposit public money in the bank without the banking commissioner's prior written approval.

Sec. 37.007. Temporary Branch or Office. (a) If the banking commissioner determines that an emergency has affected and will continue to affect one or more particular bank offices for an extended period, either as a result of the emergency or subsequent recovery operations, the banking commissioner may authorize the bank or banks affected to open temporary branch offices or other facilities required for bank operations for the purpose of prompt restoration of access by the public to banking services.

(b) A temporary bank office opened under the authority of Subsection (a) may remain open only for the period specified in the banking commissioner's order, except that the banking commissioner may extend the period the office may remain open on a finding that the conditions requiring the temporary office continue to exist. The bank may convert a temporary branch office to a permanent bank location only by obtaining the prior written approval of the banking commissioner under Section 32.203.

(c) If requested by the state bank regulatory agency of another state that is experiencing an emergency and is contiguous to this state, the banking commissioner may authorize a bank or banks located in the state to open temporary offices in this state for the purpose of prompt restoration of banking services to the existing customers of the bank or banks, as the circumstances of such emergency may require. A temporary bank office opened under the authority of this subsection may remain open only for the period specified in the banking commissioner's order, except that the banking commissioner may extend the period the office may remain open on a finding that the conditions requiring the temporary office continue to exist. A bank may convert a temporary branch office to a permanent bank location if permitted by and subject to the conditions and requirements of Chapter 203.

[2] This section does not address the impact of federal law, which must be independently researched. However, federal law generally is in accord with this section, see, e.g., 12 C.F.R. §§210.14 and 229.13(f) (emergency exceptions in Regulations F and CC to deadlines for delivery of items, funds availability, and check clearing).

Sec. 37.008. Regulatory Coordination. (a) To ensure effective coordination among and between the department and other state and federal agencies and the banking industry, and to further rapid restoration of banking services after an emergency, the banking commissioner may:

(1) enter into cooperative, coordinating, or information-sharing agreements with other state or federal agencies or with or through organizations affiliated with or representing one or more state or federal agencies;

(2) enter into cooperative, coordinating, or information-sharing agreements with banks or banking trade associations or other organizations affiliated with or representing one or more banks; and

(3) issue interpretive statements or opinions to temporarily waive or suspend regulatory requirements that threaten to impede recovery and restoration of financial services.

(b) Disclosure of information by or to the banking commissioner under this section does not constitute a waiver of or otherwise affect or diminish an evidentiary privilege to which the information is otherwise subject, regardless of whether the disclosure is governed by a confidentiality agreement. Notwithstanding other law, a party to an agreement described by Subsection (a) may execute, honor, and comply with an agreement to maintain confidentiality and oppose disclosure of information obtained from the banking commissioner, and shall treat as confidential any information obtained from the banking commissioner that is entitled to confidential treatment under applicable state or federal law.

(c) The banking commissioner shall coordinate and cooperate with and assist the office of the governor in the performance of duties under this chapter and other state or federal law as required by Section 421.071, Government Code.

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[The next chapter is Chapter 59]

CHAPTER 59. MISCELLANEOUS PROVISIONS

Subchapter A. General Provisions

Subchapter B. Safe Deposit Boxes

Subchapter C. Electronic Terminals

Subchapter D. Safety at Unmanned Teller Machines

CHAPTER 59. MISCELLANEOUS PROVISIONS

Subchapter A. General Provisions

Sec. 59.001. Definitions. In this subchapter:

(1) “Civil action” means a civil proceeding pending in a tribunal. The term does not include an examination or enforcement proceeding initiated by:

(A) a governmental agency with primary regulatory jurisdiction over a financial institution in possession of a compliance review document;

(B) the Federal Deposit Insurance Corporation or its successor; or

(C) the board of governors of the Federal Reserve System or its successor.

(2) “Claim against a customer” means a writ of attachment, writ of garnishment, notice of freeze, notice of levy, notice of child support lien, notice of seizure, notice of receivership, restraining order, injunction or other instrument served on or delivered to a financial institution and purporting to assert, establish, or perfect any interest in or claim against an account, extension of credit, or product of the financial institution held or established by the financial institution in the name of the customer or for the benefit of the customer, or in the name of the financial institution as the fiduciary, agent, or custodian or in another representative capacity for the customer. The term does not include citation or other process in a civil suit in which the financial institution is made a defendant and against which claims for affirmative relief are asserted, even though the subject matter of the suit is an account, extension of credit, or product of the financial institution held or established by the financial institution in the name of a customer or in the name of the financial institution as the fiduciary, agent, or custodian or in another representative capacity for the customer.

(3) “Compliance review document” means a document prepared by or for a compliance review committee acting pursuant to Section 59.009.

(4) “Customer” means a person who uses, purchases, or obtains an account, extension of credit, or product of a financial institution or for whom a financial institution acts as a fiduciary, agent, or custodian or in another representative capacity.

(5) “Financial institution” has the meaning assigned by Section 201.101, except that the term does not include a financial institution organized under the laws of another state or organized under federal law with its main office in another state that does not maintain a branch or other office in this state.

(6) “Out-of-state financial institution” means a financial institution, organized under the laws of another state or organized under federal law with its main office in another state, that has a branch or other office in this state.

(7) “Record” means financial or other information of a customer maintained by a financial institution.

(8) “Record request” means a valid and enforceable subpoena, request for production, or other instrument issued under authority of a tribunal that compels production of a customer record.

(9) “Texas financial institution” means a financial institution organized under the laws of this state or organized under federal law with its main office in this state.

(10) “Tribunal” means a court or other adjudicatory tribunal with jurisdiction to issue a request for records, including a government agency exercising adjudicatory functions and an alternative dispute resolution mechanism, voluntary or required, under which a party may compel the production of records.

Sec. 59.002. Slander or Libel of Bank. (a) A person commits an offense if the person:

(1) knowingly makes, circulates, or transmits to another person an untrue statement that is derogatory to the financial condition of a bank located in this state; or

(2) with intent to injure a bank located in this state, counsels, aids, procures, or induces another person to knowingly make, circulate, or transmit to another person an untrue statement that is derogatory to the financial condition of any bank located in this state.

(b) An offense under this section is a state jail felony.

Sec. 59.003. Authority of Notary Public. A notary public is not disqualified from taking an acknowledgment or proof of a written instrument as provided by Section 406.016, Government Code, solely because of the person’s ownership of stock or a participation interest in or employment by a financial institution that is an interested party to the underlying transaction.

Sec. 59.004. Succession of Trust Powers. (a) If, at the time of a merger, reorganization, conversion, sale of substantially all of its assets under Chapter 32 or other applicable law, or sale of substantially all of its trust accounts and related activities at a separate branch or other office, a reorganizing or selling financial institution is acting as trustee, guardian, executor, or administrator, or in another fiduciary capacity, a successor or purchasing financial institution with sufficient fiduciary authority may continue the office, trust, or fiduciary relationship:

(1) without the necessity of judicial action or action by the creator of the office, trust, or fiduciary relationship; and

(2) without regard to whether the successor or purchasing financial institution meets qualification requirements specified in an instrument creating the office, trust, or fiduciary relationship other than a requirement related to geographic locale of account administration, including requirements as to jurisdiction of incorporation, location of principal office, or type of financial institution.

(b) The successor or purchasing financial institution may perform all the duties and exercise all the powers connected with or incidental to the fiduciary relationship in the same manner as if the successor or purchasing financial institution had been originally designated as the fiduciary.

Sec. 59.005. Agency Activities. (a) A financial institution may receive deposits, renew time deposits, close loans, service loans, receive payments on loans and other obligations, and perform other services as an agent for another financial institution under a written agency agreement.

(b) A financial institution may not under an agency agreement:

(1) conduct an activity as agent that it would be prohibited from conducting as a principal under applicable state or federal law; or

(2) have an agent conduct an activity that the bank as principal would be prohibited from conducting under applicable state or federal law.

(c) The banking commissioner may order a state bank or another financial institution subject to the banking commissioner's enforcement powers to cease acting as an agent or principal under an agency agreement in a manner that the banking commissioner finds to be inconsistent with safe and sound banking practices or governing law.

(d) Notwithstanding another law, a financial institution acting as an agent for another financial institution in accordance with this section is not considered to be a branch of the institution acting as principal.

(e) This section does not affect:

(1) authority under another law for a financial institution to act as an agent on behalf of another person or to act as a principal in employing another person as agent; or

(2) whether an agent's activities on behalf of a financial institution under another law would cause the agent to be considered a branch of the financial institution.

Sec. 59.006. Discovery of Customer Records. (a) This section provides the exclusive method for compelled discovery of a record of a financial institution relating to one or more customers but does not create a right of privacy in a record. This section does not apply to and does not require or authorize a financial institution to give a customer notice of:

(1) a demand or inquiry from a state or federal government agency authorized by law to conduct an examination of the financial institution;

(2) a record request from a state or federal government agency or instrumentality under statutory or administrative authority that provides for, or is accompanied by, a specific mechanism for discovery and protection of a customer record of a financial institution, including a record request from a federal agency subject to the Right to Financial Privacy Act of 1978 (12 U.S.C. Section 3401 et seq.), as amended, or from the Internal Revenue Service under Section 1205, Internal Revenue Code of 1986;

(3) a record request from or report to a government agency arising out of:

(A) the investigation or prosecution of a criminal offense;

(B) the investigation of alleged abuse, neglect, or exploitation of an elderly or disabled person in accordance with Chapter 48, Human Resources Code; or

(C) the assessment for or provision of guardianship services under Subchapter E, Chapter 161, Human Resources Code;

(4) a record request in connection with a garnishment proceeding in which the financial institution is garnishee and the customer is debtor;

(5) a record request by a duly appointed receiver for the customer;

(6) an investigative demand or inquiry from a state legislative investigating committee;

(7) an investigative demand or inquiry from the attorney general of this state as authorized by law other than the procedural law governing discovery in civil cases;

(8) the voluntary use or disclosure of a record by a financial institution subject to other applicable state or federal law; or

(9) a record request in connection with an investigation conducted under Section 1054.151, 1054.152, or 1102.001, Estates Code.

(b) A financial institution shall produce a record in response to a record request only if:

(1) it is served with the record request not later than the 24th day before the date that compliance with the record request is required;

(2) before the financial institution complies with the record request the requesting party pays the financial institution's reasonable costs of complying with the record request, including costs of reproduction, postage, research, delivery, and attorney's fees, or posts a cost bond in an amount estimated by the financial institution to cover those costs; and

(3) if the customer is not a party to the proceeding in which the request was issued, the requesting party complies with Subsections (c) and (d) and:

(A) the financial institution receives the customer's written consent to release the record after a request under Subsection (c)(3); or

(B) the tribunal takes further action based on action initiated by the requesting party under Subsection (d).

(b-1) If the requesting party has not paid a financial institution's costs or posted a cost bond as required by Subsection (b)(2), a court may not:

(1) order the financial institution to produce a record in response to the record request; or

(2) find the financial institution to be in contempt of court for failing to produce the record.

(c) If the affected customer is not a party to the proceeding in which the record request was issued, in addition to serving the financial institution with a record request, the requesting party shall:

(1) give notice stating the rights of the customer under Subsection (e) and a copy of the request to each affected customer in the manner and within the time provided by Rule 21a, Texas Rules of Civil Procedure;

(2) file a certificate of service indicating that the customer has been mailed or served with the notice and a copy of the record request as required by this subsection with the tribunal and the financial institution; and

(3) request the customer's written consent authorizing the financial institution to comply with the request.

(d) If the customer that is not a party to the proceeding does not execute the written consent requested under Subsection (c)(3) on or before the date that compliance with the request is required, the requesting party may by written motion seek an in camera inspection of the requested record as its sole means of obtaining access to the requested record. In response to a motion for in camera inspection, the tribunal may inspect the requested record to determine its relevance to the matter before the tribunal. The tribunal may order redaction of portions of the records that the tribunal determines should not be produced and shall enter a protective order preventing the record that it orders produced from being:

(1) disclosed to a person who is not a party to the proceeding before the tribunal; and

(2) used by a person for any purpose other than resolving the dispute before the tribunal.

(e) A customer that is a party to the proceeding bears the burden of preventing or limiting the financial institution's compliance with a record request subject to this section by seeking an appropriate remedy, including filing a motion to quash the record request or a motion for a protective order. Any motion filed shall be served on the financial institution and the requesting party before the date that compliance with the request is required. A financial institution is not liable to its customer or another person for disclosure of a record in compliance with this section.

(f) A financial institution may not be required to produce a record under this section before the later of:

(1) the 24th day after the date of receipt of the record request as provided by Subsection (b)(1);

(2) the 15th day after the date of receipt of a customer consent to disclose a record as provided by Subsection (b)(3); or

(3) the 15th day after the date a court orders production of a record after an in camera inspection of a requested record as provided by Subsection (d).

(g) An order to quash or for protection or other remedy entered or denied by the tribunal under Subsection (d) or (e) is not a final order and an interlocutory appeal may not be taken.

Sec. 59.007. Attachment, Injunction, Execution, or Garnishment. (a) An attachment, injunction, execution, or writ of garnishment may not be issued against or served on a financial institution that has its principal office or a branch in this state to collect a money judgment or secure a prospective money judgment against the financial institution before the judgment is final and all appeals have been foreclosed by law.

(b) An attachment, injunction, execution, or writ of garnishment issued to or served on a financial institution for the purpose of collecting a money judgment or securing a prospective money judgment against a customer of the financial institution is governed by Section 59.008 and not this section.

Sec. 59.008. Claims Against Customers of Financial Institutions. (a) A claim against a customer of a financial institution shall be delivered or served as otherwise required or permitted by law at the address designated as the address of the registered agent of the financial institution in a registration filed with the secretary of state pursuant to Section 201.102, with respect to an out-of-state financial institution, or Section 201.103, with respect to a Texas financial institution.

(b) If a financial institution files a registration statement with the secretary of state pursuant to Section 201.102, with respect to an out-of-state financial institution, or Section 201.103, with respect to a Texas financial institution, a claim against a customer of the financial institution is not effective as to the financial institution if the claim is served or delivered to an address other than that designated by the financial institution in the registration as the address of the financial institution's registered agent.

(c) The customer bears the burden of preventing or limiting a financial institution's compliance with or response to a claim subject to this section by seeking an appropriate remedy, including a restraining order, injunction, protective order, or other remedy, to prevent or suspend the financial institution's response to a claim against the customer.

(d) A financial institution that does not file a registration with the secretary of state pursuant to Section 201.102, with respect to an out-of-state financial institution, or Section 201.103, with respect to a Texas financial institution, is subject to service or delivery of all claims against customers of the financial institution as otherwise provided by law.

Sec. 59.009. Compliance Review Committee. (a) A financial institution or an affiliate of a financial institution, including its holding company, may establish a compliance review committee to test, review, or evaluate the financial institution's conduct, transactions, or potential transactions for the purpose of monitoring and improving or enforcing compliance with:

(1) a statutory or regulatory requirement;

(2) financial reporting to a governmental agency;

(3) the policies and procedures of the financial institution or its affiliates; or

(4) safe, sound, and fair lending practices.

(b) Except as provided by Subsection (c):

(1) a compliance review document is confidential and is not discoverable or admissible in evidence in a civil action;

(2) an individual serving on a compliance review committee or acting under the direction of a compliance review committee may not be required to testify in a civil action as to:

(A) the contents or conclusions of a compliance review document; or

(B) an action taken or discussions conducted by or for a compliance review committee; and

(3) a compliance review document or an action taken or discussion conducted by or for a compliance review committee that is disclosed to a governmental agency remains confidential and is not discoverable or admissible in a civil action.

(c) Subsection (b)(2) does not apply to an individual who has management responsibility for the operations, records, employees, or activities being examined or evaluated by the compliance review committee.

(d) This section does not limit the discovery or admissibility in a civil action of a document that is not a compliance review document.

Sec. 59.010. Confidentiality of Administrative Subpoena. (a) Except to the extent disclosure is necessary to locate and produce responsive records, an administrative subpoena that meets the requirements of Subsection (b) and is served on a financial institution may provide that the financial institution to whom the subpoena is directed may not:

(1) disclose that the subpoena has been issued;

(2) identify or describe any records requested in the subpoena; or

(3) disclose whether records have been furnished in response to the subpoena.

(b) The government agency issuing the subpoena may prohibit the disclosure of information described in Subsection (a) only if the agency finds, and the subpoena states the agency's finding that:

(1) the records relate to an ongoing criminal investigation by the agency; and

(2) the disclosure could significantly impede or jeopardize the investigation.

(c) For purposes of this section, "administrative subpoena" means a valid and enforceable subpoena requesting customer records, issued under the laws of this state by a government agency exercising investigatory or adjudicative functions with respect to a matter within the agency's jurisdiction.

Sec. 59.011. Lender Liability for Construction. (a) For purposes of Chapter 27, Property Code, and Title 16, Property Code, a federally insured financial institution regulated under this code is not a builder.

(b) A lender regulated by this code that forecloses on or otherwise acquires a home through the foreclosure process or other legal means when the loan is in default is not liable to a subsequent purchaser for any construction defects of which the lender had no knowledge that were created prior to the acquisition of the home by the lender.

(c) A builder hired by a lender to complete the construction of a foreclosed home is not liable for any construction defects of which the builder had no knowledge that existed prior to the acquisition of the home by the lender, but the builder is subject to Chapter 27, Property Code, and Title 16, Property Code, for work performed for the lender subsequent to the acquisition of the home by the lender.

Sec. 59.012. Loans for Developments That Use Harvested Rainwater. Financial institutions may consider making loans for developments that will use harvested rainwater as the sole source of water supply.

Subchapter B. Safe Deposit Boxes[1]

Sec. 59.101. Definition. In this subchapter, "safe deposit company" means a person who maintains and rents safe deposit boxes.

Sec. 59.102. Authority to Act as Safe Deposit Company. Any person may be a safe deposit company.

Sec. 59.103. Relationship of Safe Deposit Company and Renter. In a safe deposit transaction the relationship of the safe deposit company and the renter is that of lessor and lessee and landlord and tenant, and the rights and liabilities of the safe deposit company are governed accordingly in the absence of a contract or statute to the contrary. The lessee is considered for all purposes to be in possession of the box and its contents.

Sec. 59.104. Delivery of Notice. A notice required by this subchapter to be given to a lessee of a safe deposit box must be in writing and personally delivered or sent by registered or certified mail, return receipt requested, to each lessee at the most recent address of the person according to the records of the safe deposit company.

Sec. 59.105. Effect of Subchapter on Other Law. This subchapter does not affect Chapter 151, Estates Code, or another statute of this state governing safe deposit boxes.

Sec. 59.106. Access by More than One Person. (a) If a safe deposit box is leased in the name of two or more persons jointly or if a person other than the lessee is designated in the lease agreement as having a right of access to the box, each of those persons is entitled to have access to the box and to remove its contents in the absence of a contract to the contrary. This right of access and removal is not affected by the death or incapacity of another person who is a lessee or otherwise entitled to have access to the box.

(b) A safe deposit company is not responsible for damage arising from access to a safe deposit box or removal of any of its contents by a person with a right of access to the box.

Sec. 59.107. Nonemergency Opening and Relocation. (a) A safe deposit company may not relocate

[1] See 7 TAC §3.35, relating to safe deposit box facilities.

a safe deposit box rented for a term of at least six months if the box rental is not delinquent or open a safe deposit box to relocate its contents to another safe deposit box or other location except:

(1) in the presence of the lessee;

(2) with the lessee's written authorization; or

(3) as otherwise provided by this section or Section 59.108.

(b) A safe deposit box may not be relocated under this section unless the storage conditions at the new location are at least as secure as the conditions at the original box location.

(c) Not later than the 30th day before the scheduled date of a nonemergency relocation, the safe deposit company shall give notice of the relocation to each lessee of the safe deposit box. The notice must state the scheduled date and time of the relocation and whether the box will be opened during the relocation.

(d) A lessee may personally supervise the relocation or authorize the relocation in writing if notice is given to each lessee.

(e) If during the relocation the box is opened and a lessee does not personally supervise the relocation or has not authorized the relocation in writing, two employees, at least one of whom is an officer or manager of the safe deposit company and at least one of whom is a notary public, shall inventory the contents of the box in detail. The safe deposit company shall notify each lessee of the new box number or location not later than the 30th day after the date of the relocation and shall include a signed and notarized copy of the inventory report. The cost of a certified mailing other than the first notice sent in connection with each relocation may be treated as box rental due at the expiration of the rental term.

(f) This section does not apply to a relocation of a safe deposit box within the same building.

Sec. 59.108. Emergency Opening and Relocation. (a) A safe deposit company may relocate a safe deposit box or open the box to relocate its contents to another box or location without complying with Sections 59.107(a)-(d) if the security of the original box is threatened or destroyed by natural disaster, including tornado, flood, fire, or other unforeseeable circumstances beyond the control of the safe deposit company.

(b) The safe deposit company shall follow the procedure provided by Section 59.107(e), except that the notice of the new box number or location must be given not later than the 90th day after the date of a relocation under this section.

(c) This section does not apply to a relocation of a safe deposit box within the same building.

Sec. 59.109. Delinquent Rental; Lien; Sale of Contents. (a) If the rental for a safe deposit box is delinquent for at least six months, the safe deposit company may send notice to each lessee that the company will remove the contents of the box if the rent is not paid before the date specified in the notice, which may not be earlier than the 60th day after the date the notice is delivered or sent. If the rent is not paid before the date specified in the notice, the safe deposit company may open the box in the presence of two employees, at least one of whom is an officer or manager of the safe deposit company and at least one of whom is a notary public. The safe deposit company shall inventory the contents of the box in detail as provided by the comptroller's reporting instructions and place the contents of the box in a sealed envelope or container bearing the name of the lessee.

(b) The safe deposit company has a lien on the contents of the box for an amount equal to the rental owed for the box and the cost of opening the box. The safe deposit company may retain possession of the contents. If the rental and the cost of opening the box are not paid before the second anniversary of the date the box was opened, the safe deposit company may sell all or part of the contents at public auction in the manner and with the notice prescribed by Section 51.002, Property Code, for the sale of real property under a deed of trust. Any unsold contents of the box and any excess proceeds from a sale of contents shall be remitted to the comptroller as provided by Chapters 72-75, Property Code.

Sec. 59.110. Routing Number on Key. (a) A depository institution that rents or permits access to a safe deposit box shall imprint the depository institution's routing number on each key to the box or on a tag attached to the key.

(b) If a depository institution believes that the routing number imprinted on a key, or on a tag attached to a key, used to open a safe deposit box has been altered or defaced so that the correct routing number is illegible, the depository institution shall notify the Department of Public Safety of the State of Texas, on a form designed by the banking commissioner, not later than the 10th day after the date the key is used to open the box.

(c) This section does not require a depository institution to inspect the routing number imprinted on a key or an attached tag to determine whether the number has been altered or defaced. A depository institution that has imprinted a key to a safe deposit box or a tag attached to the key as provided by this section and that follows applicable law and the depository institution's established security procedures in permitting access to the box is not liable for any damage arising because of access to or removal of the contents of the box.

(d) Subsection (a) does not apply to a key issued under a lease in effect on September 1, 1992, until the date the term of that lease expires, without regard to any extension of the lease term.

Subchapter C. Electronic Terminals

Sec. 59.201. Electronic Terminals Authorized; Sharing of Electronic Terminal. (a) A person may install, maintain, and operate one or more electronic terminals at any location for the convenience of customers of financial institutions.

(b) Financial institutions may agree in writing to share in the use of an electronic terminal on a reasonable, nondiscriminatory basis and on the condition that a financial institution using an electronic terminal may be required to meet necessary and reasonable technical standards and to pay charges for the use of the electronic terminal. The standards or charges imposed must be reasonable, fair, equitable, and nondiscriminatory among the financial institutions. Any charges imposed:

(1) may not exceed an equitable proportion of the cost of establishing the electronic terminal, including provisions for amortization of development costs and capital expenditures over a reasonable period, and the cost of operation and maintenance of the electronic terminal, plus a reasonable return on those costs; and

(2) must be related to the services provided to the financial institution or its customers.

(c) This section does not apply to:

(1) an electronic terminal located at the domicile or home office or a branch of a financial institution; or

(2) the use by a person of an electronic terminal, regardless of location, solely to withdraw cash, make account balance inquiries, or make transfers between the person's accounts in the same financial institution.

(d) In this section, the term "financial institution" has the meaning assigned by Section 201.101.

Sec. 59.202. User Fee for Shared Electronic Terminal. (a) The owner of an electronic terminal that is located in this state and that is connected to a shared network may impose a fee for the use of that terminal if imposition of the fee is disclosed at a time and in a manner that allows a user to avoid the transaction without incurring the transaction fee.

(b) An agreement to share an electronic terminal may not:

(1) limit the right of the owner of an electronic terminal to charge a fee described by Subsection (a) as allowed by the law of this state or the United States;

(2) require the owner to limit or waive its rights or obligations under this section; or

(3) otherwise discriminate in any manner against the owner as a result of the owner's charging of a fee authorized under this section.

(c) In this section:

(1) "Electronic fund transfer" means any transfer of money, other than a transaction originated by check, draft, or similar paper instrument, that is initiated through an electronic terminal and orders, instructs, or authorizes a financial institution to debit or credit an account. The term includes a point-of-sale transfer, an unmanned teller machine transaction, and a cash dispensing machine transaction.

(2) "Electronic terminal" means an electronic device, other than a telephone, through which a consumer may initiate an electronic fund transfer. The term includes a point-of-sale terminal, an unmanned teller machine, and a cash dispensing machine.

(3) "Financial institution" has the meaning assigned by Section 201.101.

(4) "Shared network" means an electronic information communication and processing facility used by two or more owners of electronic terminals to receive, transmit, or retransmit electronic impulses or other electronic indicia of transactions, originating at electronic terminals, to financial institutions or to other transmission facilities for the purpose of:

(A) the withdrawal by a customer of money from the customer's account, including a withdrawal under a line of credit previously authorized by a financial institution for the customer;

(B) the deposit of money by a customer in the customer's account with a financial institution;

(C) the transfer of money by a customer between one or more accounts maintained by the customer with a financial institution, including the application of money against an indebtedness of the customer to the financial institution; or

(D) a request for information by a customer concerning the balance of the customer's account with a financial institution.

Subchapter D. Safety at Unmanned Teller Machines[2]

Sec. 59.301. Definitions. In this subchapter:

(1) "Access area" means a paved walkway or sidewalk that is within 50 feet of an unmanned teller machine. The term does not include a public right-of-way or any structure, sidewalk, facility, or appurtenance incidental to the right-of-way.

(2) "Access device" has the meaning assigned by Regulation E (12 C.F.R. Section 205.2), as amended, adopted under the Electronic Fund Transfer Act (15 U.S.C. Section 1693 et seq.), as amended.

(3) "Candlefoot power" means the light intensity of candles on a horizontal plane at 36 inches above ground level and five feet in front of the area to be measured.

(4) "Control" means the authority to determine how, when, and by whom an access area or defined parking area may be used, maintained, lighted, and landscaped.

(5) "Customer" means an individual to whom an access device is issued for personal, family, or household use.

(6) "Defined parking area" means the portion of a parking area open for unmanned teller machine customer parking that is contiguous to an access area, is regularly, principally, and lawfully used during the period beginning 30 minutes after sunset and ending 30 minutes before sunrise for parking by customers using the machine, and is owned or leased by the owner or operator of the machine or owned or controlled by a person leasing the machine site to the owner or operator of the machine. The term does not include:

(A) a parking area that is physically closed or on which one or more conspicuous signs indicate that the area is closed; or

(B) a level of a multiple-level parking area other than the level considered by the operator of the unmanned teller machine to be the most directly accessible to a customer.

(7) "Financial institution" has the meaning assigned by Section 201.101.

(8) "Operator" means the person primarily responsible for the operation of an unmanned teller machine.

(9) "Owner" means a person having the right to determine which financial institutions are permitted to use or participate in the use of an unmanned teller machine.

(10) "Unmanned teller machine" means a machine, other than a telephone, capable of being operated solely by a customer to communicate to a financial institution:

(A) a request to withdraw money from the customer's account directly or under a line of credit previously authorized by the financial institution for the customer;

(B) an instruction to deposit money in the customer's account with the financial institution;

(C) an instruction to transfer money between one or more accounts maintained by the customer with the financial institution;

(D) an instruction to apply money against an indebtedness of the customer to the financial institution; or

(E) a request for information concerning the balance of the account of the customer with the financial institution.

Sec. 59.302. Exception for Certain Unmanned Teller Machines. This subchapter does not apply to an unmanned teller machine:

(1) by which:

(A) a customer of a financial institution can authorize and effect the electronic transfer of money from the customer's account at the financial institution to a merchant's account at a financial institution in the county

[2] See 7 TAC §3.92, relating to user safety at unmanned teller machines.

or municipality in which the terminal is located to obtain cash or to purchase, rent, or pay for goods or services; and

(B) the merchant can ascertain that the transaction has been completed and the money has been or will be transferred to the merchant's account at the merchant's financial institution in the county or municipality in which the terminal is located; or

(2) located:

(A) inside a building:

(i) unless the building is a freestanding installation existing solely to provide an enclosure for the machine; or

(ii) except to the extent a transaction can be conducted from outside the building; or

(B) in an area not controlled by the owner or operator of the machine.

Sec. 59.303. Applicability to Certain Persons Who Are Not Owners or Operators. (a) A person is not an owner or operator solely because the person's primary function is to provide for the exchange, transfer, or dissemination of electronic fund transfer data.

(b) A person whose primary function is to provide for the exchange, transfer, or dissemination of electronic fund transfer data and who is not an owner or operator is not liable to a customer or user of an unmanned teller machine for a claim arising out of or in connection with a use or attempted use of the machine.

Sec. 59.304. Construction of Subchapter. (a) This subchapter does not require the relocation or modification of an unmanned teller machine on the occurrence of a particular event or circumstance.

(b) A violation of this subchapter or a rule adopted under this subchapter is not negligence per se. Substantial compliance with this subchapter and each rule adopted under this subchapter is prima facie evidence that a person has provided adequate safety protection measures relating to an unmanned teller machine under this subchapter.

Sec. 59.305. Lighting Required. During the period beginning 30 minutes after sunset and ending 30 minutes before sunrise, lighting shall be provided for:

(1) an unmanned teller machine;

(2) the machine's access area and defined parking area; and

(3) the exterior of the machine's enclosure, if the machine is located in an enclosure.

Sec. 59.306. Persons Required to Provide Lighting. (a) Except as provided by Subsection (b), the owner or operator shall provide the lighting required by this subchapter.

(b) A person who leases the site where an unmanned teller machine is located shall provide the lighting required by this subchapter if the person controls the access area or defined parking area for the machine and the owner or operator does not control the access area or defined parking area.

Sec. 59.307. Standards for Lighting. The lighting must be at least:

(1) 10 candlefoot power at the face of the unmanned teller machine and extending in an unobstructed direction outward five feet;

(2) two candlefoot power within 50 feet from any unobstructed direction from the face of the machine, except as provided by Subdivision (3);

(3) if the machine is located within 10 feet of the corner of a building and is generally accessible from the adjacent side, two candlefoot power along the first 40 unobstructed feet of the adjacent side of the building; and

(4) two candlefoot power in the part of the defined parking area within 60 feet of the unmanned teller machine.

Sec. 59.308. Safety Evaluation. (a) An owner or operator shall in good faith evaluate the safety of each unmanned teller machine that the person owns or operates.

(b) In making the evaluation, the owner or operator shall consider:

(1) the extent to which the lighting for the machine complies with Section 59.307;

(2) the presence of obstructions, including landscaping and vegetation, in the area of the machine and the access area and defined parking area for the machine; and

(3) the incidence of violent crimes in the immediate neighborhood of the machine as shown by local law enforcement records and of which the owner or operator has actual knowledge.

Sec. 59.309. Notice of Safety Precautions. (a) An issuer of an access device shall give the customer a notice of basic safety precautions that the customer should follow while using an unmanned teller machine.

(b) The issuer shall personally deliver or mail the notice to each customer whose mailing address is in this state according to records for the account to which the access device relates. If the issuer furnishes an access device to more than one customer on the same account, the issuer is required to furnish a notice to only one of the customers.

(c) The issuer may furnish information under this section with other disclosures related to the access device, including an initial or periodic disclosure statement furnished under the Electronic Fund Transfer Act (15 U.S.C. Section 1693 et seq.).

Sec. 59.310. Enforcement and Rules. (a) The finance commission and the Credit Union Commission shall enforce this subchapter and adopt rules to implement this subchapter.[3]

(b) The rules must establish security requirements to be implemented by a financial institution for the operation of an unmanned teller machine. The rules may require the financial institution to install and maintain security devices in addition to those required by this subchapter to be operated in conjunction with the machine for the protection of customers using the machine, including:

(1) video surveillance equipment that is maintained in working order and operated continuously during the hours of operation of the machine; and

(2) adequate lighting around the premises that contain the machine.

(b-1) The rules may provide for a system that enhances customer security, taking into account emerging technologies, the availability of networks to exchange information, and the potential compliance costs for financial institutions and other unmanned teller machine service providers.

(c) A financial institution that violates a rule adopted under this section is subject to a civil penalty of not less than $50 or more than $1,000 for each day of violation and each act of violation.

[3] See 7 TAC §3.92, relating to user safety at unmanned teller machines.

Subchapter E. Prohibition of Surcharge

[Transferred][4]

[4] Transferred to Title 12, Business & Commerce Code, Acts 2015, 84th Leg.

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[The next chapter is Chapter 180]

SUBTITLE E. OTHER FINANCIAL BUSINESSES

CHAPTER 180. RESIDENTIAL MORTAGE LOAN ORIGINATORS

Subchapter A. General Provisions

Subchapter B. Licensing and Registration Requirements

Subchapter C. Reporting and Other Requirements Regarding Nationwide Mortgage Licensing System and Registry

Subchapter D. Business Practices; Prohibited Acts

Subchapter D-1. Requirement for Individuals Originating Residential Mortgage Loans Exclusively for Certain Depository Institution

Subchapter E. Enforcement Provisions

Subchapter F. Duties of Regulatory Officials

CHAPTER 180. RESIDENTIAL MORTAGE LOAN ORIGINATORS

Subchapter A. General Provisions

Sec. 180.001. Short Title. This chapter may be cited as the Texas Secure and Fair Enforcement for Mortgage Licensing Act of 2009.

Sec. 180.002. Definitions. In this chapter:

(1) "Clerical or support duties," following the receipt of an application from a consumer, includes:

(A) the receipt, collection, distribution, and analysis of information related to the processing or underwriting of a residential mortgage loan; and

(B) communication with a consumer to obtain information necessary to process or underwrite a loan, to the extent that the communication does not include offering or negotiating loan rates or terms or counseling the consumer about residential mortgage loan rates or terms.

(2) "Credit union" means a state or federal credit union operating in this state.

(3) "Credit union subsidiary organization" means an agency, association, or company wholly or partly owned by a credit union that is designed primarily to serve or otherwise assist credit union operations. The term includes a credit union service organization authorized by:

(A) Section 124.351(a)(1);

(B) Credit Union Commission rule; or

(C) Part 712 of the National Credit Union Administration's Rules and Regulations.

(4) "Depository institution" has the meaning assigned by Section 3, Federal Deposit Insurance Act (12 U.S.C. Section 1813). The term includes a credit union but does not include a credit union subsidiary organization.

(5) "Dwelling" has the meaning assigned by Section 103(v) of the Truth in Lending Act (15 U.S.C. Section 1602(v)).

(6) "Federal banking agency" means:

(A) the Board of Governors of the Federal Reserve System;

(B) the Office of the Comptroller of the Currency;

(C) the Office of Thrift Supervision;

(D) the National Credit Union Administration;

(E) the Federal Deposit Insurance Corporation; or

(F) the successor of any of those agencies.

(7) "Finance commission" means the Finance Commission of Texas.

(8) "Immediate family member" means the spouse, child, sibling, parent, grandparent, or grandchild of an individual. The term includes a stepparent, stepchild, and stepsibling and a relationship established by adoption.

(9) "Individual" means a natural person.

(10) "License" means a license issued under the laws of this state to an individual acting as or engaged in the business of a residential mortgage loan originator.

(11) "Loan processor or underwriter" means an individual who performs clerical or support duties as an employee at the direction of and subject to the supervision and instruction of an individual licensed as a residential mortgage loan originator or exempt from licensure under Section 180.003.

(12) "Nationwide Mortgage Licensing System and Registry" means a mortgage licensing system developed and maintained by the Conference of State Bank Supervisors and the American Association of Residential Mortgage Regulators for the licensing and

registration of state residential mortgage loan originators.

(13) "Nontraditional mortgage product" means a mortgage product other than a 30-year fixed rate mortgage.

(14) "Person" means an individual, corporation, company, limited liability company, partnership, or association.

(15) "Real estate brokerage activity" means an activity that involves offering or providing real estate brokerage services to the public, including:

(A) acting as a real estate broker or salesperson for a buyer, seller, lessor, or lessee of real property;

(B) bringing together parties interested in the sale, purchase, lease, rental, or exchange of real property;

(C) negotiating, on a party's behalf, any provision of a contract relating to the sale, purchase, lease, rental, or exchange of real property, other than a negotiation conducted in connection with providing financing with respect to such a transaction;

(D) engaging in an activity for which a person is required to be registered or licensed by the state as a real estate broker or salesperson; and

(E) offering to engage in an activity described by Paragraphs (A) through (D) or to act in the same capacity as a person described by Paragraphs (A) through (D).

(16) "Registered mortgage loan originator" means an individual who:

(A) is a residential mortgage loan originator and is an employee of:

(i) a depository institution;

(ii) a subsidiary that is:

(a) owned and controlled by a depository institution; and

(b) regulated by a federal banking agency; or

(iii) an institution regulated by the Farm Credit Administration; and

(B) is registered with, and maintains a unique identifier through, the Nationwide Mortgage Licensing System and Registry.

(17) "Regulatory official" means:

(A) with respect to Subtitles A, F, and G of this title, the banking commissioner of Texas;

(B) with respect to Chapters 156 and 157, the savings and mortgage lending commissioner; and

(C) with respect to Chapters 342, 347, 348, and 351, the consumer credit commissioner.

(18) "Residential mortgage loan" means a loan primarily for personal, family, or household use that is secured by a mortgage, deed of trust, or other equivalent consensual security interest on a dwelling or on residential real estate.

(19) "Residential mortgage loan originator":

(A) means an individual who for compensation or gain or in the expectation of compensation or gain:

(i) takes a residential mortgage loan application; or

(ii) offers or negotiates the terms of a residential mortgage loan; and

(B) does not include:

(i) an individual who performs solely administrative or clerical tasks on behalf of an individual licensed as a residential mortgage loan originator or exempt from licensure under Section 180.003, except as otherwise provided by Section 180.051;

(ii) an individual who performs only real estate brokerage activities and is licensed or registered by the state as a real estate broker or salesperson, unless the individual is compensated by:

(a) a lender or other residential mortgage loan originator; or

(b) an agent of a lender or other residential mortgage loan originator;

(iii) an individual licensed under Chapter 1201, Occupations Code, unless the individual is directly compensated for arranging financing for activities regulated under that chapter by:

(a) a lender or other residential mortgage loan originator; or

(b) an agent of a lender or other residential mortgage loan originator;

(iv) an individual who receives the same benefits from a financed transaction as the individual would receive if the transaction were a cash transaction; or

(v) an individual who is involved solely in providing extensions of credit relating to timeshare plans, as defined by 11 U.S.C. Section 101(53D).

(20) "Residential real estate" means real property located in this state on which a dwelling is constructed or intended to be constructed.

(21) "Rulemaking authority" means the finance commission.

(22) "S.A.F.E. Mortgage Licensing Act" means the federal Secure and Fair Enforcement for Mortgage Licensing Act of 2008 (Pub. L. No. 110-289).

(23) "Unique identifier" means a number or other identifier assigned by protocols established by the Nationwide Mortgage Licensing System and Registry.

Sec. 180.003. Exemption. (a) The following persons are exempt from this chapter:

(1) a registered mortgage loan originator when acting for an entity described by Section 180.002(16)(A)(i), (ii), or (iii);

(2) an individual who offers or negotiates terms of a residential mortgage loan with or on behalf of an immediate family member of the individual;

(3) a licensed attorney who negotiates the terms of a residential mortgage loan on behalf of a client as an ancillary matter to the attorney's representation of the client, unless the attorney:

(A) takes a residential mortgage loan application; and

(B) offers or negotiates the terms of a residential mortgage loan;

(4) an individual who offers or negotiates terms of a residential mortgage loan secured by a dwelling that serves as the individual's residence;

(5) an owner of residential real estate who in any 12-consecutive-month period makes no more than five residential mortgage loans to purchasers of the property for all or part of the purchase price of the residential real estate against which the mortgage is secured; and

(6) an owner of a dwelling who in any 12-consecutive-month period makes no more than five residential mortgage loans to purchasers of the property for all or part of the purchase price of the dwelling against which the mortgage or security interest is secured.

(b) An individual is exempt from this chapter, other than Section 180.171, if the individual:

(1) in any 12-consecutive-month period originates five or fewer closed residential mortgage loans exclusively for a single federally chartered depository institution and the loans are closed within that period;

(2) is contractually prohibited from soliciting, processing, negotiating, or placing a residential mortgage loan with a person other than the depository institution described by Subdivision (1); and

(3) is sponsored by a life insurance company, or an affiliate of the company, authorized to engage in business in this state.

(c) The finance commission may grant an exemption from the licensing requirements of this chapter to a municipality, county, community development corporation, or public or private grant administrator to the extent the entity is administering the Texas HOME Investment Partnerships program if the commission determines that granting the exemption is not inconsistent with the intentions of the federal Secure and Fair Enforcement for Mortgage Licensing Act of 2008 (Pub. L. No. 110-289).

Sec. 180.004. Administrative Authority; Rulemaking. (a) A regulatory official has broad authority to administer, interpret, and enforce this chapter.

(b) The finance commission may implement rules necessary to comply with this chapter and as required to carry out the intentions of the federal Secure and Fair Enforcement for Mortgage Licensing Act of 2008 (Pub. L. No. 110-289).

(c) This chapter does not limit the authority of a regulatory official to take disciplinary action against a license holder for a violation of this chapter or the rules adopted by the regulatory official under this chapter. A regulatory official has broad authority to investigate, revoke a license, and inform the proper authority when fraudulent conduct or a violation of this chapter occurs.

Sec. 180.005. Severability. The provisions of this chapter or applications of those provisions are severable as provided by Section 311.032(c), Government Code.

Subchapter B. Licensing and Registration Requirements

Sec. 180.051. State License Required; Renewal. (a) Unless exempted by Section 180.003, an individual may not engage in business as a residential mortgage loan originator with respect to a dwelling located in this state unless the individual:

(1) is licensed to engage in that business under Chapter 156, 157, 342, 347, 348, or 351; and

(2) complies with the requirements of this chapter.

(b) Unless exempted by Section 180.003, a loan processor or underwriter who is an independent contractor may not engage in the activities of a loan processor or underwriter unless the independent contractor loan processor or underwriter obtains and maintains the appropriate residential mortgage loan originator license and complies with the requirements of this chapter.

(c) The individual must renew the license annually to be considered licensed for purposes of this section.

(d) Notwithstanding any provision of law listed in Subsection (a)(1), the regulatory official shall provide for annual renewal of licenses for individuals seeking to engage in residential mortgage loan origination activities.

Sec. 180.052. Enrollment or Registration with Nationwide Mortgage Licensing System and Registry. (a) A licensed residential mortgage loan originator must enroll with and maintain a valid unique identifier issued by the Nationwide Mortgage Licensing System and Registry.

(b) A non-federally insured credit union that employs loan originators, as defined by the S.A.F.E. Mortgage Licensing Act, shall register those employees with the Nationwide Mortgage Licensing System and Registry by furnishing the information relating to the employees' identity set forth in Section 1507(a)(2) of the S.A.F.E. Mortgage Licensing Act.

(c) Each independent contractor loan processor or underwriter licensed as a residential mortgage loan originator must have and maintain a valid unique identifier issued by the Nationwide Mortgage Licensing System and Registry.

(d) The regulatory official who administers the law under which a residential mortgage loan originator is licensed shall require the residential mortgage loan originator to be enrolled with the Nationwide Mortgage Licensing System and Registry.

(e) For purposes of implementing Subsection (d), the regulatory official may participate in the Nationwide Mortgage Licensing System and Registry.

Sec. 180.053. Application Form. (a) A regulatory official shall prescribe application forms for a license as a residential mortgage loan originator.

(b) A regulatory official may change or update an application form as necessary to carry out the purposes of this chapter.

Sec. 180.054. Criminal and Other Background Checks. (a) In connection with an application for a license as a residential mortgage loan originator, the applicant shall, at a minimum, furnish in the form and manner prescribed by the regulatory official and acceptable to the Nationwide Mortgage Licensing System and Registry information concerning the applicant's identity, including:

(1) fingerprints for submission to the Federal Bureau of Investigation and any governmental agency or entity authorized to receive the information to conduct a state, national, and international criminal background check; and

(2) personal history and experience information in a form prescribed by the Nationwide Mortgage Licensing System and Registry, including the submission of authorization for the Nationwide Mortgage Licensing System and Registry and the appropriate regulatory official to obtain:

(A) an independent credit report obtained from a consumer reporting agency described by Section 603(p), Fair Credit Reporting Act (15 U.S.C. Section 1681a(p)); and

(B) information related to any

administrative, civil, or criminal findings by a governmental jurisdiction.

(b) For purposes of this section and to reduce the points of contact that the Federal Bureau of Investigation may have to maintain for purposes of Subsection (a)(1), a regulatory official may use the Nationwide Mortgage Licensing System and Registry as a channeling agent for requesting information from and distributing information to the United States Department of Justice, any governmental agency, or any source at the regulatory official's direction.

(c) For purposes of this section and to reduce the points of contact that a regulatory official may have to maintain for purposes of Subsection (a) or (b), the regulatory official may use the Nationwide Mortgage Licensing System and Registry as a channeling agent for requesting information from and distributing information to and from any source as directed by the regulatory official

Sec. 180.055. Issuance of License. (a) The regulatory official may not issue a residential mortgage loan originator license to an individual unless the regulatory official determines, at a minimum, that the applicant:

(1) has not had a residential mortgage loan originator license revoked in any governmental jurisdiction;

(2) has not been convicted of, or pled guilty or nolo contendere to, a felony in a domestic, foreign, or military court:

(A) during the seven-year period preceding the date of application; or

(B) at any time preceding the date of application, if the felony involved an act of fraud, dishonesty, breach of trust, or money laundering;

(3) demonstrates financial responsibility, character, and general fitness so as to command the confidence of the community and to warrant a determination that the individual will operate honestly, fairly, and efficiently as a residential mortgage loan originator within the purposes of this chapter and any other appropriate regulatory law of this state;

(4) provides satisfactory evidence that the applicant has completed prelicensing education courses described by Section 180.056;

(5) provides satisfactory evidence of having passed a written test that meets the requirements of Section 180.057; and

(6) has paid a recovery fund fee or obtained a surety bond as required under the appropriate state regulatory law.

(b) A revocation that has been formally vacated may not be considered a license revocation for purposes of Subsection (a)(1).

(c) A conviction for which a full pardon has been granted may not be considered a conviction for purposes of Subsection (a)(2).

(d) For purposes of Subsection (a)(3), an individual is considered not to be financially responsible if the individual has shown a lack of regard in managing the individual's own financial affairs or condition. A determination that an individual has not shown financial responsibility may include:

(1) an outstanding judgment against the individual, other than a judgment imposed solely as a result of medical expenses;

(2) an outstanding tax lien or other governmental liens and filings;

(3) a foreclosure during the three-year period preceding the date of the license application; and

(4) a pattern of seriously delinquent accounts during the three-year period preceding the date of the application.

Sec. 180.056. Prelicensing Educational Courses. (a) An applicant for a residential mortgage loan originator license must complete education courses that include at least the minimum number of hours and type of courses required by the S.A.F.E. Mortgage Licensing Act and the minimum number of hours of training related to lending standards for the nontraditional mortgage product marketplace required by that Act and any additional requirements established by the regulatory official and adopted by rule of the rulemaking authority.

(b) Education courses required under this section must be reviewed and approved by the Nationwide Mortgage Licensing System and Registry in accordance with the S.A.F.E. Mortgage Licensing Act.

(c) Nothing in this section precludes any education course approved in accordance with the S.A.F.E. Mortgage Licensing Act from being provided by:

(1) an applicant's employer;

(2) an entity affiliated with the applicant by an agency contract; or

(3) a subsidiary or affiliate of the employer or entity.

(d) Education courses required under this section may be offered in a classroom, online, or by any other means approved by the Nationwide Mortgage Licensing System and Registry

(e) An individual who has successfully completed prelicensing education requirements approved by the Nationwide Mortgage Licensing System and Registry for another state shall be given credit toward completion of the prelicensing education requirements of this section.

(f) An applicant who has previously held a residential mortgage loan originator license that meets the requirements of this chapter and other appropriate regulatory law, before being issued a new original license, must demonstrate to the appropriate regulatory official that the applicant has completed all continuing education requirements for the calendar year in which the license was last held by the applicant.

(g) If the appropriate federal regulators and the Nationwide Mortgage Licensing System and Registry establish additional educational requirements for licensed residential mortgage loan originators, the rulemaking authority shall adopt necessary rules to implement the changes to the educational requirements of this section.

(h) An individual who fails to maintain a residential mortgage loan originator license for at least five consecutive years must retake the prelicensing education requirements prescribed by the S.A.F.E. Mortgage Licensing Act.

Sec. 180.057. Testing Requirements. (a) An applicant for a residential mortgage loan originator license must pass a qualified, written test that:

(1) meets the standards and requirements established by the S.A.F.E. Mortgage Licensing Act;

(2) is developed by the Nationwide Mortgage Licensing System and Registry; and

(3) is administered by a test provider in accordance with the S.A.F.E. Mortgage Licensing Act.

(b) An individual may retake the test the number of times and within the period prescribed by the S.A.F.E. Mortgage Licensing Act.

(c) An individual who fails to maintain a residential mortgage loan originator license for at least five consecutive years must retake the test.

(d) This section does not prohibit a test provider approved in accordance with the S.A.F.E. Mortgage Licensing Act from providing a test at the location of:

(1) the license applicant's employer;

(2) a subsidiary or affiliate of the applicant's employer; or

(3) an entity with which the applicant holds an exclusive arrangement to conduct the business of a residential mortgage loan originator.

Sec. 180.058. Recovery Fund Fee or Surety Bond Requirement. (a) A regulatory official may not issue a residential mortgage loan originator license unless the official determines that the applicant meets the surety bond requirement or has paid a recovery fund fee, as applicable, in accordance with the requirements of the S.A.F.E. Mortgage Licensing Act.

(b) Each regulatory official shall adopt rules requiring an individual licensed as a residential mortgage loan originator to obtain a surety bond or pay a recovery fund fee as the official determines appropriate to comply with the S.A.F.E. Mortgage Licensing Act.

Sec. 180.059. Standards for License Renewal. A license to act as a residential mortgage loan originator may be renewed on or before its expiration date if the license holder:

(1) continues to meet the minimum requirements for license issuance;

(2) pays all required fees for the renewal of the license; and

(3) provides satisfactory evidence that the license holder has completed the continuing education requirements of Section 180.060.

Sec. 180.060. Continuing Education Courses. (a) To renew a residential mortgage loan originator license, a license holder must annually complete the minimum number of hours and type of continuing education courses required by the S.A.F.E. Mortgage Licensing Act, the minimum requirements established by the Nationwide Mortgage Licensing System and

Registry, and any additional requirements established by the regulatory official.

(b) Continuing education courses, including the course provider, must be reviewed and approved by the Nationwide Mortgage Licensing System and Registry as required by the S.A.F.E. Mortgage Licensing Act. Course credit must be granted in accordance with that Act.

(c) Nothing in this section precludes any continuing education course approved in accordance with the S.A.F.E. Mortgage Licensing Act from being provided by:

(1) the employer of the license holder;

(2) an entity affiliated with the license holder by an agency contract; or

(3) a subsidiary or affiliate of the employer or entity.

(d) A person who successfully completes continuing education requirements approved by the Nationwide Mortgage Licensing System and Registry for another state shall be given credit toward completion of the continuing education requirements of this section.

Sec. 180.061. Rulemaking Authority. A rulemaking authority may adopt rules establishing requirements as necessary for:

(1) conducting background checks by obtaining:

(A) criminal history information through fingerprint or other databases;

(B) civil administrative records;

(C) credit history information; or

(D) any other information considered necessary by the Nationwide Mortgage Licensing System and Registry;

(2) payment of fees to apply for or renew licenses through the Nationwide Mortgage Licensing System and Registry;

(3) setting or resetting, as necessary, license renewal dates or reporting periods;

(4) amending or surrendering a license or any other activity a regulatory official considers necessary for participation in the Nationwide Mortgage Licensing System and Registry; and

(5) investigation and examination authority for purposes of investigating a violation or complaint arising under this chapter or for purposes of examining, reviewing, or investigating any license holder or individual subject to this chapter.

Sec. 180.062. Confidentiality of Information. (a) Except as otherwise provided by this section, a requirement under federal or state law regarding the privacy or confidentiality of information or material provided to the Nationwide Mortgage Licensing System and Registry, and a privilege arising under federal or state law, or under the rules of a federal or state court, continue to apply to the information or material after the disclosure of the information or material to the Nationwide Mortgage Licensing System and Registry. The information and material may be shared with federal and state regulatory officials with mortgage industry oversight authority without the loss of any privilege or confidentiality protections afforded by federal or state laws.

(b) Information or material subject to a privilege or confidential under Subsection (a) may not be subject to:

(1) disclosure under any federal or state law governing the disclosure to the public of information held by an officer or an agency of the federal government or this state; or

(2) subpoena, discovery, or admission into evidence in a private civil action or administrative proceeding.

(c) A person who is the subject of information or material in the Nationwide Mortgage Licensing System and Registry may waive, wholly or partly, any privilege held by the Nationwide Mortgage Licensing System and Registry with respect to the information or material.

(d) A regulatory official may enter into an agreement or sharing arrangement with another governmental agency, the Conference of State Bank Supervisors, the American Association of Residential Mortgage Regulators, or other associations representing appropriate governmental agencies as established by rule of the rulemaking authority or order issued by the regulatory official. A protection provided by Subsection (a) also applies to information and material shared under an agreement or sharing arrangement entered into under this subsection.

(e) To the extent of a conflict between Subsection (a) and Chapter 552, Government Code, or another state law relating to the disclosure of confidential information or information or material described by Subsection (a), Subsection (a) controls to the extent Chapter 552, Government Code, or the other law provides less confidentiality or a weaker privilege than is provided by Subsection (a).

(f) This section does not apply to information or material relating to the employment history of, and publicly adjudicated disciplinary and enforcement actions against, a residential mortgage loan originator that is included in the Nationwide Mortgage Licensing System and Registry for access by the public.

Subchapter C. Reporting and Other Requirements Regarding Nationwide Mortgage Licensing System and Registry

Sec. 180.101. Mortgage Call Reports. Each licensed residential mortgage loan originator shall submit to the Nationwide Mortgage Licensing System and Registry a report of condition that is in the form and contains the information required by the Nationwide Mortgage Licensing System and Registry.

Sec. 180.102. Report of Violations and Enforcement Actions. Subject to the confidentiality provisions of this chapter, a regulatory official shall report to the Nationwide Mortgage Licensing System and Registry on a regular basis regarding violations of, enforcement actions under, or information relevant to this chapter or the S.A.F.E. Mortgage Licensing Act under the regulatory official's licensure, regulation, or examination of a licensed residential mortgage loan originator or person registered under the S.A.F.E. Mortgage Licensing Act.

Sec. 180.103. Information Challenge Process. The applicable rulemaking authority by rule shall establish a process by which licensed residential mortgage loan originators may dispute information submitted by the regulatory official to the Nationwide Mortgage Licensing System and Registry.

Subchapter D. Business Practices; Prohibited Acts

Sec. 180.151. Display of Unique Identifier. The unique identifier of a person originating a residential mortgage loan must be clearly shown on each residential mortgage loan application form, solicitation, or advertisement, including business cards and websites, and any other document required by rule of the rulemaking authority.

Sec. 180.152. Representations. An individual who is engaged exclusively in loan processor or underwriter activities may not represent to the public, through the use of advertising, business cards, stationery, brochures, signs, rate lists, or other means, that the individual can or will perform any of the activities of a residential mortgage loan originator unless the individual is licensed as a residential mortgage loan originator.

Sec. 180.153. Prohibited Acts and Practices. An individual or other person subject to regulation under this chapter may not:

(1) employ, directly or indirectly, a scheme, device, or artifice to defraud or mislead borrowers or lenders or to defraud a person;

(2) engage in an unfair or deceptive practice toward a person;

(3) obtain property by fraud or misrepresentation;

(4) solicit or enter into a contract with a borrower that provides in substance that the individual or other person subject to this chapter may earn a fee or commission through "best efforts" to obtain a loan even though no loan was actually obtained for the borrower;

(5) solicit, advertise, or enter into a contract for specific interest rates, points, or other financing terms unless the terms are actually available at the time of soliciting, advertising, or contracting;

(6) conduct any business regulated by this chapter without holding a license as required by this chapter;

(7) assist, aid, or abet an individual in the conduct of business without a license required by this chapter;

(8) fail to make disclosures as required by this chapter and any other applicable state or federal law, including rules or regulations under applicable state or federal law;

(9) fail to comply with this chapter or rules adopted under this chapter;

(10) fail to comply with any other state or federal law, including rules or regulations adopted under that law, applicable to a business or activity regulated by this chapter;

(11) make, in any manner, a false or deceptive statement or representation;

(12) negligently make a false statement or knowingly or wilfully make an omission of material fact in connection with:

(A) information or a report filed with a governmental agency or the Nationwide Mortgage Licensing System and Registry; or

(B) an investigation conducted by the regulatory official or another governmental agency;

(13) make a payment, threat, or promise, directly or indirectly, to a person for purposes of influencing the person's independent judgment in connection with a residential mortgage loan, or make a payment, threat, or promise, directly or indirectly, to an appraiser of property, for purposes of influencing the appraiser's independent judgment with respect to the property's value;

(14) collect, charge, attempt to collect or charge, or use or propose an agreement purporting to collect or charge a fee prohibited by this chapter;

(15) cause or require a borrower to obtain property insurance coverage in an amount that exceeds the replacement cost of the improvements as established by the property insurer; or

(16) fail to truthfully account for money belonging to a party to a residential mortgage loan transaction.

Subchapter D-1. Requirement for Individuals Originating Residential Mortgage Loans Exclusively for Certain Depository Institution

Sec. 180.171. Enrollment with Department of Savings and Mortgage Lending. (a) This section applies only to an individual who:

(1) in any 12-consecutive-month period originates five or fewer residential mortgage loans exclusively for a single federally chartered depository institution and the loans are closed within that period;

(2) is contractually prohibited from soliciting, processing, negotiating, or placing a residential mortgage loan with a person other than the depository institution described by Subdivision (1); and

(3) is sponsored by a life insurance company, or an affiliate of the company, authorized to engage in business in this state.

(b) Before conducting business in this state with respect to a residential mortgage loan, an individual to whom this section applies must enroll as a financial exclusive agent with the Department of Savings and Mortgage Lending until the time any registration with the Nationwide Mortgage Licensing System and Registry is required for the individual by federal law or regulation and a suitable category is created for that registration with that nationwide registry.

(c) An enrollment under this section must be renewed annually.

(d) An individual required under this section to enroll as a financial exclusive agent shall pay to the savings and mortgage lending commissioner an annual fee in an amount not to exceed $40 as prescribed by the commissioner.

Subchapter E. Enforcement Provisions

Sec. 180.201. Enforcement Authority. To ensure the effective supervision and enforcement of this chapter, a regulatory official may:

(1) deny, suspend, revoke, condition, or decline to renew a license for a violation of this chapter, a rule adopted under this chapter, or an order or directive issued under this chapter;

(2) deny, suspend, revoke, condition, or decline to renew a license if an applicant or license holder:

(A) fails to meet the requirements of Subchapter B; or

(B) withholds information or makes a material misstatement in an application for a license or renewal of a license;

(3) order restitution against a person subject to regulation under this chapter for a violation of this chapter;

(4) impose an administrative penalty on a

person subject to regulation under this chapter, subject to Section 180.202; or

(5) issue orders or directives as provided by Section 180.203.

Sec. 180.202. Administrative Penalty. (a) A regulatory official may impose an administrative penalty on a residential mortgage loan originator or other person subject to regulation under this chapter, if the official, after notice and opportunity for hearing, determines that the residential mortgage loan originator or other person subject to regulation under this chapter has violated or failed to comply with:

(1) this chapter;

(2) a rule adopted under this chapter; or

(3) an order issued under this chapter.

(b) The penalty may not exceed $25,000 for each violation.

(c) The amount of the penalty shall be based on:

(1) the seriousness of the violation, including the nature, circumstances, extent, and gravity of the violation;

(2) the economic harm to property caused by the violation;

(3) the history of previous violations;

(4) the amount necessary to deter a future violation;

(5) efforts to correct the violation; and

(6) any other matter that justice may require.

Sec. 180.203. Cease and Desist Orders. A regulatory official may:

(1) order or direct a person subject to regulation under this chapter to cease and desist from conducting business, including issuing an immediate temporary order to cease and desist from conducting business;

(2) order or direct a person subject to regulation under this chapter to cease a violation of this chapter or a harmful activity in violation of this chapter, including issuing an immediate temporary order to cease and desist;

(3) enter immediate temporary orders against a person subject to regulation under this chapter to cease engaging in business under a license if the regulatory official determines that the license was erroneously granted or the license holder is in violation of this chapter; and

(4) order or direct other affirmative action as the regulatory official considers necessary.

Subchapter F. Duties of Regulatory Officials

Sec. 180.251. General Duties of Regulatory Officials. (a) The savings and mortgage lending commissioner shall administer and enforce this chapter with respect to individuals licensed under Chapter 157.

(b) Repealed by Acts 2013, 83rd Leg., Ch. 160 (S.B. 1004), §87(9), eff. Sept. 1, 2013.

(c) The consumer credit commissioner shall administer and enforce this chapter with respect to individuals licensed under Chapter 342, 347, 348, or 351.

(d) To the extent permitted or required by this chapter and as reasonably necessary for the implementation and enforcement of the S.A.F.E. Mortgage Licensing Act, the banking commissioner of Texas may administer and enforce this chapter with respect to a person otherwise under the commissioner's jurisdiction under Subtitle A, F, or G of this title.

Sec. 180.252. Authority of Regulatory Officials to Establish Relationship with Nationwide Mortgage Licensing System and Registry; Contracting Authority.
To fulfill the purposes of this chapter, a regulatory official may establish a relationship with or contract with the Nationwide Mortgage Licensing System and Registry or an entity designated by the Nationwide Mortgage Licensing System and Registry to collect and maintain records and process transaction fees or other fees related to licensed residential mortgage loan originators or other persons subject to regulation under this chapter.

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SUBTITLE F. TRUST COMPANIES

CHAPTER 181. GENERAL PROVISIONS

Subchapter A. General Provisions

Subchapter B. Regulation of Trust Companies by Banking Department

Subchapter C. Administrative Procedure

Subchapter D. Confidentiality of Information

CHAPTER 181. GENERAL PROVISIONS

Subchapter A. General Provisions

Sec. 181.001. Short Title. This subtitle may be cited as the Texas Trust Company Act.

Sec. 181.002. Definitions. (a) In this subtitle:

(1) "Account" means the client relationship established with a trust institution involving the transfer of funds or property to the trust institution, including a relationship in which the trust institution acts as trustee, executor, administrator, guardian, custodian, conservator, receiver, registrar, or agent.

(2) "Affiliate" means a company that directly or indirectly controls, is controlled by, or is under common control with a state trust company or other company.

(3) [Repealed][1]

(4) "Banking commissioner" means the banking commissioner of Texas or a person designated by the banking commissioner and acting under the banking commissioner's direction and authority.

(5) "Board" means the board of directors, managers, or managing participants of, or a person or group of persons acting in a comparable capacity for, a state trust company or other entity.

(6) [Repealed][1]

(7) "Capital" means:

(A) the sum of:

(i) the par value of all shares or participation shares of a state trust company having a par value that have been issued;

(ii) the consideration set by the board for all shares or participation shares of the state trust company without par value that have been issued, except the part of that consideration that:

(a) has been actually received;

(b) is less than all of that consideration; and

(c) the board, by resolution adopted not later than the 60th day after the date of issuance of those shares, has allocated to surplus with the prior approval of the banking commissioner; and

(iii) an amount not included in Subparagraphs (i) and (ii) that has been transferred to capital of the state trust company, on the payment of a share dividend or on adoption by the board of a resolution directing that all or part of surplus be transferred to capital, minus each reduction made as permitted by law; less

(B) all amounts otherwise included in Paragraphs (A)(i) and (ii) that are attributable to the issuance of securities by the state trust company and that the banking commissioner determines, after notice and an opportunity for hearing, should be classified as debt rather than equity securities.

(8) "Certified surplus" means the part of surplus designated by a vote of the board of a state trust company under Section 182.105 and recorded in the board minutes as certified.

(9) "Charter" means a charter issued under this subtitle to engage in a trust business.

(10) "Client" means a person to whom a trust institution owes a duty or obligation under a trust or other account administered by the trust institution, regardless of whether the trust institution owes a fiduciary duty to the person. The term includes a beneficiary of a trust for whom the trust institution acts as trustee and a person for whom the trust institution acts as agent, custodian, or bailee.

(11) "Company" means a corporation, a partnership, an association, a business trust, another trust, or a similar organization, including a trust institution.

(12) "Conservator" means the banking commissioner or an agent of the banking commissioner exercising the powers and duties provided by Subchapter B, Chapter 185.

(13) "Control" means:

(A) the ownership of or ability or power to vote, directly, acting through one or more other persons, or otherwise indirectly, 25 percent or more of the outstanding shares of a class of voting securities of a state trust company or other company;

(B) the ability to control the election of a majority of the board of the state trust company or other company;

(C) the power to exercise, directly or indirectly, a controlling influence over the management or policies of the state trust company or other company as determined by the banking commissioner after notice and an opportunity for hearing; or

(D) the conditioning of the transfer of 25 percent or more of the outstanding shares or participation shares of a class of voting securities of the state trust company or other company on the transfer of 25 percent or more of the outstanding shares of a class of voting securities of another state trust company or other company.

(14) "Department" means the Texas Department of Banking.

[1] Repealed eff. Sept. 1, 2001, by 77th Tex. Leg., ch. 1420 (H.B. 2812), §6.027.

(15) "Depository institution" means an entity with the power to accept deposits under applicable law.

(15-a) "Equity capital" means the amount by which the total assets of a state trust company exceed the total liabilities of the trust company.

(16) [Repealed][1]

(17) "Equity security" means:

(A) stock or a similar security, any security convertible, with or without consideration, into such a security, a warrant or right to subscribe to or purchase such a security, or a security carrying such a warrant or right;

(B) a certificate of interest or participation in a profit-sharing agreement, collateral-trust certificate, preorganization certificate or subscription, transferable share or participation share, investment contract, voting-trust certificate, or partnership interest; and

(C) a certificate of interest or participation in, temporary or interim certificate for, or receipt for a security described by this subdivision that evidences an existing or contingent equity ownership interest.

(18) "Fiduciary record" means a matter written, transcribed, recorded, received, or otherwise in the possession of a trust institution that is necessary to preserve information concerning an act or event relevant to an account of a trust institution.

(19) "Finance commission" means the Finance Commission of Texas.

(20) [Repealed][1]

(21) "Full liability participant" means a participant that agrees under the terms of a participation agreement to be liable under a judgment, decree, or order of court for the entire amount of all debts, obligations, or liabilities of a limited trust association.

(22) "Hazardous condition" means:

(A) a refusal by a trust company or an affiliate of a trust company to permit an examination of its books, papers, accounts, records, or affairs by the banking commissioner as provided by Section 181.104;

(B) a violation by a trust company of a condition of its chartering or an agreement entered into between the trust company and the banking commissioner or the department; or

(C) a circumstance or condition in which an unreasonable risk of loss is threatened to clients or creditors of a trust company, excluding risk of loss to a client that arises as a result of the client's decisions or actions, but including a circumstance or condition in which a trust company:

(i) is unable or lacks the means to meet its current obligations as they come due in the regular and ordinary course of business, even if the book or fair market value of its assets exceeds its liabilities;

(ii) has equity capital less than the amount of restricted capital the trust company is required to maintain under Section 182.008, or has equity capital the adequacy of which is threatened, as determined under regulatory accounting principles;

(iii) has concentrated an excessive or unreasonable portion of its assets in a particular type or character of investment;

(iv) violates or refuses to comply with this subtitle, another statute or regulation applicable to trust companies, or a final and enforceable order of the banking commissioner;

(v) is in a condition that renders the continuation of a particular business practice hazardous to its clients and creditors; or

(vi) conducts business in an unsafe or unsound manner, including conducting business with:

(a) inexperienced or inattentive management;

(b) weak or potentially dangerous operating practices;

(c) infrequent or inadequate audits;

(d) administration of assets that is notably deficient in relation to the volume and character of or responsibility for asset holdings;

(e) unsound administrative practices;

(f) frequent and uncorrected material occurrences of violations of law, including rules, or terms of the governing instruments; or

(g) a notable degree of conflicts of interest and engaging in self-dealing.

(23) “Home office” means a location registered with the banking commissioner as a state trust company’s home office at which:

(A) the trust company does business;

(B) the trust company keeps its corporate books and records; and

(C) at least one executive officer of the trust company maintains an office.

(24) “Insider” means:

(A) each director, manager, managing participant, officer, and principal shareholder or participant of a state trust company;

(B) each affiliate of the state trust company and each director, officer, and employee of the affiliate;

(C) any person who participates or has authority to participate, other than in the capacity of a director, in major policy-making functions of the state trust company, whether or not the person has an official title or the officer is serving without salary or compensation; or

(D) each company controlled by a person described by Paragraph (A), (B), or (C).

(25) “Insolvent” means a circumstance or condition in which a state trust company:

(A) is unable or lacks the means to meet its current obligations as they come due in the regular and ordinary course of business, even if the value of its assets exceeds its liabilities;

(B) has equity capital that is 50 percent or less of the amount restricted capital the trust company is required to maintain;

(C) fails to maintain deposit insurance for its deposits with the Federal Deposit Insurance Corporation or its successor, or fails to maintain adequate security for its deposits as provided by Section 184.301(c);

(D) sells or attempts to sell substantially all of its assets or merges or attempts to merge substantially all of its assets or business with another entity other than as provided by Chapter 182; or

(E) attempts to dissolve or liquidate other than as provided by Chapter 186.

(26) “Investment security” means a marketable obligation evidencing indebtedness of a person in the form of a bond, note, debenture, or investment security.

(27) “Limited trust association” means a state trust company organized under this subtitle as a limited liability company, authorized to issue participation shares, and controlled by its participants.

(28) “Loans and extensions of credit” means direct or indirect advances of money by a state trust company to a person that are conditioned on the obligation of the person to repay the funds or that are repayable from specific property pledged by or on behalf of the person.

(29) “Manager” means a person elected to the board of a limited trust association.

(30) “Managing participant” means a participant in a limited trust association in which management has been retained by the participants.

(31) “Mutual funds” means equity securities of an investment company registered under the Investment Company Act of 1940 (15 U.S.C. Section 80a-1 et seq.) and the Securities Act of 1933 (15 U.S.C. Section 77a et seq.). The term does not include money market funds.

(32) “Officer” means the presiding officer of the board, the principal executive officer, or another officer appointed by the board of a state trust company or other company, or a person or group of persons acting in a comparable capacity for the state trust company or other company.

(33) “Operating subsidiary” means a company for which a state trust company has the ownership, ability, or power to vote, directly, acting through one or more other persons, or otherwise indirectly, more than 50 percent of the outstanding shares of each class of voting securities or its equivalent of the company.

(34) “Participant” means an owner of a participation share in a limited trust association.

(35) “Participant-transferee” means a transferee of a participation share who has not received the unanimous consent of all participants to be a participant, or who becomes a participant-transferee under Subchapter C, Chapter 183.

(36) “Participation agreement” means the instrument stating the agreement among the participants of a limited trust association relating to the rights and

duties of the participants and participant-transferees, including allocations of income, loss, deduction, credit, distributions, liquidation rights, redemption rights, liabilities of participants, priority rights of participant-transferees to transfer participation shares, rights of participants to purchase participation shares of participant-transferees, the procedures for elections and voting by participants, and any other matter not prohibited by or inconsistent with this subtitle.

(37) "Participation shares" means the units into which the proprietary interests of a limited trust association are divided or subdivided by means of classes, series, relative rights, or preferences.

(38) "Principal shareholder" means a person who owns or has the ability or power to vote, directly, acting through one or more other persons, or otherwise indirectly, 10 percent or more of the outstanding shares or participation shares of any class of voting securities of a state trust company or other company.

(39) "Restricted capital" means the sum of capital and certified surplus.

(40) "Regulatory accounting principles" means generally accepted accounting principles as modified by rules adopted under:

(A) this subtitle; or

(B) an applicable federal statute or regulation.

(41) "Secondary capital" means the amount by which the assets of a state trust company exceed restricted capital, required by Section 182.008, and liabilities.

(42) "Shareholder" means an owner of a share in a state trust company.

(43) "Shares" means the units into which the proprietary interests of a state trust company are divided or subdivided by means of classes, series, relative rights, or preferences.

(44) "State bank" means a banking association or limited banking association organized or reorganized under Subtitle A, including an association organized under the laws of this state before September 1, 1997, with the express power to receive and accept deposits and possessing other rights and powers granted by that subtitle expressly or by implication. The term does not include a savings association, savings bank, or credit union.

(45) "State trust company" or "trust company" means a trust association or limited trust association organized or reorganized under this subtitle, including an association organized under the laws of this state before September 1, 1997. If the context or circumstances require, the term includes a trust company organized under the laws of another state that lawfully maintains a trust office in this state in accordance with Chapter 187.

(46) "Subsidiary" means a state trust company or other company that is controlled by another person. The term includes a subsidiary of a subsidiary.

(47) "Supervisor" means the banking commissioner or an agent of the banking commissioner exercising the powers and duties specified in Subchapter B, Chapter 185.

(47-a) "Surplus" means the amount by which the assets of a state trust company exceed the company's liabilities, capital, and undivided profits.

(48) "Trust association" means a trust company organized under this subtitle as a corporation, authorized to issue shares of stock, and controlled by its shareholders.

(49) "Trust business" means the business of a company holding itself out to the public as a fiduciary for hire or compensation to hold or administer accounts.

(50) "Trust deposits" means client funds held by a trust institution and authorized to be deposited with itself as a permanent investment or pending investment, distribution, or payment of debts on behalf of the client.

(51) "Trust institution" means a bank, credit union, foreign bank, savings association, savings bank, or trust company that is authorized by its charter to conduct a trust business.

(52) "Unauthorized trust activity" means an act or practice within this state by a company without a charter, license, permit, registration, or other authority issued or granted by the banking commissioner or other appropriate regulatory authority for which such a charter, license, permit, registration, or other authority is required to conduct trust business.

(53) "Undivided profits" means the part of equity capital of a state trust company equal to the balance of its net profits, income, gains, and losses since the date of its formation minus subsequent distributions to shareholders or participants and transfers to surplus or capital under share dividends or appropriate board

resolutions. The term includes amounts allocated to undivided profits as a result of a merger.

(54) "Voting security" means a share, participation share, or other evidence of proprietary interest in a state trust company or other company that has as an attribute the right to vote or participate in the election of the board of the trust company or other company, regardless of whether the right is limited to the election of fewer than all of the board members. The term includes a security that is convertible or exchangeable into a voting security and a nonvoting participation share of a managing participant.

(b) The definitions provided by this section shall be liberally construed to accomplish the purposes of this subtitle.

(c) The finance commission by rule may adopt other definitions to accomplish the purposes of this subtitle.

Sec. 181.003. Trust Company Rules. [2] (a) The finance commission may adopt rules to accomplish the purposes of this subtitle, including rules necessary or reasonable to:

(1) implement and clarify this subtitle;

(2) preserve or protect the safety and soundness of state trust companies;

(3) grant the same rights and privileges to state trust companies with respect to the exercise of fiduciary powers and the conducting [*sic*] of financial activities or activities incidental or complementary to financial activities that are or may be granted to a trust institution that maintains its principal office or a branch or trust office in this state;

(4) provide for recovery of the cost of maintenance and operation of the department and the cost of enforcing this subtitle through the imposition and collection of ratable and equitable fees for notices, applications, and examinations; and

(5) facilitate the fair hearing and adjudication of matters before the banking commissioner and the finance commission.

(b) The presence or absence in this subtitle of a specific reference to rules regarding a particular subject does not enlarge or diminish the rulemaking authority conferred by this section.

Sec. 181.004 Implying That Person Is Trust Company. (a) A person or company may not use in a business name or advertising the words "trust," "trust company," or any similar term or phrase, any word pronounced "trust" or "trust company," any foreign word that means "trust" or "trust company," or any term that tends to imply that the business is holding out to the public that it engages in the business of a fiduciary for hire unless the banking commissioner has approved the use in writing after finding that the use will not be misleading. This subsection does not prohibit an individual from engaging in the business of a fiduciary for compensation or from using the words "trust" or "trustee" for the purpose of identifying assets held or actions taken in an existing capacity.

(b) Subsection (a) does not apply to:

(1) a trust institution authorized under this subtitle to conduct a trust business in this state; or

(2) another entity organized under the laws of this state, another state, the United States, or a foreign sovereign state to the extent that:

(A) the entity is authorized under its charter or the laws of this state or the United States to use a term, word, character, ideogram, phonogram, or phrase prohibited by Subsection (a); and

(B) the entity is authorized by the laws of this state or the United States to conduct the activities in which the entity is engaged in this state.

Sec. 181.005. Liability of Trust Company Directors and Personnel. (a) The provisions of the Business Organizations Code regarding liability, defenses, and indemnification of a director, officer, agent, or employee apply to a director, officer, agent, or employee of a state trust company in this state. Except as limited by those provisions, a disinterested director, manager, managing participant, officer, or employee of a state trust company may not be held personally liable in an action seeking monetary damages arising from the conduct of the state trust company's affairs unless the damages resulted from the gross negligence or wilful or intentional misconduct of the person during the person's term of office or service with the state trust company.

(b) A director, manager, managing participant, officer, or employee of a state trust company is disinterested with respect to a decision or transaction if:

[2] See 7 TAC Chapters 17-21, relating generally to trust companies.

(1) the person fully discloses any interest in the decision or transaction and does not participate in the decision or transaction; or

(2) the decision or transaction does not involve any of the following:

(A) personal profit for the person through dealing with the state trust company or usurping an opportunity of the trust company;

(B) buying or selling assets of the state trust company in a transaction in which the person has a direct or indirect pecuniary interest;

(C) dealing with another state trust company or other person in which the person is a director, manager, managing participant, officer, or employee or otherwise has a significant direct or indirect financial interest; or

(D) dealing with a family member of the person.

(c) A director, manager, managing participant, or officer who, in performing the person's duties and functions, acts in good faith and reasonably believes that reliance is warranted is entitled to rely on information, including an opinion, report, financial statement or other type of statement or financial data, decision, judgment, or performance, that is prepared, presented, made, or rendered by:

(1) one or more directors, managers, managing participants, officers, or employees of the state trust company, or of an entity under joint or common control with the state trust company, whom the director, manager, managing participant, or officer reasonably believes merits confidence;

(2) legal counsel, a public accountant, or another person whom the director, manager, managing participant, or officer reasonably believes merits confidence; or

(3) a committee of the board of the state trust company of which the director, manager, or managing participant is not a member.

(d) In this section, "family member" means a person's:

(1) spouse;

(2) minor child; or

(3) adult child who resides in the person's home.

Sec. 181.006. Exemption of Trust Institution Directors and Personnel from Securities Law. An officer, director, manager, managing participant, or employee of a trust institution with fewer than 500 shareholders or participants, including a state trust company or a trust institution organized under the laws of another state that lawfully maintains an office in this state, or a holding company with fewer than 500 shareholders or participants that controls a trust institution is exempt from the registration and licensing provisions of The Securities Act (Article 581-1 et seq., Vernon's Texas Civil Statutes) with respect to that person's participation in a transaction, including a sale, involving securities issued by the trust institution or the holding company of which that person is an officer, director, manager, managing participant, or employee if the person is not compensated for the person's participation in the transaction.

Sec. 181.007. Attachment, Injunction, or Execution. An attachment, injunction, or execution to collect a money judgment or secure a prospective money judgment against a trust institution, including a state trust company or a trust institution organized under the laws of another state that lawfully maintains an office in this state, or against a client of or client account in the trust institution, is governed by Sections 59.007 and 59.008.

Subchapter B. Regulation of Trust Companies by Banking Department

Sec. 181.101. Issuance of Interpretive Statements. (a) The banking commissioner:

(1) may issue interpretive statements containing matters of general policy for the guidance of the public and state trust companies; and

(2) may amend or repeal a published interpretive statement by issuing an amended statement or notice of repeal of a statement.

(b) An interpretive statement may be disseminated by newsletter, via an electronic medium such as the Internet, in a volume of statutes or related materials published by the banking commissioner or others, or by other means reasonably calculated to notify persons affected by the interpretive statement. Notice of an amended or withdrawn statement must be published in a substantially similar manner as the affected statement was originally published.

Sec. 181.102. Issuance of Opinion. (a) In response to a specific request from a member of the public or industry, the banking commissioner may issue an opinion directly or through a deputy banking commissioner or department attorney.

(b) If the banking commissioner determines that the opinion is useful for the general guidance of trust companies and the public, the banking commissioner may disseminate the opinion by newsletter, via an electronic medium such as the Internet, in a volume of statutes or related materials published by the banking commissioner or others, or by other means reasonably calculated to notify persons affected by the opinion. A published opinion must be redacted to preserve the confidentiality of the requesting party unless the requesting party consents to be identified in the published opinion.

(c) The banking commissioner may amend or repeal a published opinion by issuing an amended opinion or notice of repeal of an opinion and disseminating the opinion or notice in a substantially similar manner as the affected statement or opinion was originally published. The requesting party, however, may rely on the original opinion if:

(1) all material facts were originally disclosed to the banking commissioner;

(2) the safety and soundness of the affected trust companies will not be affected by further reliance on the original opinion; and

(3) the text and interpretation of relevant governing provisions of this subtitle have not been changed by legislative or judicial action.

Sec. 181.103. Effect of Interpretive Statement or Opinion. An interpretive statement or opinion issued under this subchapter does not have the force of law and is not a rule for the purposes of Chapter 2001, Government Code, unless adopted as a rule by the finance commission as provided by Chapter 2001, Government Code. An interpretive statement or opinion is an administrative construction of this subtitle entitled to great weight if the construction is reasonable and does not conflict with this subtitle.

Sec. 181.104. Examination Requirement. (a) The banking commissioner shall examine each state trust company annually, or on another periodic basis as may be required by rule or policy, or as the commissioner considers necessary to:

(1) safeguard the interests of clients, creditors, shareholders, participants, or participant-transferees; and

(2) efficiently enforce applicable law..[3]

(b) [Repealed][4]

(c) [Repealed][4]

(d) Disclosure of information to the banking commissioner pursuant to an examination request or a subpoena issued under this section does not constitute a waiver of or otherwise affect or diminish an evidentiary privilege to which the information is otherwise subject. A report of an examination under this section is confidential and may be disclosed only under the circumstances provided by this subtitle.

(e) The banking commissioner may:

(1) accept an examination of a state trust company, a third-party contractor, or an affiliate of the state trust company by a federal or other governmental agency in lieu of an examination under this section; or

(2) conduct an examination of a state trust company, a third-party contractor, or an affiliate of the state trust company jointly with a federal or other governmental agency.

(f) The banking commissioner may:

(1) administer oaths and examine persons under oath on any subject that the banking commissioner considers pertinent to the financial condition or the safety and soundness of the activities of a state trust company; and

(2) subpoena witnesses and require and compel by subpoena the production of documents not voluntarily produced.

(f-1) If a person refuses to obey a subpoena, a district court of Travis County, on application by the commissioner, may issue an order requiring the person to appear before the commissioner and produce documents or give evidence regarding the matter under examination or investigation.

(g) A subpoena issued to a financial institution under this section is not subject to Section 59.006.

[3] See Policy Memorandum Nos. 1002, 1004, 1006, and 1012, relating generally to policy for examinations.

[4] Repealed eff. Sept. 1, 2015, by 84th Tex. Leg., ch. 250 (S.B. 875), §11(1).

Sec. 181.105. Cost of Regulation. Each state trust company shall pay, through the imposition and collection of fees established by the finance commission under Section 181.003(a)(4):[5]

(1) the cost of examination;

(2) the equitable or proportionate cost of maintenance and operation of the department; and

(3) the cost of enforcement of this subtitle.

Sec. 181.106. Regulation and Examination of Related Entities. (a) The banking commissioner may regulate and examine, to the same extent as if the services or activities were performed by a state trust company on its own premises:

(1) the activities of a state trust company affiliate; and

(2) the performance of data processing, electronic fund transfers, or other services or activities performed on behalf of a state trust company by a third-party contractor.

(b) The banking commissioner may collect a fee from the state trust company to cover the cost of the examination.

Sec. 181.107. Statements of Condition and Income; Penalty. (a) Each state trust company periodically shall file with the banking commissioner a copy of its statement of condition and income.

(b) The finance commission by rule may:[6]

(1) require the statement to be filed with the banking commission at the intervals the finance commission determines;

(2) specify the form of the statement of condition and income, including specified confidential and public information to be in the statement; and

(3) require public information in the statement to be published at the times and in the publications and locations the finance commission determines.

[5] See 7 TAC §17.22, relating to examination and investigation fees.

[6] See 7 TAC §17.23, relating to call reports.

(c) A statement of condition and income is a public record except for:

(1) portions of the statement designated confidential by the banking commissioner; and

(2) the statement of condition and income for a state trust company exempt under Section 182.011 or 182.019 with regard to the period during which the exemption is in effect.

(d) A state trust company that fails to file a statement of condition and income on or before the date it is due is, after notice and hearing, subject to a penalty of not more than $500 a day for each day of noncompliance.

Sec. 181.108. Liability of Commission and Department Officers and Personnel Limited. (a) The banking commissioner, a member of the finance commission, a deputy banking commissioner, an examiner, assistant examiner, supervisor, conservator, agent, or other officer or employee of the department, or an agent of the banking commissioner is not personally liable for damages arising from the person’s official act or omission unless the act or omission is corrupt or malicious.

(b) The attorney general shall defend an action brought against a person because of an official act or omission under Subsection (a), regardless of whether the defendant has terminated service with the department before the action commences.

Subchapter C. Administrative Procedure

Sec. 181.201. Banking Commissioner Hearing; Informal Disposition.[7] (a) The banking commissioner may convene a hearing to receive evidence and argument regarding any matter within the jurisdiction of and before the banking commissioner for decision or review. The hearing must be conducted under Chapter 2001, Government Code. A matter made confidential by law must be considered by the banking commissioner in a closed hearing.

(b) A hearing before the banking commissioner that is required or authorized by law may be conducted by a hearings officer on behalf of the banking commissioner.

(c) This section does not grant a right to hearing to a person that is not otherwise granted by governing law.

[7] See 7 TAC §§9.11-9.39, relating to procedure in contested case hearings.

(d) The banking commissioner may informally dispose of a matter within the jurisdiction of and before the banking commissioner by consent order, agreed settlement, or default.

Sec. 181.202. Appeal of Banking Commissioner Decision or Order. Except as expressly provided otherwise by this subtitle, a person affected by a decision or order of the banking commissioner made under this subtitle after hearing may appeal the decision or order:

(1) to the finance commission; or

(2) directly to a district court in Travis County as provided by Section 181.204.

Sec. 181.203. Appeal to Finance Commission.[8] (a) In an appeal to the finance commission, the finance commission shall consider the questions raised by the application for review and may also consider additional matters pertinent to the appeal.

(b) An order of the banking commissioner continues in effect pending review unless the order is stayed by the finance commission. The finance commission may impose any condition before granting a stay of the appealed order.

(c) The finance commission may not be required to accept additional evidence or hold an evidentiary hearing if a hearing was held and a record made before the banking commissioner. The finance commission shall remand the proceeding to the banking commissioner to receive any additional evidence the finance commission chooses to consider.

(d) A hearing before the finance commission that is required or authorized by law may be conducted by a hearings officer on behalf of the finance commission.

(e) A matter made confidential by law must be considered by the finance commission in a closed hearing.

Sec. 181.204. Direct Appeal to Court or Appeal of Finance Commission Order. A person affected by a final order of the banking commissioner who elects to appeal directly to district court, or a person affected by a final order of the finance commission under this subchapter, may appeal the final order by filing a petition for judicial review as provided by Chapter 2001, Government Code. A petition for judicial review filed in the district court does not stay or vacate the appealed order unless the court, after notice and hearing, expressly stays or vacates the order.

Subchapter D. Confidentiality of Information[9]

Sec. 181.301. Disclosure by Department Prohibited. (a) Except as expressly provided otherwise by this subtitle or a rule adopted under Section 181.003(a)(1), the following are confidential and may not be disclosed by the banking commissioner or an employee of the department:

(1) information directly or indirectly obtained by the department in any manner, including through an application or examination, concerning the financial condition or business affairs of a state trust company or a present, former, or prospective shareholder, participant, officer, director, manager, affiliate, or service provider of the state trust company, other than the public portions of a report of condition or income statement; and

(2) each related file or record of the department.

(b) Information obtained by the department from a federal or state regulatory agency that is confidential under federal or state law may not be disclosed except as provided by federal or state law.

(c) The banking commissioner or an officer or employee of the department commits an offense if the person:

(1) discloses information or permits access to a file or record of the department; and

(2) knows at the time of disclosure or permission that the disclosure or permission violates this subchapter.

(d) An offense under this section is a Class A misdemeanor.

Sec. 181.302. Disclosure to Finance Commission. Confidential information may not be disclosed to a member of the finance commission. A member of the finance commission may not be given access to the files and records of the department except that the banking commissioner may disclose to the finance commission information, files, and records pertinent to a hearing or matter pending before the finance commission.

Sec. 181.303. Disclosure to Other Agencies. (a) For purposes of this section, "affiliated group," "agency,"

[8] See 7 TAC §§9.51-9.57, relating to appeals to the finance commission.

[9] See 7 TAC §3.111, relating to confidential information.

"functional regulatory agency," and "privilege" have the meanings assigned by Section 31.303.

(b) The banking commissioner may, as the banking commissioner considers necessary or proper to the enforcement of the laws of this state, another state, the United States, or a foreign sovereign state with whom the United States currently maintains diplomatic relations, or in the best interest of the public, disclose information in the possession of the department to another agency. The banking commissioner may not disclose information under this section that is confidential under applicable state or federal law unless:

(1) the recipient agency agrees to maintain the confidentiality and take all reasonable steps to oppose an effort to secure disclosure of the information from the agency; or

(2) the banking commissioner determines in the exercise of discretion that the interest of law enforcement outweighs and justifies the potential for disclosure of the information by the recipient agency.

(c) The banking commissioner by agreement may establish an information sharing and exchange program with a functional regulatory agency that has overlapping regulatory jurisdiction with the department, with respect to all or part of an affiliated group, including a financial institution, to reduce the potential for duplicative and burdensome filings, examinations, and other regulatory activities. Each agency party to the agreement must agree to maintain confidentiality of information that is confidential under applicable state or federal law and take all reasonable steps to oppose any effort to secure disclosure of the information from the agency. An agreement may also specify procedures regarding use and handling of confidential information and identify types of information to be shared and procedures for sharing on a recurring basis.

(d) Disclosure of information by or to the banking commissioner under this section does not constitute a waiver of or otherwise affect or diminish an evidentiary privilege to which the information is otherwise subject, whether or not the disclosure is governed by a confidentiality agreement.

(e) Notwithstanding other law, an agency of this state:

(1) may execute, honor, and comply with an agreement to maintain confidentiality and oppose disclosure of information obtained from the banking commissioner as provided in this section; and

(2) shall treat as confidential any information obtained from the banking commissioner that is entitled to confidential treatment under applicable state or federal law and take all reasonable steps to oppose an effort to secure disclosure of the information from the agency.

Sec. 181.304. Other Disclosure Prohibited; Penalty. (a) Confidential information that is provided to a state trust company, affiliate, or service provider of the state trust company, whether in the form of a report of examination or otherwise, is the confidential property of the department. The information may not be made public or disclosed by the recipient or by an officer, director, manager, employee, or agent of the recipient to a person not officially connected to the recipient as officer, director, employee, attorney, auditor, independent auditor, or bonding company, except as authorized by rules adopted under this subtitle.

(b) A person commits an offense if the person discloses or uses the confidential information in violation of this section. An offense under this subsection is punishable as if it were an offense under Section 37.10, Penal Code.

Sec. 181.305. Civil Discovery. Civil discovery of confidential information from a person subject to Section 181.304 under subpoena or other legal process in a civil proceeding must comply with rules adopted under this subtitle and other applicable law. The rules may:

(1) restrict release of confidential information to the portion directly relevant to the legal dispute at issue; and

(2) require that a protective order, in the form and under circumstances specified by the rules, be issued by a court before release of the confidential information.[10]

Sec. 181.306. Investigative Information. Notwithstanding any other law, the banking commissioner may refuse to release information or records concerning a state trust company in the custody of the department if, in the opinion of the banking commissioner, release of the information or records might jeopardize an ongoing investigation of potentially unlawful activity.

Sec. 181.307. Employment Information. (a) A person may provide employment information concerning the known or suspected involvement of a present or former employee, officer, or director of a state trust company in a violation of any state or federal law, rule, or

[10] For form of protective order, see 7 TAC §3.111(f).

regulation that has been reported to appropriate state or federal authorities to:

(1) a state trust company; or

(2) a person providing employment information to a state trust company.

(b) A person may not be held liable for providing information under Subsection (a) unless the information provided is false and the person provided the information with disregard for the truth.

Sec. 181.308. Shareholder Inspection Rights. (a) Notwithstanding Section 21.218 or 101.502, Business Organizations Code, a shareholder or participant of a state trust company may not examine:

(1) a report of examination or other confidential property of the department that is in the possession of the state trust company; or

(2) a book or record of the state trust company that directly or indirectly pertains to financial or other information maintained by the state trust company on behalf of its clients, including a specific item in the minutes of the board or a committee of the board regarding client account review and approval or any report that would tend to identify the state trust company's client.

(b) This section does not affect the rights of a shareholder or participant of a state trust company acting in another capacity.

CHAPTER 182. POWERS, ORGANIZATION, AND FINANCIAL REQUIREMENTS

Subchapter A. Organization and Powers in General

Subchapter B. Amendment of Certificate; Changes in Capital and Surplus

Subchapter C. State Trust Company Offices

Subchapter D. Merger

Subchapter E. Purchase or Sale of Assets

Subchapter F. Exit of State Trust Company or Entry of Another Trust Institution

CHAPTER 182. POWERS, ORGANIZATION, AND FINANCIAL REQUIREMENTS

Subchapter A. Organization and Powers in General

182.001. Organization and General Powers of State Trust Company. (a) Subject to Subsection (g) and the other provisions of this chapter, one or more persons may organize and charter a state trust company as a state trust association or a limited trust association.

(b) A state trust company may engage in the trust business by:

(1) acting as trustee under a written agreement;

(2) receiving money and other property in its capacity as trustee for investment in real or personal property;

(3) acting as trustee and performing the fiduciary duties committed or transferred to it by order of a court;

(4) acting as executor, administrator, or trustee of the estate of a deceased person;

(5) acting as a custodian, guardian, conservator, or trustee for a minor or incapacitated person;

(6) acting as a successor fiduciary to a trust institution or other fiduciary;

(7) receiving for safekeeping personal property;

(8) acting as custodian, assignee, transfer agent, escrow agent, registrar, or receiver;

(9) acting as investment advisor, agent, or attorney in fact according to an applicable agreement;

(10) with the prior written approval of the banking commissioner and to the extent consistent with applicable fiduciary principles, engaging in a financial activity or an activity incidental or complementary to a financial activity, directly or through a subsidiary;

(11) exercising additional powers expressly conferred by rule of the finance commission; and

(12) exercising any incidental power that is reasonably necessary to enable it to fully exercise the powers expressly conferred according to commonly accepted fiduciary customs and usages.

(c) For purposes of other state law, a trust association is considered a corporation and a limited trust association is considered a limited liability company. To the extent consistent with this subtitle, a trust association may exercise the powers of a Texas business corporation and a limited trust association may exercise the powers of a Texas limited liability company as reasonably necessary to enable exercise of specific powers under this subtitle.

(d) A state trust company may contribute to a community fund or to a charitable, philanthropic, or benevolent instrumentality conducive to public welfare an amount that the state trust company's board considers appropriate and in the interests of the state trust company.

(e) Subject to Section 184.301, a state trust company may deposit trust funds with itself.

(f) A state trust company insured by the Federal Deposit Insurance Corporation may receive and pay deposits, with or without interest, made by the United States, the state, a county, or a municipality.

(g) In the exercise of discretion consistent with the purposes of this subtitle, the banking commissioner may require a state trust company to conduct an otherwise authorized activity through a subsidiary.

Sec. 182.002. Certificate of Formation of State Trust Company. (a) The certificate of formation of a state trust company must be signed and acknowledged by each organizer and must contain:

(1) the name of the state trust company, subject to Subsection (b);

(2) the period of the state trust company's duration, which may be perpetual;

(3) the powers of the state trust company, which may be stated as:

(A) all powers granted to a state trust company in this state; or

(B) a list of the specific powers that the state trust company chooses and is authorized to exercise;

(4) the aggregate number of shares, or participation shares in the case of a limited trust association, that the state trust company will be authorized to issue, and the number of classes of shares or participation shares, which may be one or more;

(5) if the shares or participation shares are to be divided into classes:

(A) the designation of each class and statement of the preferences, limitations, and relative rights of the shares or participation shares of each class, which in the case of a limited trust association may be more fully set forth in the participation agreement;

(B) the number of shares or participation shares of each class; and

(C) a statement of the par value of the shares or participation shares of each class or that the shares or participation shares are to be without par value;

(6) any provision limiting or denying to shareholders or participants the preemptive right to acquire additional or treasury shares or participation shares of the state trust company;

(7) any provision granting the right of shareholders or participants to cumulative voting in the election of directors or managers;

(8) the aggregate amount of consideration to be received for all shares or participation shares initially issued by the state trust company and a statement that:

(A) all authorized shares or participation shares have been subscribed; and

(B) all subscriptions received have been irrevocably paid in cash;

(9) any provision consistent with law that the organizers elect to set forth in the certificate of formation for the regulation of the internal affairs of the state trust company or that is otherwise required by this subtitle to be set forth in the certificate of formation;

(10) the street address of the state trust company's home office; and

(11) either:

(A) the number of directors or managers constituting the initial board and the names and street addresses of the persons who are to serve as directors or managers until the first annual meeting of shareholders or participants or until successor directors or managers have been elected and qualified; or

(B) the statement described by Subsection (c).

(b) The banking commissioner may determine that a proposed state trust company name is potentially misleading to the public and require the organizers to select a different name.

(c) The organizers of a limited trust association that will have not fewer than five or more than 25 participants may include in the certificate of formation a statement that management is vested in a board composed of all participants, with management authority vested in each participant in proportion to the participant's contribution to capital as adjusted from time to time to properly reflect any additional contribution, and the names and street addresses of the persons who are to be the initial managing participants.

Sec. 182.003. Application for State Trust Company Charter; Standards for Approval. (a) An application for a state trust company charter must be made under oath and in the form required by the banking commissioner. The application must be supported by information, records, and opinions of counsel that the banking commissioner requires. The application must be accompanied by all charter fees and deposits required by statute or rule.[1]

(b) The banking commissioner shall grant a state trust company charter only on proof satisfactory to the banking commissioner that public convenience and advantage will be promoted by the establishment of the state trust company. In determining whether public convenience and advantage will be promoted, the

[1] See 7 TAC §§21.2 and 21.6, relating to application for trust company charter; also see 7 TAC §21.23, relating to option to withhold identity of officers.

banking commissioner shall consider the convenience of the public to be served and whether:

(1) the organizational and capital structure and amount of initial capitalization is adequate for the business and location;

(2) the anticipated volume and nature of business indicates a reasonable probability of success and profitability based on the market sought to be served;

(3) the proposed officers, directors, and managers, or managing participants, as a group have sufficient fiduciary experience, ability, standing, competence, trustworthiness, and integrity to justify a belief that the state trust company will operate in compliance with law and that success of the state trust company is probable;

(4) each principal shareholder or participant has sufficient experience, ability, standing, competence, trustworthiness, and integrity to justify a belief that the state trust company will be free from improper or unlawful influence or interference with respect to the state trust company's operation in compliance with law; and

(5) the organizers are acting in good faith.

(c) The organizers bear the burden of proof to establish that public convenience and advantage will be promoted by the establishment of the state trust company. The failure of an applicant to furnish required information, opinions of counsel, and other material, or the required fee, is considered an abandonment of the application.

Sec. 182.004. Notice and Investigation of Charter Application. (a) The organizers shall solicit comments and protests by publishing notice of the application, its date of filing, and the identity of the organizers, in the form and frequency specified by the banking commissioner, in a newspaper of general circulation in the county where the initial home office of the proposed state trust company is to be located, or in another publication or location as directed by the banking commissioner. The banking commissioner may require the organizers to publish the notice at other locations reasonably necessary to solicit the views of potentially affected persons.

(b) At the expense of the organizers, the banking commissioner shall thoroughly investigate the application and inquire fully into the identity and character of each proposed director, manager, officer, managing participant, and principal shareholder or participant. The banking commissioner shall prepare a written report of the investigation.

(c) Rules adopted under this subtitle may specify the confidential or nonconfidential character of information obtained or prepared by the department under this section. Except as provided by Subchapter D, Chapter 181, or in rules regarding confidential information,[2] the business plan of the applicant and the financial statement of a proposed officer, director, manager, or managing participant are confidential and not subject to public disclosure.

Sec. 182.005. Protest; Hearing; Decision on Charter Application. (a) A protest of a charter application must be received by the department before the 15th day after the date the organizers publish notice under Section 182.004(a) and must be accompanied by the fees and deposits required by law.[3] If the protest is untimely, the department shall return all submitted fees and deposits to the protesting party. If the protest is timely, the department shall notify the applicant of the protest and mail or deliver a complete copy of the nonconfidential sections of the charter application to the protesting party before the 15th day after the later of the date of receipt of the protest or receipt of the charter application.

(b) A protesting party must file a detailed protest responding to each contested statement contained in the nonconfidential portion of the application not later than the 20th day after the date the protesting party receives the application from the department, and relate each statement and response to the standards for approval set forth in Section 182.003(b).[4] The applicant must file a written reply to the protesting party's detailed response on or before the 10th day after the date the response is filed. The protesting party's response and the applicant's reply must be verified by affidavit and must certify that a copy was served on the opposing party. If applicable, statements in the response and in the reply may be supported by references to data available in sources of which official notice may properly be taken. Any comment received by the department and any reply of the applicant to the comment shall be made available to the protesting party.

[2] See 7 TAC §3.111, relating to confidential information.

[3] A protest fee may be required, see 7 TAC §21.2(c), relating to filing and investigation fees.

[4] See 7 TAC §§9.11-9.39, relating to contested case hearings.

(c) The banking commissioner may not be compelled to hold a hearing before granting or denying the charter application. In the exercise of discretion, the banking commissioner may consider granting a hearing on a charter application at the request of the applicant or a protesting party. The banking commissioner may order a hearing regardless of whether a hearing has been requested by a party. A party requesting a hearing must indicate with specificity the issues involved that cannot be determined on the basis of the record compiled under Subsection (b) and why the issues cannot be determined. A request for hearing and the banking commissioner's decision with regard to granting a hearing shall be made a part of the record. If the banking commissioner sets a hearing, the banking commissioner shall conduct a public hearing and as many prehearing conferences and opportunities for discovery as the banking commissioner considers advisable and consistent with governing statutes and rules, except that the banking commissioner may not permit discovery of confidential information in the charter application or the investigation report.

(d) Based on the record, the banking commissioner shall determine whether all of the necessary conditions set forth in Section 182.003(b) have been established and shall enter an order granting or denying the charter.

(e) The banking commissioner may make approval of any application conditional. The banking commissioner shall include any conditions in the order granting the charter.

(f) Chapter 2001, Government Code, does not apply to a charter application filed for the purpose of assuming all or any portion of the assets, liabilities, and accounts of a trust institution considered by the banking commissioner to be in hazardous condition.

Sec. 182.006. Issuance of Charter. A state trust company may not engage in the trust business until it receives its charter from the banking commissioner. The banking commissioner may not deliver the charter until the state trust company has:

(1) received cash in at least the full amount of restricted capital from subscriptions for the issuance of shares or participation shares;

(2) elected or qualified the initial officers and directors or managers, as appropriate, named in the application for charter or other officers and directors or managers approved by the banking commissioner; and

(3) complied with all other requirements of this subtitle relating to the organization of the state trust company.

Sec. 182.007. Deadline to Begin Business. If a state trust company does not open and engage in the trust business within six months after the date it receives its charter or conditional approval of application for charter, the banking commissioner may revoke the charter or cancel the conditional approval of application for charter without judicial action.

Sec. 182.008. Restricted Capital. (a) The banking commissioner may not issue a charter to a state trust company having restricted capital of less than $2 million.

(b) The banking commissioner may, on a case-by-case basis, require additional restricted capital for a proposed or existing state trust company if the banking commissioner finds the condition and operations of the existing state trust company or the proposed scope or type of operations of the proposed state trust company requires additional restricted capital to protect the safety and soundness of the state trust company. The safety and soundness factors to be considered by the banking commissioner in the exercise of discretion include:

(1) the nature and type of business the state trust company conducts;

(2) the nature and degree of liquidity in assets held in a corporate capacity;

(3) the amount, type, and depository of fiduciary assets that the state trust company manages;

(4) the complexity of the state trust company's fiduciary duties and degree of discretion undertaken;

(5) the competence and experience of the state trust company's management;

(6) the extent and adequacy of internal controls maintained by the state trust company;

(7) the presence or absence of annual unqualified audits by an independent certified public accountant;

(8) the reasonableness of the state trust company's business plans for retaining or acquiring additional restricted capital; and

(9) the existence and adequacy of insurance obtained or held by the state trust company to protect its clients, beneficiaries, and grantors.

(c) The effective date of an order under Subsection (b) must be stated in the order and must be on or after the 21st day after the date the order is mailed or delivered. Unless the state trust company requests a hearing before the banking commissioner in writing before the effective date of the order, the order takes effect and is final and nonappealable.[5] This subsection does not prohibit an application to reduce capital requirements of an existing state trust company under Subsection (e) or under Section 182.011.

(d) Subject to Subsection (e) and Section 182.011, a state trust company to which the banking commissioner issues a charter shall at all times maintain restricted capital in at least the amount required under Subsection (a) and in any additional amount the banking commissioner requires under Subsection (b).

(e) Notwithstanding Subsection (a), on application, the banking commissioner may, on a case-by-case basis in the exercise of discretion, reduce the amount of minimum restricted capital required for a state trust company in a manner consistent with protecting the state trust company's safety and soundness. In making a determination under this subsection, the banking commissioner shall consider the factors listed by Subsection (b).

Sec. 182.009. Application of General Corporate Law. (a) The Business Organizations Code applies to a trust association as if it were a for-profit corporation, and to a limited trust association as if it were a limited liability company, to the extent not inconsistent with this subtitle or the proper business of a state trust company, except that:

(1) a reference to the secretary of state means the banking commissioner unless the context requires otherwise; and

(2) the right of shareholders or participants to cumulative voting in the election of directors or managers exists only if granted by the state trust company's certificate of formation.

(b) Unless expressly authorized by this subtitle or a rule of the finance commission, a state trust company may not take an action authorized by a law listed under Subsection (a) regarding its corporate status, capital structure, or a matter of corporate governance, of the type for which a law listed under Subsection (a) would require a filing with the secretary of state if the state trust company were a filing entity, without submitting the filing to the banking commissioner for prior written approval of the action.

(c) The finance commission may adopt rules to alter or supplement the procedures and requirements of the laws listed by Subsection (a) applicable to an action taken under this chapter by a state trust company.[6]

(d) In this subtitle, a reference to a term or phrase listed in a subdivision of Section 1.006, Business Organizations Code, includes a synonymous term or phrase referenced by the same subdivision in Section 1.006 of that code.

Sec. 182.010. Parity. (a) A state trust company has the same rights and privileges with respect to the exercise of fiduciary powers that are or may be granted to a trust institution that maintains its principal office or a branch or trust office in this state, except that this section may not be used by a state trust company to:

(1) diminish its otherwise applicable fiduciary duties to a client under the laws of this state; or

(2) avoid otherwise applicable consumer protection laws of this state.

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

[5] See 7 TAC §§9.11-9.39, relating to contested case hearings.

[6] See 7 TAC §21.9, relating to corporate filings.

(1) a trust institution described in Subsection (a) does not possess the specific right or privilege to perform the activity the state trust company seeks to perform; or

(2) the performance of the activity by the state trust company would adversely affect the safety and soundness of the requesting state trust company.

(c) The banking commissioner may extend the 30-day period under Subsection (b) if the banking commissioner determines that the state trust company's letter raises issues requiring additional information or additional time for analysis. If the 30-day period is extended, the state trust company 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 181.201 not later than the 60th day after the date the commissioner receives the state trust company'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 trust company 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 181.202–181.204 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) The finance commission may adopt rules implementing the method or manner in which a state trust company exercises specific rights and privileges, including rules regarding the exercise of rights and privileges that would be prohibited to state trust companies under state law except as provided by this section. The finance commission may not adopt rules under this subsection unless it finds that:

(1) trust institutions described in Subsection (a) possess the rights or privileges to perform activities the rules would permit state trust companies to perform; and

(2) if the rights and privileges would be prohibited to state trust companies 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 impact.

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

Sec. 182.0105. Financial Activities. (a) The finance commission by rule may determine that an activity not otherwise approved or authorized for state trust companies is:

(1) a financial activity;

(2) incidental to a financial activity; or

(3) complementary to a financial activity.

(b) In adopting a rule under Subsection (a), the finance commission shall consider:

(1) the purposes of this subtitle and the Gramm-Leach-Bliley Act (Pub. L. No. 106-102);

(2) changes or reasonably expected changes in the marketplace in which state trust companies compete;

(3) changes or reasonably expected changes in the technology for delivering fiduciary and financial services;

(4) whether the activity is necessary or appropriate to allow a state trust company to:

(A) compete effectively with another company seeking to provide fiduciary and financial services;

(B) efficiently deliver information and services that are financial in nature through the use of technological means, including an application necessary to protect the security or efficacy of systems for the transmission of data or financial transactions; or

(C) offer customers available or emerging technological means for using fiduciary and financial services or for the document imaging of data;

(5) whether the activity would violate applicable fiduciary duties or otherwise pose a substantial risk to the safety and soundness of a state trust company or the fiduciary and financial system generally; and

(6) if otherwise determined to be permissible, whether the conduct of the activity by a state trust company should be qualified through the imposition of

reasonable and necessary conditions to protect the public and require appropriate regard for safety and soundness of the trust company and the fiduciary and financial system generally.

(c) A rule adopted by the finance commission under this section does not alter or negate applicable licensing and regulatory requirements administered by a functional regulatory agency of this state, as defined by Section 31.303, including licensing and regulatory requirements pertaining to:

(1) insurance activities;

(2) securities activities; and

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

Sec. 182.011. Exemption from Statutory Provisions for Certain State Trust Companies. (a) A state trust company may request in writing that it be exempted from specified provisions of this subtitle. The banking commissioner may grant the exemption in whole or in part, subject to Subsection (c), if the banking commissioner finds that the state trust company:

(1) has only family clients and transacts business solely on behalf of family clients and their related interests;

(2) is wholly owned, directly or indirectly, legally or beneficially, by one or more family members; and

(3) does not hold itself out to the general public as a corporate fiduciary for hire.

(a-1) In this section:

(1) "Family client" includes:

(A) a family member;

(B) a former family member;

(C) a key employee of the trust company as defined by and to the extent permitted by rules adopted under Subsection (e), including a former key employee for a reasonable transition period specified by rule;

(D) a nonprofit organization, charitable foundation, charitable trust, including a charitable lead trust or charitable remainder trust whose only current beneficiaries are other family clients and charitable or nonprofit organizations, or another charitable organization for which all the funding came exclusively from one or more other family clients;

(E) the estate of a family member or former family member;

(F) an irrevocable trust under which one or more other family clients are the only current beneficiaries;

(G) an irrevocable trust funded exclusively by one or more family clients in which other family clients and nonprofit organizations, charitable foundations, charitable trusts, or other charitable organizations are the only current beneficiaries;

(H) a company wholly owned by, and operated for the sole benefit of, one or more other family clients;

(I) a revocable trust of which one or more other family clients are the sole grantors, including any such trust that becomes irrevocable, wholly or partly, for a reasonable transition period as specified by rule; and

(J) any other persons as may be permitted by rules adopted under Subsection (e).

(2) "Family member," with respect to an individual, means an individual related to the individual within the seventh degree of consanguinity or affinity, as determined under Subchapter B, Chapter 573, Government Code, except that a foster child is considered the child of the foster parent and a person for whom a guardian was appointed before the person's 18th birthday is considered the child of the guardian.

(3) "Former family member" includes a former spouse or stepchild who was a family member but is no longer a family member due to a divorce or other similar event.

(b) At the expense of a state trust company, the banking commissioner may examine or investigate the state trust company in connection with an application for an exemption. Unless the application presents novel or unusual questions, the banking commissioner shall approve the application for exemption or set the application for hearing not later than the 61st day after the date the banking commissioner considers the application complete and accepted for filing. The banking commissioner may require the submission of additional information as considered necessary to an informed decision.

(c) An exemption granted under this section may be made subject to conditions or limitations imposed by the banking commissioner consistent with this subtitle.

(d) A state trust company that is or has been exempt from a provision of this subtitle under this section or a predecessor statute may not transact business with the public unless the banking commissioner determines, as provided by Section 182.003, that general public convenience and advantage will be promoted by permitting the state trust company to engage in the trust business with the general public.

(e) The finance commission may adopt rules:

(1) defining other circumstances under which a state trust company may be exempted from a provision of this subtitle because it does not transact business with the general public;

(2) specifying the provisions of this subtitle that are subject to an exemption request;

(3) establishing procedures and requirements for obtaining, maintaining, or revoking an exemption; and[7]

(4) defining or further defining terms used by this section.

Sec. 182.012. Application for Exemption. (a) A state trust company requesting an exemption under Section 182.011 shall file an application with the banking commissioner that includes:

(1) a nonrefundable application fee set by the finance commission;

(2) a detailed sworn statement showing the state trust company's assets and liabilities as of the end of the calendar month preceding the filing of the application;

(3) a sworn statement of the reason for requesting the exemption;

(4) a sworn statement that the state trust company:

(A) has or will have only family clients and transacts or will transact business solely on behalf of family clients and their related interests;

(B) is or will be wholly owned, directly or indirectly, legally or beneficially, by one or more family members;

(C) does not or will not hold itself out to the general public as a corporate fiduciary for hire; and

(D) will not transact business with the general public without the prior written permission of the banking commissioner;

(5) the current street mailing address and telephone number of the physical location in this state at which the state trust company will maintain its books and records, with a sworn statement that the address given is true and correct and is not a United States Postal Service post office box or a private mail box, postal box, or mail drop; and

(6) a list of the specific provisions of this subtitle for which the request for an exemption is made.

(b) The banking commissioner may not approve an exemption unless the application is completed as required by Subsection (a).

(c) In this section, "family client" and "family member" have the meanings assigned by Section 182.011.

Sec. 182.013. Annual Certification for Exempt State Trust Company. (a) An exempt state trust company shall file a certification annually with its statement of condition and income, on a form provided by the banking commissioner, that it is maintaining the conditions and limitations of its exemption. The certification must be accompanied by a fee set by the finance commission.

(b) [Repealed][8]

(c) The state trust company shall maintain records necessary to verify the certification. The records are subject to examination under Section 181.104.

Sec. 182.014. Limitation on Effect of Exemption. (a) An exempt state trust company shall comply with the home office provisions of Section 182.202.

[7] See 7 TAC §21.24, relating to exemptions for trust companies administering family trusts.

[8] Repealed eff. Sept. 1, 2015, by 84th Tex. Leg., ch. 250 (S.B. 875), §11(2).

(b) The grant of an exemption to a state trust company does not affect the state trust company's obligation to pay any corporate franchise tax required by state law.

Sec. 182.015. Change of Control of Exempt State Trust Company. If control of an exempt state trust company is sold or otherwise transferred, the acquiring person must comply with Sections 182.003, 182.004, 182.005, 183.001, and 183.002. For the exempt status of the state trust company to continue, the acquiring person must file a certification with the banking commissioner that the state trust company will comply, or continue to comply, with the requirements of Section 182.011 after control is transferred. The banking commissioner may examine or investigate the acquiring person and the state trust company as necessary to verify the certification. If the commissioner determines that the state trust company will not comply, or continue to comply, with the requirements of Section 182.011 after control is transferred, the commissioner shall terminate the exemption on the effective date of the transfer. After the termination, the acquiring person must file a separate application to obtain a new exemption for the state trust company under Section 182.011.

Sec. 182.016. Grounds for Revocation of Exemption. The banking commissioner may revoke an exemption of a state trust company if the trust company:

(1) makes a false statement under oath on any document required to be filed by this subtitle or finance commission rule;

(2) fails to submit to an examination as required by Section 181.104;

(3) withholds requested information from the banking commissioner; or

(4) violates any provision of this subtitle applicable to an exempt state trust company.

Sec. 182.017. Notice and Effect of Revocation of Exemption. (a) If the banking commissioner determines from examination or other credible evidence that an exempt state trust company has violated any of the requirements of this subchapter relating to an exempt state trust company, the banking commissioner may by personal delivery or registered or certified mail, return receipt requested, notify the state trust company in writing that the state trust company's exemption has been revoked. The notice must state grounds for the revocation with reasonable certainty. The notice must state its effective date, which may not be earlier than the fifth day after the date the notification is mailed or delivered.

(b) The revocation takes effect for the state trust company if the state trust company does not request a hearing in writing before the effective date. After taking effect the revocation is final and nonappealable as to that state trust company, and the state trust company is subject to all of the requirements and provisions of this subtitle applicable to nonexempt state trust companies.

Sec. 182.018. Action after Revocation of Exemption. (a) A state trust company must comply with all of the provisions of Sections 182.003(b) and (c) not later than the fifth day after the date the revocation of the exemption takes effect. If, however, the banking commissioner determines at the time of revocation that the state trust company has been engaging in or attempting to engage in acts intended or designed to deceive or defraud the public, the banking commissioner, in the banking commissioner's sole discretion, may waive the compliance period provided by this subsection.

(b) If within the period prescribed by Subsection (a) the state trust company does not comply with all of the provisions of this subtitle, including capitalization requirements determined by the banking commissioner as necessary to assure the safety and soundness of the state trust company, the banking commissioner may:

(1) institute any action or remedy prescribed by this subtitle or any applicable rule; or

(2) refer the state trust company to the attorney general for institution of a quo warranto proceeding to revoke the state trust company's charter.

Sec. 182.019. Prior Exemption. (a) Subject to Subsection (b), a state trust company that was exempt before September 1, 1997, may no longer operate with that prior exempt status after the earlier of:

(1) September 1, 2020; or

(2) The date control is sold or otherwise transferred.

(b) A state trust company may apply for a new exemption under Section 182.011 before loss of its exempt status under Subsection (a).

Sec. 182.020. Foreign Corporation Exercising Trust Powers. (a) A foreign corporation may not conduct a trust business in this state. A foreign corporation may control a state trust company in this state if the state trust company is formed or acquired and operated as provided by this subtitle and applicable rules.

(b) A foreign corporation or other entity chartered or domiciled in another jurisdiction as a trust company or depository institution with trust powers may act as a trustee in this state only as provided by Subchapter A, Chapter 505, Estates Code.

Sec. 182.021. Activities Not Requiring Charter. Subject to Subchapter C, Chapter 187, a company does not engage in the trust business in a manner requiring a state charter by:

(1) acting in a manner authorized by law and in the scope of authority as an agent of a trust institution;

(2) rendering a service customarily performed as an attorney in a manner approved and authorized by the Supreme Court of Texas or State Bar of Texas;

(3) acting as trustee under a deed of trust made only as security for the payment of money or for the performance of another act;

(4) conducting business as a trust institution if the exercise of fiduciary powers in this state by the trust institution is not otherwise prohibited by law;

(5) engaging in a business regulated by the Office of Consumer Credit Commissioner, except as limited by rules adopted by the finance commission;

(6) receiving and distributing rents and proceeds of sale as a licensed real estate broker on behalf of a principal in a manner authorized by the Texas Real Estate Commission;

(7) engaging in a securities transaction or providing an investment advisory service as a licensed and registered dealer, salesman, or advisor to the extent that the activity is regulated by the State Securities Board or the Securities and Exchange Commission;

(8) engaging in the sale and administration of an insurance product by an insurance company or agent authorized or licensed by the Texas Department of Insurance to the extent that the activity is regulated by the Texas Department of Insurance;

(9) engaging in the lawful sale of prepaid funeral benefits under a permit issued by the banking commissioner under Chapter 154;

(10) engaging in the lawful business of a perpetual care cemetery corporation under Chapter 712, Health and Safety Code;

(11) engaging as a principal in the money services business under a license issued by the banking commissioner under Chapter 151;

(12) acting as trustee under a voting trust as provided by Section 6.251, Business Organizations Code;

(13) acting as trustee by a public, private, or independent institution of higher education or a university system, as defined by Section 61.003, Education Code, including an affiliated foundation or corporation of such an institution or system acting as trustee as provided by the Education Code;

(14) engaging in another activity expressly excluded from the application of this subtitle by rule of the finance commission;

(15) rendering services customarily performed by a certified accountant in a manner authorized by the Texas State Board of Public Accountancy;

(16) serving as trustee of a charitable trust as provided by Section 2.106, Business Organizations Code;

(17) performing escrow or settlement services if licensed or authorized under Title 11, Insurance Code;

(18) acting as a qualified intermediary in a tax deferred exchange under Section 1031, Internal Revenue Code of 1986, and applicable regulations; or

(19) providing permitted services at a trust representative office established in this state pursuant to Subchapter C, Chapter 187.

Sec. 182.0211. Conformance with Securities Act. For the purposes of Section 182.021(7), “salesman” includes “agent” and “advisor” includes “investment adviser” or “investment adviser representative.”

Subchapter B. Amendment of Certificate; Changes in Capital and Surplus

Sec. 182.101. Amendment or Restatement of State Trust Company Certificate of Formation. (a) A state trust company that has been granted a charter under Section 182.006 or a predecessor statute may amend or restate its certificate of formation for any lawful purpose, including the creation of authorized but unissued shares or participation shares in one or more classes or series.[9]

(b) An amendment authorizing the issuance of shares or participation shares in series must contain:

(1) the designation of each series and a statement of any variations in the preferences, limitations, and relative rights among series to the extent that the preferences, limitations, and relative rights are to be established in the certificate of formation; and

(2) a statement of any authority to be vested in the board to establish series and determine the preferences, limitations, and relative rights of each series.

(c) A limited trust association may not amend its certificate of formation to extend its period of existence for a perpetual period or for any period of years, unless the period of existence is expressly contingent on those events resulting in dissolution of the trust association under Section 183.208.

(d) Amendment or restatement of the certificate of formation of a state trust company and approval of the board and shareholders or participants must be made or obtained in accordance with the Business Organizations Code, except as otherwise provided by this subtitle or rules adopted under this subtitle. The original and one copy of the certificate of amendment or restated certificate of formation must be filed with the banking commissioner for approval. Unless the submission presents novel or unusual questions, the banking commissioner shall approve or reject the amendment or restatement not later than the 31st day after the date the banking commissioner considers the submission informationally complete and accepted for filing. The banking commissioner may require the submission of additional information as considered necessary to an informed decision to approve or reject any amendment or restatement of a certificate of formation under this section.

(e) If the banking commissioner finds that the amendment or restatement conforms to law and any conditions imposed by the banking commissioner, and any required filing fee has been paid, the banking commissioner shall:

(1) endorse the face of the original and copy with the date of approval and the word "Approved";

(2) file the original in the department's records; and

(3) deliver a certified copy of the amendment or restatement to the state trust company.

(f) An amendment or restatement, if approved, takes effect on the date of approval, unless the amendment or restatement provides for a different effective date.

Sec. 182.102. Establishing Series of Shares or Participation Shares. (a) If the certificate of formation expressly gives the board authority to establish series and determine the preferences, limitations, and relative rights of each series, the board may do so only on compliance with this section and any rules adopted under this chapter.

(b) A series of shares or participation shares may be established in the manner provided by the Business Organizations Code, but the shares or participation shares of the series may not be issued and sold except on compliance with Section 182.103. The state trust company shall file the original and one copy of the statement of action required by the Business Organizations Code with the banking commissioner.

(c) Unless the submission presents novel or unusual questions, the banking commissioner shall approve or reject the series not later than the 31st day after the date the banking commissioner considers the submission informationally complete and accepted for filing. The banking commissioner may require the submission of additional information as considered necessary to an informed decision.

(d) If the banking commissioner finds that the interests of the clients and creditors of the state trust company will not be adversely affected by the series, that the series otherwise conforms to law and any conditions imposed by the banking commissioner, and that any required filing fee has been paid, the banking commissioner shall:

(1) endorse the face of the original and copy of the statement with the date of approval and the word "Approved";

(2) file the original in the department's records; and

[9] See 7 TAC §21.2, relating to filing and investigation fees.

(3) deliver a certified copy of the statement to the state trust company.

Sec. 182.103. Change in Restricted Capital. (a) A state trust company may not reduce or increase its restricted capital through dividend, redemption, issuance of shares or participation shares, or otherwise without the prior approval of the banking commissioner, except as permitted by this section or rules adopted under this chapter.[10]

(b) Unless otherwise restricted by rules, prior approval is not required for an increase in restricted capital accomplished through:

(1) issuance of shares of common stock or their equivalent in participation shares for cash, or a cash contribution to surplus by shareholders or participants that does not result in issuance of additional common stock or other securities;

(2) declaration and payment of pro rata share dividends as defined by the Business Organizations Code; or

(3) adoption by the board of a resolution directing that all or part of undivided profits be transferred to restricted capital.

(c) Prior approval is not required for:

(1) a decrease in restricted capital caused by losses in excess of undivided profits; or

(2) a change in restricted capital resulting from accounting adjustments required by a transaction approved by the banking commissioner if the accounting adjustments are reasonably disclosed in the submitted application.

Sec. 182.104. Capital Notes or Debentures. (a) With the prior written approval of the banking commissioner, a state trust company may at any time through action of its board, and without requiring action of its shareholders or participants, issue and sell its capital notes or debentures. The notes or debentures must be subordinate to the claims of depositors and may be subordinate to other claims, including the claims of other creditors or classes of creditors or the shareholders or participants.

(b) Capital notes or debentures may be convertible into shares or participation shares of any class or series. The issuance and sale of convertible capital notes or debentures are subject to satisfaction of preemptive rights, if any, to the extent provided by law.

(c) Without the prior written approval of the banking commissioner, a state trust company may not pay interest due or principal repayable on outstanding capital notes or debentures when the state trust company is in hazardous condition or insolvent, as determined by the banking commissioner, or to the extent that payment will cause the state trust company to be in hazardous condition or insolvent.

(d) The amount of any outstanding capital notes or debentures that meet the requirements of this section and that are subordinated to unsecured creditors of the state trust company may be included in equity capital of the state trust company for purposes of determining hazardous condition or insolvency, and for such other purposes provided by rules adopted under this subtitle.

Sec. 182.105. Board Designation of Certified Surplus. Periodically the board may vote to designate and record in its minutes the amount of certified surplus. Except to absorb losses in excess of undivided profits and uncertified surplus, certified surplus may not be reduced without the prior written approval of the banking commissioner.

Subchapter C. State Trust Company Offices

Sec. 182.201. Conduct of Trust Business. A state trust company may engage in the trust business at its home office and at other locations as permitted by this subchapter.

Sec. 182.202. Home Office. (a) Each state trust company must have and continuously maintain in this state a home office. The home office must be a location at which the state trust company does business and keeps its corporate books and records. At least one executive officer must maintain an office at the home office.

(b) [Repealed][11]

(c) A state trust company may change its home office to any location in this state, if the location that is the home office before the change remains an office of the state trust company at which the state trust company does business. To change the location of its home office, the state trust company must file a written notice

[10] See 7 TAC §21.2, relating to filing and investigation fees.

[11] Repealed eff. Sept. 1, 2007, by 80th Tex. Leg., ch. 244 (H.B. 2219), §3.

with the banking commissioner setting forth the name of the state trust company, the street address of its home office before the change, the street address to which the home office is to be changed, and a copy of the resolution adopted by the board authorizing the change. The change of home office takes effect on the 31st day after the date the banking commissioner receives the notice.[12]

(d) A relocation of a state trust company's home office may not be made, and another action that would effect an abandonment of the state trust company's initial home office may not be taken, without the prior written approval of the banking commissioner. The state trust company must establish to the satisfaction of the banking commissioner that the abandonment is consistent with the original determination of public convenience and advantage for the establishment of a state trust company at that location.

Sec. 182.203. Additional Offices. (a) A state trust company may establish and maintain additional offices. To establish an additional office, the state trust company must file a written notice with the banking commissioner setting forth the name of the state trust company, the street address of the proposed additional office, a description of the activities proposed to be conducted at the additional office, and a copy of the resolution adopted by the board authorizing the additional office.[13]

(b) A state trust company may not commence business at the additional office before the 31st day after the date the banking commissioner receives the notice, unless the banking commissioner specifies an earlier or later date. The banking commissioner may specify a later date on a determination that the written notice raises issues that require additional information or additional time for analysis. If a later date is specified, the state trust company may establish the additional office only on prior written approval by the banking commissioner. The banking commissioner may deny permission to establish an additional office of the state trust company if the banking commissioner has a significant supervisory or regulatory concern regarding the proposed additional office, the applicant, or an affiliate.

[12] See 7 TAC §§21.2 and 21.41, relating to change of home office.

[13] See 7 TAC §§21.2 and 21.42, relating to additional offices. With respect to a trust office in another state, see Section 187.003, Finance Code.

Subchapter D. Merger

Sec. 182.301. Merger Authority. (a) Two or more trust institutions, corporations, or other entities with the authority to participate in a merger, at least one of which is a state trust company, may adopt and implement a plan of merger in accordance with this section. The merger may not be made without the prior written approval of the banking commissioner if any surviving, new, or acquiring entity that is a party to the merger or created by the terms of the merger is a state trust company or is not a trust institution.[14]

(b) Implementation of the plan of merger by the parties and approval of the board, shareholders, participants, or owners of the parties must be made or obtained as provided by the Business Organizations Code as if the state trust company were a filing entity and all other parties to the merger were foreign entities, except as otherwise provided by rules adopted under this chapter.

Sec. 182.302. Merger Application; Grounds for Approval. (a) To apply for approval of a merger, the parties must submit the original certificate of merger, a number of copies of the certificate of merger equal to the number of surviving, new, and acquiring entities, and an application in the form required by the banking commissioner. The banking commissioner may require the submission of additional information as considered necessary to an informed decision.[15]

(b) The banking commissioner shall investigate the condition of the merging parties.

(c) The banking commissioner may approve the merger if:

(1) each resulting state trust company:

(A) has complied with the statutes and rules relating to the organization of a state trust company; and

(B) will be solvent and have adequate capitalization for its business and location;

(2) all obligations and liabilities of each trust company that is a party to the merger have been

[14] With respect to establishing a trust office in another state by merger, see Section 187.003, Finance Code.

[15] See 7 TAC §§21.2 and 21.64, relating to application for merger or share exchange.

properly discharged or otherwise lawfully assumed or retained by a trust institution or other fiduciary;

(3) each surviving, new, or acquiring person that is not authorized to engage in the trust business will not engage in the trust business and has complied with the laws of this state; and

(4) all conditions imposed by the banking commissioner have been satisfied or otherwise resolved.

Sec. 182.303. Approval of Banking Commissioner. (a) If the banking commissioner approves the merger and finds that all required filing fees and investigative costs have been paid, the banking commissioner shall:

(1) endorse the face of the original and each copy of the certificate of merger with the date of approval and the word "Approved";

(2) file the original in the department's records; and

(3) deliver a certified copy of the certificate of merger to each surviving, new, or acquiring entity.

(b) A merger is effective on the date of approval, unless the merger agreement provides and the banking commissioner consents to a different effective date.

Sec. 182.304. Rights of Dissenters to Merger. A shareholder, participant, or participant-transferee may dissent from the merger to the extent and by following the procedure provided by the Business Organizations Code or rules adopted under this subtitle.

Subchapter E. Purchase or Sale of Assets

Sec. 182.401. Authority to Purchase Assets. (a) A state trust company may purchase assets from another trust institution, including the right to control accounts established with the trust institution, or assets from another seller, except that the prior written approval of the banking commissioner is required if the purchase price exceeds an amount equal to three times the sum of the trust company's equity capital less intangible assets. The finance commission by rule may require a state trust company to obtain the prior written approval of the banking commissioner for a transaction not otherwise subject to approval that involves potentially substantial risks to the safety and soundness of the purchasing trust company.

(b) Except as otherwise expressly provided by this section or another statute, the purchase of all or part of the assets of the selling entity does not make the purchasing state trust company responsible for any liability or obligation of the selling entity that the purchasing state trust company does not expressly assume.

(c) If prior approval of the banking commissioner is required under this section, an application in the form required by the banking commissioner must be filed with the banking commissioner. The banking commissioner shall investigate the condition of the purchaser and seller and may require the submission of additional information as considered necessary to make an informed decision.

(d) The banking commissioner shall approve the application to purchase if:

(1) the purchasing state trust company:

(A) has complied with all applicable statutes and rules; and

(B) will be solvent and have sufficient capitalization for its business and location;

(2) all fiduciary obligations and liabilities of each trust institution that is a party to the purchase or sale of assets have been properly discharged or otherwise lawfully assumed or retained by a trust institution or other fiduciary;

(3) all conditions imposed by the banking commissioner have been satisfied or otherwise resolved; and

(4) all fees and costs have been paid.

(e) A purchase subject to prior approval is effective on the date of approval unless the purchase agreement provides for and the banking commissioner consents to a different effective date.

(f) If the purchase transaction includes all or substantially all of the assets of another trust institution or other fiduciary, the acquiring state trust company shall succeed by operation of law to all of the rights, privileges, and fiduciary obligations of the selling trust institution or other fiduciary under each account included in the assets acquired.

Sec. 182.402. Authority to Act as Disbursing Agent. (a) The purchasing state trust company may hold the purchase price and any additional funds delivered to it by the selling institution in trust for the selling institution and may act as agent of the selling institution in disbursing those funds in trust by paying the creditors of the selling institution.

(b) If the purchasing state trust company acts under written contract of agency approved by the banking commissioner that specifically names each creditor and the amount to be paid each, and if the agency is limited to the purely ministerial act of paying creditors the amounts due them as determined by the selling institution and reflected in the contract of agency and does not involve discretionary duties or authority other than the identification of the creditors named, the purchasing trust company:

(1) may rely on the contract of agency and the instructions included in it; and

(2) is not responsible for:

(A) any error made by the selling institution in determining its liabilities and creditors to whom the liabilities are due or the amounts due the creditors; or

(B) any preference that results from the payments made under the contract of agency and the instructions included in it.

Sec. 182.403. Liquidation of Selling Institution. If the selling institution is at any time after the sale of assets voluntarily or involuntarily closed for liquidation by a state or federal regulatory agency, the purchasing state trust company shall pay to the receiver of the selling institution the balance of the money held by it in trust for the selling institution and not yet paid to the creditors of the selling institution. Without further action the purchasing state trust company is discharged of all responsibilities to the selling institution, its receiver, or its creditors, shareholders, participants, or participant-transferees.

Sec. 182.404. Payment to Creditors. The purchasing state trust company may pay a creditor of the selling institution the amount to be paid the creditor under the terms of the contract of agency by opening an agency account in the name of the creditor, crediting the account with the amount to be paid the creditor under the terms of the agency contract, and mailing or personally delivering a duplicate ticket evidencing the credit to the creditor at the creditor's address shown in the records of the selling institution. The relationship between the purchasing state trust company and the creditor is that of agent to creditor only to the extent of the credit reflected by the ticket.

Sec. 182.405. Sale of Assets. (a) A state trust company may sell all or any portion of its assets to another trust institution or other buyer, except that the prior written approval of the banking commissioner is required if the sales price exceeds an amount equal to three times the sum of the trust company's equity capital less intangible assets. The finance commission by rule may require a state trust company to obtain the prior written approval of the banking commissioner for a transaction not otherwise subject to approval that involves potentially substantial risks to the safety and soundness of the selling trust company.

(b) If the prior approval of the banking commissioner for a sale of assets is not required under Subsection (a) and the sale involves the disposition of an established location of the state trust company, the state trust company must provide written notice of the transaction to the banking commissioner at least 30 days before the expected closing date of the transaction.

(c) The board of a state trust company, with the banking commissioner's approval, may cause the state trust company to sell all or substantially all of its assets, including the right to control accounts established with the state trust company, without shareholder or participant approval if:

(1) the banking commissioner finds that the interests of the state trust company's clients, depositors, and creditors are jeopardized because of the hazardous condition of the state trust company and that the sale is in their best interest; and

(2) the Federal Deposit Insurance Corporation or its successor approves the transaction, if the deposits of the state trust company are insured.

(d) A sale under Subsection (c) must include an assumption and promise by the buyer to pay or otherwise discharge:

(1) all of a state trust company's liabilities to clients and depositors;

(2) all of the state trust company's liabilities for salaries of the state trust company's employees incurred before the date of the sale;

(3) obligations incurred by the banking commissioner arising out of the supervision or sale of the state trust company; and

(4) fees and assessments due the department.

(e) This section does not affect the banking commissioner's right to take action under another law. The sale by a state trust company of all or substantially all of its assets with shareholder or participant approval is considered a voluntary dissolution and liquidation and is governed by Subchapter B, Chapter 186.

(f) Each buyer in a transaction described by Subsection (c) that is a trust institution or other fiduciary shall succeed by operation of law to all of the rights, privileges, and fiduciary obligations of the selling state trust company under each account included in the assets acquired.

Subchapter F. Exit of State Trust Company or Entry of Another Trust Institution

Sec. 182.501. Merger or Conversion of State Trust Company into Another Trust Institution Exercising Fiduciary Powers. (a) Subject to Chapter 187, a state trust company may act as necessary and to the extent permitted by the laws of the United States, this state, another state, or another country to merge or convert into another form of trust institution.

(b) The merger or conversion must be made and approval of the state trust company's board, shareholders, or participants must be obtained in accordance with the Business Organizations Code as if the state trust company were a filing entity and all other parties to the transaction, if any, were foreign entities, except as may be otherwise provided by rule. For purposes of this subsection, a conversion is considered a merger into the successor trust institution.

(c) The state trust company does not cease to be a state trust company subject to the supervision of the banking commissioner unless:

(1) the banking commissioner has been given written notice of the intention to merge or convert before the 31st day before the date of the proposed transaction;[16]

(2) the state trust company has filed with the banking commissioner:

(A) a copy of the application filed with the successor regulatory authority, including a copy of each contract evidencing or implementing the merger or conversion, or other documents sufficient to show compliance with applicable law; and

(B) a certified copy of all minutes of board meetings and shareholder or participant meetings at which action was taken regarding the merger or conversion;

(3) the banking commissioner determines that:

(A) all accounts and liabilities of the state trust company are fully discharged, assumed, or otherwise retained by the successor trust institution;

(B) any conditions imposed by the banking commissioner for the protection of clients and creditors have been met or otherwise resolved; and

(C) any required filing fees have been paid; and

(4) the state trust company has received a certificate of authority to do business as the successor trust institution.

Sec. 182.502. Conversion of Trust Institution into State Trust Company. (a) A trust institution may apply to the banking commissioner for conversion into a state trust company on a form prescribed by the banking commissioner and accompanied by any required fee if the trust institution follows the procedures prescribed by the laws of the United States, this state, another state, or another country governing the exit of the trust institution for the purpose of conversion into a state trust company from the regulatory system applicable before the conversion. A trust association or limited trust association may convert its organizational form under this section.

(b) A trust institution applying to convert into a state trust company may receive a certificate of authority to do business as a state trust company if the banking commissioner finds that:

(1) the trust institution is not engaging in a pattern or practice of unsafe and unsound fiduciary or banking practices;

(2) the trust institution has adequate capitalization for a state trust company to act as a fiduciary at the same locations as the trust institution is acting as a fiduciary before the conversion;

(3) the trust institution can be expected to operate profitably after the conversion;

(4) the officers and directors of the trust institution as a group have sufficient banking

[16] See 7 TAC §21.67, relating to notice of merger or conversion into another fiduciary institution.

experience, ability, standing, competence, trustworthiness, and integrity to justify a belief that the trust institution will operate as a state trust company in compliance with law; and

(5) each principal shareholder has sufficient experience, ability, standing, competence, trustworthiness, and integrity to justify a belief that the trust institution will be free from improper or unlawful influence or interference with respect to the trust institution's operation as a state trust company in compliance with law.

(c) The banking commissioner may:

(1) request additional information considered necessary to make an informed decision under this section;

(2) perform an examination of the converting trust institution at the expense of the converting trust institution; and

(3) require that examination fees be paid before a certificate of authority is issued.

(d) In connection with the application, the converting trust institution must:

(1) submit a statement of the law governing the exit of the trust institution from the regulatory system applicable before the conversion and the terms of the transition into a state trust company; and

(2) demonstrate that all applicable law has been fully satisfied.

CHAPTER 183. OWNERSHIP AND MANAGEMENT OF STATE TRUST COMPANY

Subchapter A. Transfer of Ownership Interest

Subchapter B. Board and Officers

Subchapter C. Limited Trust Association

CHAPTER 183. OWNERSHIP AND MANAGEMENT OF STATE TRUST COMPANY

Subchapter A. Transfer of Ownership Interest

Sec. 183.001. Acquisition of Control. (a) Except as expressly permitted by this subtitle, without the prior written approval of the banking commissioner a person may not directly or indirectly acquire a legal or beneficial interest in voting securities of a state trust company or a corporation or other entity owning voting securities of a state trust company if, after the acquisition, the person would control the state trust company.

(b) For purposes of this subchapter and except as otherwise provided by rules adopted under this subtitle, the principal shareholder or principal participant of a state trust company that directly or indirectly owns or has the power to vote a greater percentage of voting securities of the state trust company than any other shareholder or participant is considered to control the state trust company.[1]

[1] This provision was originally enacted effective September 1, 1997. A principal shareholder or participant affected by this provision as of September 1, 1997, is not required to file a change of control application under Section 183.002, Finance

(c) This subchapter does not prohibit a person from negotiating to acquire, but not acquiring, control of a state trust company or a person that controls a state trust company.

(d) This section does not apply to:

(1) the acquisition of securities in connection with the exercise of a security interest or otherwise in full or partial satisfaction of a debt previously contracted for in good faith if the acquiring person files written notice of acquisition with the banking commissioner before the person votes the securities acquired;

(2) the acquisition of voting securities in any class or series by a controlling person who has previously complied with and received approval under this subchapter or who was identified as a controlling person in a prior application filed with and approved by the banking commissioner;

(3) an acquisition or transfer by operation of law, will, or intestate succession if the acquiring person files written notice of acquisition with the banking commissioner before the person votes the securities acquired; or

(4) a transaction exempted by the banking commissioner or by rules adopted under this subtitle because the transaction is not within the purposes of this subchapter or the regulation of which is not necessary or appropriate to achieve the objectives of this subchapter.

Sec. 183.002. Application Regarding Acquisition of Control. (a) The transferee in an acquisition of control of a state trust company or of a person that controls a state trust company must file an application for approval of the acquisition.[2] The application must:

(1) be under oath and on a form prescribed by the banking commissioner;

(2) contain all information that:

(A) is required by rules adopted under this subtitle; or

(B) the banking commissioner requires in a particular application as necessary to an informed decision to approve or reject the acquisition; and

(3) be accompanied by any filing fee required by statute or rule.

(b) If a person proposing to acquire voting securities in a transaction subject to this section includes a group of persons acting in concert, the information required by the banking commissioner may be required of each member of the group.

(c) Rules adopted under this subtitle may specify the confidential or nonconfidential character of information obtained by the banking commissioner under this section. In the absence of rules, information obtained by the banking commissioner under this section is confidential and may not be disclosed by the banking commissioner or any employee of the department except as provided by Subchapter D, Chapter 181.[3]

(d) The applicant shall publish notice of the application, its date of filing, the identity of each applicant, and, if the applicant includes a group, the identity of each group member. The notice must be published in the form and frequency specified by the banking commissioner and in a newspaper of general circulation in the county where the state trust company's home office is located, or in another publication or location as directed by the banking commissioner.

(e) The applicant may defer publication of the notice until not later than the 34th day after the date the application is filed if:

(1) the application is filed in contemplation of a public tender offer subject to 15 U.S.C. Section 78n(d)(1);

(2) the applicant requests confidential treatment and represents that a public announcement of the tender offer and the filing of appropriate forms with the Securities and Exchange Commission or the appropriate federal banking agency, as applicable, will occur within the period of deferral; and

(3) the banking commissioner determines that the public interest will not be harmed by the requested confidential treatment.

(f) The banking commissioner may waive the requirement that a notice be published or permit delayed publication on a determination that waiver or delay is in

Code, until the person acquires one or more additional shares or participation shares of the trust company on or after September 1, 1997 (Acts 1997, 75th Leg. R.S., ch. 769, §14).

[2] See 7 TAC §§21.2 and 21.51, relating to application for change of control.

[3] See 7 TAC §3.111, relating to confidential information.

the public interest. If publication of notice is waived under this subsection, the information that would be contained in a published notice becomes public information under Chapter 552, Government Code, on the 35th day after the date the application is filed.

Sec. 183.003. Hearing and Decision on Acquisition of Control. (a) Not later than the 60th day after the date the notice is published, the banking commissioner shall approve the application or set the application for hearing. If the banking commissioner sets a hearing, the department shall participate as the opposing party and the banking commissioner shall conduct a hearing and one or more prehearing conferences and opportunities for discovery as the banking commissioner considers advisable and consistent with governing statutes and rules. A hearing held under this section is confidential and closed to the public.[4]

(b) Based on the record, the banking commissioner may issue an order denying an application if:

(1) the acquisition would substantially lessen competition, be in restraint of trade, result in a monopoly, or be in furtherance of a combination or conspiracy to monopolize or attempt to monopolize the trust industry in any part of this state, unless:

(a) the anticompetitive effects of the acquisition are clearly outweighed in the public interest by the probable effect of acquisition in meeting the convenience and needs of the community to be served; and

(B) the acquisition is not in violation of the law of this state or the United States;

(2) the financial condition of the transferee, or any member of a group comprising the transferee, might jeopardize the financial stability of the state trust company being acquired;

(3) plans or proposals to operate, liquidate, or sell the state trust company or its assets are not in the best interest of the state trust company;

(4) the experience, ability, standing, competence, trustworthiness, and integrity of the transferee, or any member of a group comprising the transferee, are insufficient to justify a belief that the state trust company will be free from improper or unlawful influence or interference with respect to the state trust company's operation in compliance with law;

(5) the state trust company will not be solvent, have adequate capitalization, or be in compliance with the laws of this state after the acquisition;

(6) the transferee has failed to furnish all information pertinent to the application reasonably required by the banking commissioner; or

(7) the transferee is not acting in good faith.

(c) If the banking commissioner approves the application, the transaction may be consummated. If the approval is conditioned on a written commitment from the transferee offered to and accepted by the banking commissioner, the commitment is:

(1) enforceable against the state trust company and the transferee; and

(2) considered for all purposes an agreement under this subtitle.

Sec. 183.004. Appeal from Adverse Decision. (a) If a hearing has been held, the banking commissioner has entered an order denying the application, and the order has become final, the transferee may appeal the final order by filing a petition for judicial review.

(b) The filing of an appeal under this section does not stay the order of the banking commissioner.

Sec. 183.005. Objection to Other Transfer. This subchapter does not prevent the banking commissioner from investigating, commenting on, or seeking to enjoin or set aside a transfer of voting securities that evidence a direct or indirect interest in a state trust company, regardless of whether the transfer is governed by this subchapter, if the banking commissioner considers the transfer to be against the public interest.

Sec. 183.006. Civil Enforcement; Criminal Penalty. (a) If the banking commissioner believes that a person has violated or is about to violate this subchapter or a rule or order of the banking commissioner relating to this subchapter, the attorney general on behalf of the banking commissioner may apply to a district court in Travis County for an order enjoining the violation and for other equitable relief the nature of the case requires.

[4] See 7 TAC §§9.11-9.39, relating to rules of procedure in contested case hearings.

(b) A person who knowingly fails or refuses to file the application required by Section 183.002 commits an offense. An offense under this subsection is a Class A misdemeanor.

Subchapter B. Board and Officers

Sec. 183.101. Voting Securities Held by Trust Company. (a) Voting securities of a state trust company held by the state trust company in a fiduciary capacity under a will or trust, whether registered in its own name or in the name of its nominee, may not be voted in the election of directors or managers or on a matter affecting the compensation of directors, managers, officers, or employees of the state trust company in that capacity, unless:

(1) under the terms of the will or trust, the manner in which the voting securities are to be voted may be determined by a donor or beneficiary of the will or trust and the donor or beneficiary actually makes the determination in the matter at issue;

(2) the terms of the will or trust expressly direct the manner in which the securities must be voted to the extent that discretion is not vested in the state trust company as fiduciary; or

(3) the securities are voted solely by a cofiduciary that is not an affiliate of the state trust company, as if the cofiduciary were the sole fiduciary.

(b) Voting securities of a state trust company that cannot be voted under this section are considered to be authorized but unissued for purposes of determining the procedures for and results of the affected vote.

Sec. 183.102. Bylaws. Except as provided by Section 183.207, each state trust company shall adopt bylaws and may amend its bylaws from time to time for the purposes and in accordance with the procedures set forth in the Texas Business Corporation Act.

Sec. 183.103. Board of Directors, Managers, or Managing Participants. (a) The board of a state trust company must consist of not fewer than five or more than 25 directors, managers, or managing participants, the majority of whom must be residents of this state. Except for a limited trust association in which management has been retained by its participants, the principal executive officer of the state trust company is a member of the board. The principal executive officer acting in the capacity of board member is the board's presiding officer unless the board elects a different presiding officer to perform the duties as designated by the board.

(b) Unless the banking commissioner consents otherwise in writing, a person may not serve as director, manager, or managing participant of a state trust company if:

(1) the state trust company incurs an unreimbursed loss attributable to a charged-off obligation of or holds a judgment against:

(A) the person; or

(B) an entity that was controlled by the person at the time of funding and at the time of default on the loan that gave rise to the judgment or charged-off obligation;

(2) the person is the subject of an order described by Section 185.007(a);

(3) the person has been convicted of a felony; or

(4) the person has violated, with respect to a trust under which the state trust company has fiduciary responsibility, Section 113.052 or 113.053(a), Property Code, relating to loan of trust funds and purchase or sale of trust property by the trustee, and the violation has not been corrected.

(c) If a state trust company other than a limited trust association operated by managing participants does not elect directors or managers before the 61st day after the date of its regular annual meeting, the banking commissioner may appoint a conservator under Chapter 185 to operate the state trust company and elect directors or managers, as appropriate. If the conservator is unable to locate or elect persons willing and able to serve as directors or managers, the banking commissioner may close the state trust company for liquidation.

(d) A vacancy on the board that reduces the number of directors, managers, or managing participants to fewer than five must be filled not later than the 30th day after the date the vacancy occurs. A limited trust association with fewer than five managing participants must add one or more new participants or elect a board of managers of not fewer than five persons to resolve the vacancy. After the 30th day after the date the vacancy occurs, the banking commissioner may appoint a conservator under Chapter 185 to operate the state trust company and elect a board of not fewer than five persons to resolve the vacancy. If the conservator is unable to locate or elect five persons willing and able to serve as directors or managers, the banking commissioner may close the state trust company for liquidation.

(e) Before each term to which a person is elected to serve as a director or manager of a state trust company, or annually for a person who is a managing participant, the person shall submit an affidavit for filing in the minutes of the state trust company stating that the person, to the extent applicable:

(1) accepts the position and is not disqualified from serving in the position;

(2) will not violate or knowingly permit an officer, director, manager, managing participant, or employee of the state trust company to violate any law applicable to the conduct of business of the trust company; and

(3) will diligently perform the duties of the position.

Sec. 183.104. Advisory Director or Advisory Manager. (a) An advisory director or advisory manager is not considered to be a director if the advisory director or advisory manager:

(1) is not elected by the shareholders or participants of the state trust company;

(2) does not vote on matters before the board or a committee of the board;

(3) is not counted for purposes of determining a quorum of the board or committee; and

(4) provides solely general policy advice to the board.

(b) A state trust company may not disclose to an advisory director or advisory manager confidential information pertaining to the state trust company or the company's clients unless:

(1) the board adopts a resolution that designates the advisory director or advisory manager as a person who is officially connected to the trust company and that describes the purpose for disclosure of the information, which must be a reasonable business purpose; and

(2) the disclosure is made under a written confidentiality agreement between the state trust company and the advisory director or advisory manager.

Sec. 183.105. Required Quarterly Board Meeting. (a) The board of a state trust company shall hold at least one regular meeting each quarter.

(b) At each regular meeting the board shall review and approve the minutes of the preceding meeting and review the operations, activities, and financial condition of the state trust company. The board may designate committees from among its members to perform those duties and approve or disapprove the committees' reports at each regular meeting.

(c) All actions of the board must be recorded in its minutes.

Sec. 183.106. Officers. (a) The board shall annually appoint the officers of the state trust company, who serve at the will of the board.

(b) The state trust company must have a principal executive officer primarily responsible for the execution of board policies and operation of the state trust company and an officer responsible for the maintenance and storage of all corporate books and records of the state trust company [5] and for required attestation of signatures. Those positions may not be held by the same person.

(c) The board may appoint other officers of the state trust company as the board considers necessary.

Sec. 183.107. Limitation on Action of Officer or Employee in Relation to Asset or Liability. Unless expressly authorized by a resolution of the board recorded in its minutes, an officer or employee may not create or dispose of a state trust company asset or create or incur a liability on behalf of the state trust company.

Sec. 183.108. Certain Criminal Offenses. (a) An officer, director, manager, managing participant, employee, shareholder, or participant of a state trust company commits an offense if the person knowingly:

(1) conceals information or removes, destroys, or conceals a book or record of the state trust company for the purpose of concealing information from the banking commissioner or an agent of the banking commissioner; or

(2) for the purpose of concealing, removes or destroys any book or record of the state trust company that is material to a pending or anticipated legal or administrative proceeding.

(b) An officer, director, manager, managing participant, or employee of a state trust company commits an offense if the person knowingly makes a false entry in a

[5] See 7 TAC §17.21, relating to physical location of records required for examination.

book, record, report, or statement of the state trust company.

(c) An offense under this section is a felony of the third degree.

Sec. 183.109. Transactions with Management and Affiliates. (a) Without the prior approval of a disinterested majority of the board recorded in the minutes, or if a disinterested majority cannot be obtained, the prior written approval of the banking commissioner,[6] a state trust company may not directly or indirectly:

(1) sell or lease an asset of the state trust company to an officer, director, manager, managing participant, or principal shareholder or participant of the state trust company or an affiliate of the state trust company;

(2) purchase or lease an asset in which an officer, director, manager, managing participant, or principal shareholder or participant of the state trust company or an affiliate of the state trust company has an interest; or

(3) subject to Section 184.201, extend credit to an officer, director, manager, managing participant, or principal shareholder or participant of the state trust company or an affiliate of the state trust company.

(b) Notwithstanding Subsection (a), a lease transaction described in Subsection (a)(2) involving real property may not be consummated, renewed, or extended without the prior written approval of the banking commissioner. For purposes of this subsection only, an affiliate of a state trust company does not include a subsidiary of the state trust company.

(c) Subject to Section 184.201, a state trust company may not directly or indirectly extend credit to an employee, officer, director, manager, managing participant, or principal shareholder or participant of the state trust company or to an affiliate of the state trust company, unless:

(1) the extension of credit is made on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions by the state trust company with persons who are not employees, officers, directors, managers, managing participants, principal shareholders, participants, or affiliates of the state trust company;

(2) the extension of credit does not involve more than the normal risk of repayment or present other unfavorable features; and

(3) the state trust company follows credit underwriting procedures that are not less stringent than those applicable to comparable transactions by the state trust company with persons who are not employees, officers, directors, managers, managing participants, principal shareholders, participants, or affiliates of the state trust company.

(d) An officer, director, manager, or managing participant of a state trust company who knowingly participates in or permits a violation of this section commits an offense. An offense under this subsection is a felony of the third degree.

(e) The finance commission may adopt rules to administer and carry out this section, including rules to establish limits, requirements, or exemptions other than those specified by this section for particular categories of transactions.

Sec. 183.110. Fiduciary Responsibility. The board of a state trust company is responsible for the proper exercise of fiduciary powers by the state trust company and each matter pertinent to the exercise of fiduciary powers, including:

(1) the determination of policies;

(2) the investment and disposition of property held in a fiduciary capacity; and

(3) the direction and review of the actions of each officer, employee, and committee used by the state trust company in the exercise of its fiduciary powers.

Sec. 183.111. Recordkeeping. A state trust company shall keep its fiduciary records separate and distinct from other records of the state trust company in compliance with applicable rules adopted under this subtitle. The fiduciary records must contain all appropriate material information relative to each account.

Sec. 183.112. Bonding Requirements. (a) The board of a state trust company shall require a bond for the protection and indemnity of clients, in reasonable amounts established by rules adopted under this subtitle, against dishonesty, fraud, defalcation, forgery, theft, and other similar insurable losses.[7] The bond must be with a corporate insurance or surety company:

[6] See 7 TAC §17.3, relating to sale or lease agreements with officer, director, principal shareholder, or affiliate.

[7] See 7 TAC §17.4, relating to bonding requirements.

(1) authorized to do business in this state; or

(2) acceptable to the banking commissioner and otherwise lawfully permitted to issue the coverage against those losses in this state.

(b) Except as otherwise provided by rule, a bond is required to cover each director, manager, managing participant, officer, and employee of a state trust company without regard to whether the person receives salary or other compensation.

(c) A state trust company may apply to the banking commissioner for permission to eliminate the bonding requirement of this section for a particular individual. The banking commissioner shall approve the application if the banking commissioner finds that the bonding requirement is unnecessary or burdensome. Unless the application presents novel or unusual questions, the banking commissioner shall approve the application or set the application for hearing not later than the 61st day after the date the banking commissioner considers the application complete and accepted for filing.

Sec. 183.113. Reports of Apparent Crime. (a) A state trust company that is the victim of a robbery, has a shortage of corporate or fiduciary funds in excess of $5,000, or is the victim of an apparent or suspected misapplication of its corporate or fiduciary funds or property in any amount by a director, manager, managing participant, officer, or employee shall report the robbery, shortage, or apparent or suspected misapplication of funds or property to the banking commissioner within 48 hours after the time it is discovered. The initial report may be oral if the report is promptly confirmed in writing. The state trust company or a director, manager, managing participant, officer, employee, or agent is not subject to liability for defamation or another charge resulting from information supplied in the report.

(b) A report filed with the banking commissioner under this section may be a copy of a written report filed with an appropriate federal agency.

Subchapter C. Limited Trust Association

Sec. 183.201. Liability of Participants and Managers. (a) Except as provided by Subsection (b), a participant, participant-transferee, or manager of a limited trust association is not liable for a debt, obligation, or liability of the limited trust association, including a debt, obligation, or liability under a judgment, decree, or order of court. A participant, other than a full liability participant, or a manager of a limited trust association is not a proper party to a proceeding by or against a limited trust association unless the object of the proceeding is to enforce the participant's or manager's right against or liability to a limited trust association.

(b) A full liability participant of a limited trust association is liable under a judgment, decree, or order of court for a debt, obligation, or liability of the limited trust association that accrued during the participation of the full liability participant in the limited trust association and before the full liability participant or a successor in interest filed with the banking commissioner a notice of withdrawal as a full liability participant from the limited trust association. The filed notice of withdrawal is a public record.

Sec. 183.202. Filing of Notice of Full Liability. (a) A limited trust association shall file with the banking commissioner a copy of any participation agreement by which a participant of the limited trust association agrees to become a full liability participant and the name and address of each full liability participant. Only the portion of the filed copy containing the designation of each full liability participant is a public record.

(b) The banking commissioner may require a complete copy of the participation agreement to be filed with the department, regardless of whether a state trust company has a full liability participant, except that the provisions of the participation agreement other than those by which a participant of the limited trust association agrees to become a full liability participant are confidential and subject to release only as provided by Subchapter D, Chapter 181.

Sec. 183.203. Contracting for Debt or Obligation. Except as provided by this section or the certificate of formation of the limited trust association, a debt, liability, or other obligation may be contracted for or incurred on behalf of a limited trust association only by:

(1) a majority of the managers, if management of the limited trust association has been vested in a board of managers;

(2) a majority of the managing participants; or

(3) an officer or other agent vested with actual or apparent authority to contract for or incur the debt, liability, or other obligation.

Sec. 183.204. Management of Limited Trust Association. (a) Management of a limited trust association is vested in the participants in proportion to each participant's contribution to capital, as adjusted periodically to properly reflect any additional contribution. The certificate of formation may provide that management of a limited trust association is vested in a board of managers to be elected annually by the participants as prescribed by the bylaws or the participation agreement.

(b) Participants of a limited trust association may not retain management and must elect a board of managers if:

(1) any participant is disqualified from serving as a managing participant under Section 183.103;

(2) the limited trust association has fewer than five or more than 25 participants; or

(3) any participant has been removed by the banking commissioner under Subchapter A, Chapter 185.

(c) The certificate of formation, bylaws, and participation agreement of a limited trust association may use the term "director" instead of "manager" and the term "board" instead of "board of managers."

Sec. 183.205. Withdrawal or Reduction of Participant's Contribution to Capital. (a) Except as otherwise provided by this chapter, a participant may not receive from a limited trust association any part of the participant's contribution to capital unless:

(1) all liabilities of the limited trust association, except liabilities to participants on account of contribution to capital, have been paid;

(2) after the withdrawal or reduction, sufficient property of the limited trust association will remain to pay all liabilities of the limited trust association, except liabilities to participants on account of contribution to capital;

(3) all participants consent; or

(4) the certificate of formation is canceled or amended to set out the withdrawal or reduction.

(b) A participant may demand the return of the participant's contribution to capital on the dissolution of the association and the failure of the full liability participants to exercise the right to carry on the business of the limited trust association as provided by Section 183.208.

(c) A participant may demand the return of the participant's contribution to capital only in cash unless a different form of return of the contribution is allowed by the certificate of formation or by the unanimous consent of all participants.

Sec. 183.206. Interest in Limited Trust Association; Transferability of Interest. (a) The interest of a participant or participant-transferee in a limited trust association is the personal property of the participant or the participant-transferee and may be transferred as provided by the bylaws or the participation agreement.

(b) A transferee of a participant's interest has the status of a participant-transferee and does not by the transfer become a participant or obtain a right to participate in the management of the limited trust association.

(c) A participant-transferee is entitled to receive only a share of profits, return of contribution, or other distributive benefit in respect to the interest transferred to which the participant who transferred the interest would have been entitled.

(d) A participant-transferee may become a participant only as provided by the bylaws or the participation agreement.

(e) A limited trust association may add additional participants in the same manner as participant-transferees after payment in full of the capital contribution to the limited trust association payable for the issuance of additional participation interests.

Sec. 183.207. Bylaws of Limited Trust Association. (a) A limited trust association in which management is retained by the participants is not required to adopt bylaws if the provisions required by law to be contained in the bylaws are contained in the certificate of formation or the participation agreement.

(b) If a limited trust association has adopted bylaws that designate each full liability participant, the limited trust association shall file a copy of the bylaws with the banking commissioner. Only the portion of the bylaws designating each full liability participant is a public record.

Sec. 183.208. Dissolution. (a) A limited trust association organized under this chapter is dissolved on:

(1) the expiration of the period fixed for the duration of the limited trust association;

(2) a vote to dissolve or the execution of a written consent to dissolve by all full liability participants, if any, and a sufficient number of other participants that, combined with all full liability participants, hold at least two-thirds of the participation shares in each class in the association, or a greater fraction as provided by the certificate of formation;

(3) except as provided by the certificate of formation, the death, insanity, expulsion, bankruptcy, retirement, or resignation of a participant unless a majority in interest of all remaining participants elect in writing not later than the 90th day after the date of the event to continue the business of the association; or

(4) the occurrence of an event of dissolution specified in the certificate of formation.

(b) A dissolution under this section is considered to be the initiation of a voluntary dissolution under Subchapter B, Chapter 186.

(c) An event of dissolution described by Subsection (a)(3) does not cancel or revoke a contract to which the limited trust association is a party, including a trust indenture or agreement or voluntary dissolution under Subchapter B, Chapter 186, until the period for the remaining participants to continue the business of the limited trust association has expired without the remaining participants having completed the necessary action to continue the business of the limited trust association.

Sec. 183.209. Allocation of Profits and Losses. The profits and losses of a limited trust association may be allocated among the participants and among classes of participants as provided by the participation agreement. Without the prior written approval of the banking commissioner to use a different allocation method, the profits and losses must be allocated according to the relative interests of the participants as reflected in the certificate of formation and related documents filed with and approved by the banking commissioner.

Sec. 183.210. Distributions. Subject to Section 182.103, distributions of cash or other assets of a limited trust association may be made to the participants as provided by the participation agreement. Without the prior written approval of the banking commissioner to use a different distribution method, distributions must be made to the participants according to the relative interests of the participants as reflected in the certificate of formation and related documents filed with and approved by the banking commissioner.

Sec. 183.211. Application of Other Provisions to Limited Trust Associations. For purposes of applying the provisions of this subtitle other than this subchapter to a limited trust association, as the context requires:

(1) a manager and the board of managers are considered to be a director and the board of directors;

(2) if there is not a board of managers, a participant is considered to be a director and all of the participants are considered to be the board of directors;

(3) a participant or participant-transferee is considered to be a shareholder;

(4) a participation share is considered to be a share of stock; and

(5) a distribution is considered to be a dividend.

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CHAPTER 184. INVESTMENTS, LOANS, AND DEPOSITS

Subchapter A. Acquisition and Ownership of Trust Company Facilities and Other Real Property

Subchapter B. Investments

Subchapter C. Loans

Subchapter D. Trust Deposits

Subchapter E. Liabilities and Pledge of Assets

CHAPTER 184. INVESTMENTS, LOANS, AND DEPOSITS

Subchapter A. Acquisition and Ownership of Trust Company Facilities and Other Real Property

Sec. 184.001. Definition. In this subchapter, “state trust company facility” means real property, including an improvement, that a state trust company owns or leases, to the extent the lease or the leasehold improvement is capitalized, for the purpose of:

(1) providing space for state trust company employees to perform their duties and for state trust company employees and customers to park;

(2) conducting trust business, including meeting the reasonable needs and convenience of the public and the state trust company’s clients, computer operations, document and other item processing, maintenance, and record retention and storage;

(3) holding, improving, and occupying as an incident to future expansion of the state trust company’s facilities; or

(4) conducting another activity authorized by rules adopted under this subtitle.

Sec. 184.002. Investment in State Trust Company Facilities. (a) Without the prior written approval of the banking commissioner, a state trust company may not directly or indirectly invest an amount in excess of the company’s restricted capital in state trust company facilities, furniture, fixtures, and equipment. Except as otherwise provided by rules adopted under this subtitle, in computing the limitation provided by this subsection a state trust company:

(1) shall include:

(A) its direct investment in state trust company facilities;

(B) an investment in equity or investment securities of a company holding title to a facility used by the state trust company for the purposes specified by Section 184.001;

(C) a loan made by the state trust company to or on the security of equity or investment securities issued by a company holding title to a facility used by the state trust company; and

(D) any indebtedness incurred on state trust company facilities by a company:

(i) that holds title to the facility;

(ii) that is an affiliate of the state trust company; and

(iii) in which the state trust company is invested in the manner described by Paragraph (B) or (C); and

(2) may exclude an amount included under Subdivisions (1)(B)-(D) to the extent any lease of a facility from the company holding title to the facility is capitalized on the books of the state trust company.

(b) Real property described by Subsection 184.001(3) and not improved and occupied by the state trust company ceases to be a state trust company facility on the third anniversary of the date of its acquisition unless the banking commissioner on application grants written approval to further delay in the improvement and occupation of the property by the state trust company.

(c) A state trust company shall dispose of any real property subject to Subsection (a) not later than the fifth anniversary of the date the real property:

(1) was acquired, except as otherwise provided by rules adopted under this subtitle;

(2) ceases to be used as a state trust company facility; or

(3) ceases to be a state trust company facility as provided by Subsection (b).

Sec. 184.003. Other Real Property.[1] (a) A state trust company may not invest its restricted capital in real property except:

(1) as permitted by this subtitle or rules adopted under this subtitle; or

(2) as necessary to avoid or minimize a loss on a loan or investment previously made in good faith.

(b) With the prior written approval of the banking commissioner, a state trust company may:

(1) exchange real property for other real property or personal property;

(2) invest additional money in or improve real property acquired under this subsection or Subsection (a); or

(3) acquire additional real property to avoid or minimize loss on real property acquired as permitted by Subsection (a).

(c) A state trust company shall dispose of any real property subject to Subsection (a) not later than:

(1) the fifth anniversary of the date the real property:

(A) was acquired, except as otherwise provided by rules adopted under this subtitle; or

(B) ceases to be used as a state trust company facility; or

(2) the second anniversary of the date the real property ceases to be a state trust company facility as provided by Section 184.002(b).

(d) The banking commissioner on application may grant one or more extensions of time for disposing of real property under Subsection (c) if the banking commissioner determines that:

(1) the state trust company has made a good faith effort to dispose of the real property; or

(2) disposal of the real property would be detrimental to the state trust company.

(e) Subject to the exercise of prudent judgment, a state trust company may invest its secondary capital in real property. The factors to be considered by a state trust company in exercise of prudent judgment include the factors contained in Section 184.101(f).

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[1] See 7 TAC §19.51, relating to other real estate owned; also see Policy Memorandum (Interpretive Statement) No. 1008, relating to policy for other real estate owned.

Subchapter B. Investments

Sec. 184.101. Securities. (a) A state trust company may invest its restricted capital in any type or character of equity or investment securities under the limitations provided by this section.

(b) Unless the banking commissioner in writing approves maintenance of a lesser amount, a state trust company must invest and maintain an amount equal to at least 50 percent of the state trust company's restricted capital under Section 182.008 in investment securities that are readily marketable and can be converted to cash within four business days.

(c) Subject to Subsection (d), the total investment of its restricted capital in equity and investment securities of any one issuer, obligor, or maker, and the total investment of its restricted capital in mutual funds, held by the state trust company for its own account, may not exceed an amount equal to 15 percent of the state trust company's restricted capital. [2] The banking commissioner may authorize investments in excess of this limitation on written application if the banking commissioner determines that:

(1) the excess investment is not prohibited by other applicable law; and

(2) the safety and soundness of the requesting state trust company is not adversely affected.

(d) Notwithstanding Subsection (c), a state trust company may invest its restricted capital, without limit subject to the exercise of prudent judgment, in:

(1) bonds and other legally created general obligations of a state, an agency or political subdivision of a state, the United States, or an agency or instrumentality of the United States;

(2) obligations that this state, an agency or political subdivision of this state, the United States, or an agency or instrumentality of the United States has unconditionally agreed to purchase, insure, or guarantee;

(3) securities that are offered and sold under 15 U.S.C. Section 77d(5);

(4) mortgage related securities or small business related securities, as those terms are defined by 15 U.S.C. Section 78c(a);

(5) mortgages, obligations, or other securities that are or ever have been sold by the Federal Home Loan Mortgage Corporation under Section 305 or 306, Federal Home Loan Mortgage Corporation Act (12 U.S.C. Sections 1434 and 1455);

(6) obligations, participations, or other instruments of or issued by the Federal National Mortgage Association or the Government National Mortgage Association;

(7) obligations issued by the Federal Agricultural Mortgage Association, the Federal Farm Credit Banks Funding Corporation, or a Federal Home Loan Bank;

(8) obligations of the Federal Financing Bank or the Environmental Financing Authority;

(9) obligations or other instruments or securities of the Student Loan Marketing Association; or

(10) qualified Canadian government obligations, as defined by 12 U.S.C. Section 24.

(e) In the exercise of prudent judgment, a state trust company shall, at a minimum:

(1) exercise care and caution to make and implement investment and management decisions for the entire investment portfolio, taking into consideration the safety and soundness of the state trust company;

(2) pursue an overall investment strategy to enable management to make appropriate present and future decisions; and

(3) consider, to the extent relevant to the decision or action:

(A) the size, diversification, and liquidity of its corporate assets;

(B) the general economic conditions;

(C) the possible effect of inflation or deflation;

(D) the expected tax consequences of the investment decisions or strategies;

(E) the role that each investment or course of action plays within the investment portfolio; and

(F) the expected total return of the portfolio.

[2] See 7 TAC §§19.21-19.22, relating to grandfathered investments and investments in mutual funds.

(f) A state trust company may invest its secondary capital in any type or character of equity or investment securities subject to the exercise of prudent judgment according to the standards provided by Subsection (f).

(g) The finance commission may adopt rules to administer and carry out this section, including rules to:

(1) establish limits, requirements, or exemptions other than those specified by this section for particular classes or categories of investment; or

(2) limit or expand investment authority for state trust companies for particular classes or categories of securities or other property.

Sec. 184.102. Transactions in State Trust Company Shares or Participation Shares. Except with the prior written approval of the banking commissioner:

(1) a state trust company may not acquire its own shares or participation shares unless the amount of its undivided profits is sufficient to fully absorb the acquisition of the shares or participation shares under regulatory accounting principles;[3] and

(2) a state trust company may not acquire a lien on its own shares or participation shares unless the amount of indebtedness secured is less than the amount of the state trust company's undivided profits.

Sec. 184.103. State Trust Company Subsidiaries. (a) Except as otherwise provided by this subtitle or rules adopted under this subtitle, and subject to the exercise of prudent judgment, a state trust company may invest its secondary capital to acquire or establish one or more subsidiaries to conduct any activity that may lawfully be conducted through the form of organization chosen for the subsidiary. The factors to be considered by a state trust company in exercise of prudent judgment include the factors contained in Section 184.101(e).

(b) A state trust company that intends to acquire, establish, or perform new activities through a subsidiary shall submit a letter to the banking commissioner describing in detail the proposed activities of the subsidiary.[4]

(c) The state trust company may acquire or establish a subsidiary or begin performing new activities in an existing subsidiary on the 31st day after the date the banking commissioner receives the state trust company's letter, unless the banking commissioner specifies an earlier or later date. The banking commissioner may extend the 30-day period on a determination that the state trust company's letter raises issues that require additional information or additional time for analysis. If the period is extended, the state trust company may acquire or establish the subsidiary, or perform new activities in an existing subsidiary, only on prior written approval of the banking commissioner.

(d) A subsidiary of a state trust company is subject to regulation by the banking commissioner to the extent provided by this subtitle or rules adopted under this section. In the absence of limiting rules, the banking commissioner may regulate a subsidiary as if it were a state trust company.

Sec. 184.104. Other Investment Provisions. (a) Without the prior written approval of the banking commissioner, a state trust company may not make any investment of its secondary capital in any investment that incurs or may incur, under regulatory accounting principles, a liability or contingent liability for the state trust company.

(b) The banking commissioner may, on a case-by-case basis, require a state trust company to dispose of any investment of its secondary capital, if the banking commissioner finds that the divestiture of the asset is necessary to protect the safety and soundness of the state trust company. The banking commissioner in the exercise of discretion under this subsection shall consider safety and soundness factors, including those contained in Section 182.008(b). The proposed effective date of an order requiring a state trust company to dispose of an asset must be stated in the order and must be on or after the 21st day after the date the proposed order is mailed or delivered. Unless the state trust company requests a hearing before the banking commissioner in writing before the effective date of the proposed order, the order becomes effective and is final and nonappealable.

(c) Subject to Subsections (a) and (b), to Section 184.105, and to the exercise of prudent judgment, a state trust company may invest its secondary capital in any type or character of investment for the purpose of generating income or profit. The factors to be considered by a state trust company in exercise of prudent judgment include the factors contained in Section 184.101(e).

Sec. 184.105. Engaging in Commerce Prohibited. (a) Except as otherwise provided by this subtitle or rules

[3] See 7 TAC §§21.2 and 21.91, relating to acquisition and retention of treasury stock.

[4] See 7 TAC §21.2, relating to examination and investigation fees.

adopted under this subtitle, a state trust company may not invest its funds in trade or commerce by buying, selling, or otherwise dealing goods or by owning or operating a business not part of the state trust business, except as necessary to fulfill a fiduciary obligation to a client.

(b) Under this section, engaging in an approved financial activity or an activity incidental or complementary to a financial activity, whether as principal or agent, is not considered to be engaging in commerce.

Subchapter C. Loans

Sec. 184.201. Lending Limits.[5] (a) A state trust company's total outstanding loans and extensions of credit to a person other than an insider may not exceed an amount equal to 15 percent of the state trust company's restricted capital.

(b) The aggregate loans and extensions of credit outstanding at any time to insiders of the state trust company may not exceed an amount equal to 15 percent of the state trust company's restricted capital. All covered transactions between an insider and a state trust company must be engaged in only on terms and under circumstances, including credit standards, that are substantially the same as those for comparable transactions with a person other than an insider.

(c) The finance commission may adopt rules to administer this section, including rules to:

(1) establish limits, requirements, or exemptions other than those specified by this section for particular classes or categories of loans or extensions of credit; and

(2) establish collective lending and investment limits.

(d) The banking commissioner may determine whether a loan or extension of credit putatively made to a person will be attributed to another person for purposes of this section.

(e) A state trust company may not lend trust deposits, except that a trustee may make a loan to a beneficiary of the trust if the loan is expressly authorized or directed by the instrument or transaction establishing the trust.

Sec. 184.202. Violation of Lending Limit. (a) An officer, director, manager, managing participant, or employee of a state trust company who approves or participates in the approval of a loan with actual knowledge that the loan violates Section 184.201 is jointly and severally liable to the state trust company for the lesser of the amount by which the loan exceeded applicable lending limits or the state trust company's actual loss. The person remains liable for that amount until the loan and all prior indebtedness of the borrower to the state trust company have been fully repaid.

(b) The state trust company may initiate a proceeding to collect an amount due under this section at any time before the date the borrower defaults on the subject loan or any prior indebtedness or before the fourth anniversary of that date.

(c) A person who is liable for and pays amounts to the state trust company under this section is entitled to an assignment of the state trust company's claim against the borrower to the extent of the payments.

(d) For purposes of this section, an officer, director, manager, managing participant, or employee of a state trust company is presumed to know the amount of the state trust company's lending limit under Section 184.201 and the amount of the borrower's aggregate outstanding indebtedness to the state trust company immediately before a new loan or extension of credit to that borrower.

Sec. 184.203. Lease Financing Transaction. (a) Subject to rules adopted under this subtitle, a state trust company may become the owner and lessor of tangible personal property for lease financing transactions on a net lease basis on the specific request and for the use of a client. Without the written approval of the banking commissioner to continue holding property acquired for leasing purposes under this subsection, the state trust company may not hold the property more than six months after the date of expiration of the original or any extended or renewed lease period agreed to by the client for whom the property was acquired or by a subsequent lessee.

(b) A rental payment received by the state trust company in a lease financing transaction under this section is considered to be rent and not interest or compensation for the use, forbearance, or detention of money. However, a lease financing transaction is considered to be a loan or extension of credit for purposes of Sections 184.201 and 184.202.

Sec. 184.204. General Banking Privileges Not Conferred. This subchapter does not confer general banking privileges on a state trust company.

Subchapter D. Trust Deposits

[5] See 7 TAC §19.1, relating to grandfathered loans.

Sec. 184.301. Trust Deposits. [6] (a) A state trust company may deposit trust funds with itself as an investment if:

(1) the deposit is authorized by the settlor or beneficiary;

(2) the state trust company maintains as security for the deposit a separate fund of securities, legal for trust investments, under control of a federal reserve bank or a clearing corporation, as defined by Section 8.102, Business & Commerce Code, within or outside this state;

(3) the total market value of the security is at all times at least equal to the amount of the deposit; and

(4) the separate fund is designated as a separate fund.

(b) A state trust company may make periodic withdrawals from or additions to a securities fund required by Subsection (a) as long as the required value is maintained. Income from the securities in the fund belongs to the state trust company.

(c) Security for a deposit under this section is not required for a deposit under Subsection (a) to the extent the deposit is insured by the Federal Deposit Insurance Corporation or its successor.

Sec. 184.302. General Banking Privileges Not Conferred. This subchapter does not confer general banking privileges on a state trust company.

Subchapter E. Liabilities and Pledge of Assets

Sec. 184.401. Borrowing Limit. Except with the prior written approval of the banking commissioner, a state trust company may not have outstanding liabilities, excluding trust deposit liabilities arising under Section 184.301, that exceed an amount equal to five times its restricted capital.

Sec. 184.402. Pledge of Assets. (a) A state trust company may not pledge or create a lien on any of its assets except to secure:

(1) the repayment of money borrowed;

(2) trust deposits as specifically authorized or required by:

(A) Section 184.301;

(B) Title 9, Property Code; or

(C) rules adopted under this chapter; or

(3) deposits made by:

(A) the United States;

(B) a state, county, or municipality; or

(C) an agency of the United States or a state, county, or municipality.

(b) An act, deed, conveyance, pledge, or contract in violation of this section is void.

[6] Acceptance of deposits requires prior approval of the banking commissioner. See 7 TAC §§21.31-21.32, relating to trust deposits, and §21.2, relating to examination and investigation fees.

CHAPTER 185. ENFORCEMENT ACTIONS

Subchapter A. Enforcement Orders

Subchapter B. Supervision and Conservatorship

Subchapter C. Unauthorized Trust Activity: Investigation and Enforcement

CHAPTER 185. ENFORCEMENT ACTIONS

Subchapter A. Enforcement Orders

Sec. 185.0001. Applicability to State Trust Company Subsidiaries. This subchapter applies to a subsidiary of a state trust company, a present or former officer, director, manager, managing participant, or employee of a subsidiary, or a controlling shareholder or other person participating in the affairs of a subsidiary in the same manner as the subchapter applies to a state trust company, a present or former officer, director, manager, managing participant, or employee of a state trust company, or a controlling shareholder or other person participating in the affairs of a state trust company.

Sec. 185.001. Determination Letter. (a) If the banking commissioner determines from examination or other credible evidence that a state trust company is in a condition that may warrant the issuance of an enforcement order under this chapter, the banking commissioner may notify the state trust company in writing of the determination, the requirements the state trust company must satisfy to abate the determination, and the time in which the requirements must be satisfied to avert further administrative action. The determination letter must be delivered by personal delivery or by registered or certified mail, return receipt requested.

(b) The determination letter may be issued in connection with the issuance of a cease and desist, removal, or prohibition order under this subchapter or an order of supervision or conservatorship under Subchapter B.

Sec. 185.002. Cease and Desist Order. (a) The banking commissioner has grounds to issue a cease and desist order to an officer, employee, director, manager, or managing participant of a state trust company, or the state trust company itself acting through an authorized person, if the banking commissioner determines from examination or other credible evidence that the state trust company or person directly or indirectly has:

(1) violated this subtitle or another applicable law or rule;

(2) engaged in a breach of trust or other fiduciary duty;

(3) refused to submit to examination or examination under oath;

(4) conducted business in an unsafe or unsound manner; or

(5) violated a condition of the state trust company's charter or an agreement between the state trust company or the person and the banking commissioner or the department.

(b) If the banking commissioner has grounds for action under Subsection (a) and finds that an order to cease and desist from a violation or other conduct described by Subsection (a) appears to be necessary and in the best interest of a state trust company involved and its clients, creditors, and shareholders or participants, the banking commissioner may serve a proposed cease and desist order on the state trust company and each person who committed or participated in the violation. The order must:

(1) be delivered by personal delivery or by registered or certified mail, return receipt requested;

(2) state with reasonable certainty the grounds for the order; and

(3) state the effective date of the order, which may not be earlier than the 21st day after the date the order is mailed or delivered.

(b-1) A proposed cease and desist order may require an officer, employee, director, manager, or managing participant of a state trust company, or the state trust company itself acting through an authorized person, to cease or desist from a violation or other practice or to take affirmative action to correct the conditions resulting from a violation or other practice, including the payment of restitution or other action that the banking commissioner determines is appropriate.

(c) The order takes effect if the state trust company or person against whom the order is directed does not request a hearing in writing before the effective date. After taking effect, the order is final and nonappealable as to that state trust company or person.

Sec. 185.003. Removal or Prohibition Order. (a) The banking commissioner has grounds to remove or prohibit a present or former officer, director, manager, managing participant, or employee of a state trust company from office or employment in, or prohibit a controlling shareholder or participant or other person participating in the affairs of a state trust company from further participation in the affairs of, the state trust company or any other entity chartered, registered, permitted, or licensed by the banking commissioner if the banking commissioner determines from examination or other credible evidence that:

(1) the person:

(A) intentionally committed or participated in the commission of an act described by Section 185.002(a) with regard to the affairs of a financial institution, as defined by Section 201.101;

(B) violated a final cease and desist order issued by a state or federal regulatory agency against the person or an entity in which the person is or was an officer, director, or employee; or

(C) made, or caused to be made, false entries in the records of a financial institution;

(2) because of that action by the person:

(A) the financial institution has suffered or will probably suffer financial loss or expense, or other damage;

(B) the interests of the clients, depositors, creditors, or shareholders of the financial institution have been or could be prejudiced; or

(C) the person has received financial gain or other benefit by reason of the action, or likely would have if the action had not been discovered; and

(3) that action by the person:

(A) involves personal dishonesty on the part of the person; or

(B) demonstrates wilful or continuing disregard for the safety or soundness of the financial institution.

(b) If the banking commissioner has grounds for action under Subsection (a) and finds that a removal or prohibition order appears to be necessary and in the best interest of the public, the banking commissioner may serve a proposed removal or prohibition order, as appropriate, on an officer, employee, director, manager or managing participant, controlling shareholder or participant, or other person alleged to have committed or participated in the violation or other conduct described by Section 185.002(a). The order must:

(1) be delivered by personal delivery or by registered or certified mail, return receipt requested;

(2) state with reasonable certainty the grounds for removal or prohibition;

(3) state the effective date of the order, which may not be before the 21st day after the date the proposed order is delivered or mailed; and

(4) state the duration of the order, including whether the duration of the order is perpetual.

(b-1) The banking commissioner may make a removal or prohibition order perpetual or effective for a specific period of time, may probate the order, or may impose other conditions on the order.

(c) The order takes effect if the person against whom the order is directed does not request a hearing in writing before the effective date. After taking effect the order is final and nonappealable as to that person.

Sec. 185.0035. Removal or Prohibition Orders in Response to Certain Criminal Offenses. (a) For purposes of this section, a person is considered to have been finally convicted of an offense if the person's case is not subject to further appellate review and:

(1) a sentence was imposed on the person;

(2) the person received probation or community supervision, including deferred adjudication community supervision; or

(3) the court deferred final disposition of the person's case.

(b) The banking commissioner has grounds to remove or prohibit a present or former officer, director, manager, managing participant, or employee of a state trust company from office or employment in, or prohibit a controlling shareholder or participant or other person participating in the affairs of a state trust company from further participation in the affairs of, the state trust company or any other entity chartered, registered, permitted, or licensed by the banking commissioner if the person has been finally convicted of a felony offense involving:

(1) a financial institution, as defined by Section 201.101;

(2) dishonesty; or

(3) breach of trust.

(c) If the banking commissioner has grounds for action under Subsection (b), the banking commissioner may serve a removal or prohibition order, as appropriate, on the person who has been finally convicted of a felony offense. The banking commissioner shall also serve a copy of the order on any state trust company that the person is affiliated with at the time of service of the order.

(d) An order issued under this section becomes effective immediately on service and continues in effect unless the order is:

(1) stayed or terminated by the banking commissioner;

(2) set aside by the banking commissioner after a hearing; or

(3) stayed or vacated on appeal.

(e) Not later than the 30th day after the date an order is served under this section, the person against whom the order is issued may request in writing a hearing before the banking commissioner to show that the person's continued service to a state trust company or participation in the affairs of a state trust company does not, or is unlikely to, threaten the interests of the clients, depositors, creditors, or shareholders of the state trust company or the public confidence in the state trust company.

(f) Not later than the 30th day after the date a request for a hearing is received under this section, the banking commissioner shall hold the hearing, unless the party requesting the hearing requests a later date. At the hearing, the party requesting the hearing has the burden of proof.

(g) After the hearing, the banking commissioner may affirm, modify, or set aside, in whole or in part, the order. An order affirming or modifying the order is immediately final for purposes of enforcement and appeal. The order may be appealed as provided by Sections 181.202, 181.203, and 181.204.

Sec. 185.004. Hearing on Proposed Order.[1] (a) A requested hearing on a proposed order shall be held not later than the 30th day after the date the first request for a hearing on the order was received by the banking commissioner unless the parties agree to a later hearing date. Not later than the 11th day before the date of the hearing, each party shall be given written notice by personal delivery or by registered or certified mail, return receipt requested, of the date set by the banking commissioner for the hearing. At the hearing, the banking commissioner has the burden of proof, and each person against whom the order is directed may cross-examine witnesses and present evidence to show why the order should not be issued.

(b) After the hearing, the banking commissioner shall issue or decline to issue the order. The order may be modified as necessary to conform to the findings at the hearing and to require the board to take necessary affirmative action to correct the conditions cited in the order.

(c) An order issued under this section is immediately final for purposes of enforcement and appeal. The order may be appealed as provided by Sections 181.202-181.204.[2]

Sec. 185.005. Emergency Order. (a) If the banking commissioner believes that immediate action is needed to prevent immediate and irreparable harm to the state trust company and its clients, creditors, and shareholders or participants, the banking commissioner may issue one or more cease and desist, removal, or prohibition orders as emergency orders to become effective immediately on service without prior notice or hearing. Service must be by personal delivery or by registered or certified mail, return receipt requested.

(b) In each emergency order the banking commissioner shall notify the state trust company and any person against whom the emergency order is directed of:

(1) the specific conduct requiring the order;

(2) the citation of each statute or rule alleged to have been violated;

(3) the immediate and irreparable harm alleged to be threatened;

(4) the duration of the order, including whether the duration of the order is perpetual; and

(5) the right to a hearing.

(c) Unless a person against whom the order is directed requests a hearing in writing before the 11th

[1] See 7 TAC §§9.11-9.39, relating to procedure in contested case hearings.

[2] See 7 TAC §§9.51-9.57, relating to procedure for appeals to the finance commission.

day after the date the order is served on the person, the order is final and nonappealable as to that person.

(d) A hearing requested under Subsection (c) must be:

(1) given priority over all other matters pending before the banking commissioner; and

(2) held not later than the 20th day after the date the hearing is requested unless the parties agree to a later hearing date.[3]

(e) After the hearing, the banking commissioner may affirm, modify, or set aside in whole or part the emergency order. An order affirming or modifying the order is immediately final for purposes of enforcement and appeal. The order may be appealed as provided by Sections 181.202-181.204.[4]

(f) An emergency order continues in effect unless the order is stayed by the banking commissioner. The banking commissioner may impose any condition before granting a stay of the emergency order.

Sec. 185.006. Copy of Letter or Order in State Trust Company Records. A copy of any determination letter, proposed order, emergency order, or final order issued by the banking commissioner under this subchapter shall be immediately brought to the attention of the board of the affected state trust company, regardless of whether the state trust company is a party, and filed in the minutes of the board. Each director, manager, or managing participant shall immediately certify to the banking commissioner in writing that the certifying person has read and understood the determination letter, proposed order, emergency order, or final order. The required certification may not be considered an admission of a person in a subsequent legal or administrative proceeding.

Sec. 185.007. Effect of Final Removal or Prohibition Order. (a) Except as provided by other law, without the prior written approval of the banking commissioner, a person subject to a final and enforceable removal or prohibition order issued by the banking commissioner, or by another state, federal, or foreign financial institution regulatory agency, may not:

(1) serve as a director, officer, or employee of a state trust company or state bank, or as a director, officer, or employee with financial responsibility of any other entity chartered, registered, permitted, or licensed by the banking commissioner under the laws of this state while the order is in effect;

(2) directly or indirectly participate in any manner in the management of such an entity;

(3) directly or indirectly vote for a director of such an entity; or

(4) solicit, procure, transfer, attempt to transfer, vote, or attempt to vote a proxy, consent, or authorization with respect to voting rights in such an entity.

(b) The person subject to the order remains entitled to receive dividends or a share of profits, return of contribution, or other distributive benefit from an entity identified in Subsection (a)(1) with respect to voting securities in the entity owned by the person.

(c) If voting securities of an entity identified in Subsection (a)(1) cannot be voted under this section, the voting securities are considered to be authorized but unissued for purposes of determining the procedures for and results of the affected vote.

(d) Participants of a limited trust association in which a participant has been finally removed or prohibited from participation in the state trust company's affairs under this subchapter shall elect a board of managers.

(e) This section and Section 185.008 do not prohibit a removal or prohibition order that has indefinite duration or that by its terms is perpetual.

Sec. 185.0071. Application for Release From Final Removal or Prohibition Order. (a) After the expiration of 10 years from the date of issuance, a person who is subject to a prohibition or removal order issued under this subchapter, regardless of the order's stated duration or date of issuance, may apply to the banking commissioner to be released from the order.

(b) The application must be made under oath and in the form required by the banking commissioner. The application must be accompanied by any required fees.

[3] See 7 TAC §§9.11-9.39, relating to procedure in contested case hearings.

[4] See 7 TAC §§9.51-9.57, relating to procedure for appeals to the finance commission.

(c) The banking commissioner, in the exercise of discretion, may approve or deny an application filed under this section.

(d) The banking commissioner's decision under Subsection (c) is final and not appealable.

Sec. 185.008. Limitation on Action. The banking commissioner may not initiate an enforcement action under this subchapter later than the fifth anniversary of the date the banking commissioner discovered or reasonably should have discovered the conduct involved.

Sec. 185.009. Enforcement by Commissioner. (a) If the banking commissioner reasonably believes that a state trust company or other person has violated any of the following, the banking commissioner may take any action authorized under Subsection (a-1):

(1) this subtitle or rules enacted under this subtitle and, as a result of that violation, exposed or could have exposed the state trust company or its clients, creditors, shareholders, or participants to harm;

(2) other applicable law of this state and, as a result of that violation, exposed or could have exposed the state trust company or its clients, creditors, shareholders, or participants to harm; or

(3) a final order issued by the banking commissioner.

(a-1) The banking commissioner may:

(1) initiate administrative penalty proceedings against the state trust company or other person, as applicable, in accordance with Sections 185.010 and 185.011;

(2) refer the matter to the attorney general for enforcement by injunction or other available remedy; or

(3) pursue any other action the banking commissioner considers appropriate under applicable law.

(b) If the attorney general prevails in an action brought under Subsection (a-1)(2), the attorney general is entitled to recover reasonable attorney’s fees from a state trust company or person committing the violation.

Sec. 185.010. Administrative Penalty. (a) The banking commissioner may initiate a proceeding for an administrative penalty against a state trust company or other person by serving on the state trust company or other person, as applicable, notice of the time and place of a hearing on the penalty.[5] The hearing may not be held earlier than the 20th day after the date the notice is served. The notice must:

(1) be served by personal delivery or by registered or certified mail, return receipt requested;

(2) contain a statement of the conduct alleged to constitute a violation; and

(3) if the alleged violation is described by Section 185.009(a)(1) or (2), identify corrective action that the state trust company or other person must take to avoid or reduce the amount of a penalty that would otherwise be imposed under this section.

(b) In determining the amount of any penalty to be imposed, the banking commissioner shall consider the following factors:

(1) the financial resources of the state trust company or other person;

(2) the good faith of the state trust company or other person, including any corrective action taken;

(3) the gravity of the violation;

(4) the history of previous violations;

(5) an offset of the amount of the penalty by the amount of any penalty imposed by another state or federal agency for the same conduct; and

(6) any other matter that justice may require.

(c) If the banking commissioner determines after the hearing that the alleged conduct occurred and that the conduct constitutes a violation, the banking commissioner may impose an administrative penalty against a state trust company or other person, as applicable, in an amount:

(1) if imposed against a state trust company, not less than $500 and not more than $10,000 for each violation for each day the violation continues, except that the maximum administrative penalty that may be imposed is the lesser of $500,000 or one percent of the state trust company's assets; or

[5] See 7 TAC §§9.11-9.39, relating to procedure in contested case hearings.

(2) if imposed against a person other than a state trust company, not less than $500 and not more than $5,000 for each violation for each day the violation continues, except that the maximum administrative penalty that may be imposed is $250,000.

Sec. 185.011. Payment or Appeal of Administrative Penalty. (a) When a penalty order under Section 185.010 becomes final, a state trust company or other person, as applicable, shall pay the penalty or appeal by filing a petition for judicial review.

(b) The petition for judicial review stays the penalty order during the period preceding the decision of the court. If the court sustains the order, the court shall order the state trust company or other person, as applicable, to pay the full amount of the penalty or a lower amount determined by the court. If the court does not sustain the order, a penalty is not owed. If the final judgment of the court requires payment of a penalty, interest accrues on the penalty, at the rate charged on loans to depository institutions by the Federal Reserve Bank of New York, beginning on the date the judgment is final and ending on the date the penalty and interest are paid.

(c) If the state trust company or other person, as applicable, does not pay the penalty imposed under a final and nonappealable penalty order, the banking commissioner shall refer the matter to the attorney general for enforcement. The attorney general is entitled to recover reasonable attorney's fees from the state trust company or other person, as applicable, if the attorney general prevails in judicial action necessary for collection of the penalty.

Sec. 185.012. Confidentiality of Records. A copy of a notice, correspondence, transcript, pleading, or other document in the records of the department relating to an order issued under this subchapter is confidential and may be released only as provided by Subchapter D, Chapter 181,[6] except that the banking commissioner periodically shall publish all final removal and prohibition orders. The banking commissioner may release a final cease and desist order, a final order imposing an administrative penalty, or information regarding the existence of any of those orders to the public if the banking commissioner concludes that the release would enhance effective enforcement of the order.

[6] See 7 TAC §3.111, relating to confidential information.

Sec. 185.013. Collection of Fees. The banking commissioner may sue to enforce the collection of a fee owed to the department under a law administered by the banking commissioner. In the suit a certificate by the banking commissioner showing the delinquency is prima facie evidence of:

(1) the levy of the fee or the delinquency of the stated fee amount; and

(2) compliance by the banking commissioner with the law relating to the computation and levy of the fee.

Subchapter B. Supervision and Conservatorship

Sec. 185.1001. Applicability to State Trust Company Subsidiaries. This subchapter applies to a subsidiary of a state trust company, a present or former officer, director, manager, managing participant, or employee of a subsidiary, or a controlling shareholder or other person participating in the affairs of a subsidiary in the same manner as the subchapter applies to a state trust company, a present or former officer, director, manager, managing participant, or employee of a state trust company, or a controlling shareholder or other person participating in the affairs of a state trust company.

Sec. 185.101. Order of Supervision. (a) The banking commissioner by order may appoint a supervisor over a state trust company if the banking commissioner determines from examination or other credible evidence that the state trust company is in hazardous condition and that an order of supervision appears to be necessary and in the best interest of the state trust company and its clients, creditors, and shareholders or participants, or the public.

(b) The banking commissioner may issue the order without prior notice.

(c) The supervisor serves until the earlier of:

(1) the expiration of the period stated in the order of supervision; or

(2) the date the banking commissioner determines that the requirements for abatement of the order have been satisfied.

Sec. 185.102. Order of Conservatorship. (a) The banking commissioner by order may appoint a conservator for a state trust company if the banking commissioner determines from examination or other credible evidence that the state trust company is in hazardous condition and immediate and irreparable harm is threatened to the state trust company, its clients, creditors, or shareholders or participants, or the public.

(b) The banking commissioner may issue the order without prior notice at any time before, during, or after the period of supervision.

(c) An order of conservatorship issued under this section must specifically state the basis for the order.

Sec. 185.103. Hearing. (a) An order issued under Section 185.101 or 185.102 must contain or be accompanied by a notice that, at the request of the state trust company, a hearing will be held before the banking commissioner at which the state trust company may cross-examine witnesses and present evidence to contest the order or show that it has satisfied all requirements for abatement of the order. The banking commissioner has the burden of proof for any continuation of the order or the issuance of a new order.[7]

(b) To contest or modify the order or demonstrate that it has satisfied all requirements for abatement of the order, the state trust company shall submit to the banking commissioner a written request for a hearing. The request must state the grounds for the request to set aside or modify the order. On receiving a request for hearing, the banking commissioner shall serve notice of the time and place of the hearing, which must be not later than the 10th day after the date the banking commissioner receives the request for a hearing unless the parties agree to a later hearing date. The notice must be delivered by personal delivery or by registered or certified mail, return receipt requested.

(c) The banking commissioner may:

(1) delay a decision for a prompt examination of the state trust company; and

(2) reopen the record as necessary to allow presentation of the results of the examination and appropriate opportunity for cross-examination and presentation of other relevant evidence.

Sec. 185.104. Post-hearing Order. (a) If after the hearing the banking commissioner finds that the state trust company has been rehabilitated, that its hazardous condition has been remedied, that irreparable harm is no longer threatened, or that the state trust company should otherwise be released from the order, the banking commissioner shall release the state trust company from the order, subject to conditions the banking commissioner from the evidence believes are warranted to preserve the safety and soundness of the state trust company.

(b) If after the hearing the banking commissioner finds that the state trust company has failed to comply with the lawful requirements of the banking commissioner, has not been rehabilitated, is insolvent, or otherwise continues in hazardous condition, the banking commissioner by order shall:

(1) appoint or reappoint a supervisor pursuant to Section 185.101;

(2) appoint or reappoint a conservator pursuant to Section 185.102; or

(3) take other appropriate action authorized by law.

(c) An order issued under Subsection (b) is immediately final for purposes of appeal. The order may be appealed as provided by Sections 181.202-181.204.[8]

Sec. 185.105. Confidentiality of Records. An order issued under this subchapter and a copy of a notice, correspondence, transcript, pleading, or other document in the records of the department relating to the order are confidential and may be released only as provided by Subchapter D, Chapter 181,[9] except that the banking commissioner may release to the public an order or information relating to the existence of an order if the banking commissioner concludes that the release would enhance effective enforcement of the order.

Sec. 185.106. Duties of State Trust Company under Supervision. During a period of supervision, a state trust company, without the prior approval of the banking commissioner or the supervisor or as otherwise permitted or restricted by the order of supervision, may not:

[7] See 7 TAC §§9.11-9.39, relating to procedure in contested case hearings.

[8] See 7 TAC §§9.51-9.57, relating to procedure for appeals to the finance commission.

[9] See 7 TAC §3.111, relating to confidential information.

(1) dispose of, sell, transfer, convey, or encumber the state trust company's assets;

(2) lend or invest the state trust company's funds;

(3) incur a debt, obligation, or liability;

(4) pay a cash dividend to the state trust company's shareholders or participants;

(5) solicit or accept any new client accounts; or

(6) remove an executive officer or director, change the number of executive officers or directors, or have any other change in the position of executive officer or director.

Sec. 185.107. Powers and Duties of Conservator. (a) A conservator appointed under this subchapter shall immediately take charge of the state trust company and all of its property, books, records, and affairs on behalf and at the direction and control of the banking commissioner.

(b) Subject to any limitation contained in the order of appointment or other direction of the banking commissioner, the conservator has all the powers of the directors, managers, managing participants, officers, and shareholders or participants of a state trust company and shall conduct the business of the state trust company and take all steps the conservator considers appropriate to remove the causes and conditions requiring the conservatorship. During the conservatorship, the board may not direct or participate in the affairs of the state trust company.

(c) Except as otherwise provided by this subchapter, by rules adopted under this subtitle, or by Section 12.106, the conservator has the rights and privileges and is subject to the duties, restrictions, penalties, conditions, and limitations of the directors, officers, and employees of state trust companies.

Sec. 185.108. Qualifications of Appointee. The banking commissioner may appoint as a supervisor or conservator any person who in the judgment of the banking commissioner is qualified to serve. The banking commissioner may serve as, or may appoint an employee of the department to serve as, a supervisor or conservator.

Sec. 185.109. Expenses. (a) The banking commissioner shall determine and approve the reasonable expenses attributable to the service of a supervisor or conservator, including costs incurred by the department and the compensation and expenses of the supervisor or conservator and any professional employees appointed to represent or assist the supervisor or conservator. The banking commissioner or an employee of the department may not receive compensation in addition to salary for serving as supervisor or conservator, but the department may receive reimbursement for the fully allocated personnel cost associated with service of the banking commissioner or an employee as supervisor or conservator.

(b) All approved expenses shall be paid by the state trust company as the banking commissioner determines. The banking commissioner has a lien against the assets and funds of the state trust company to secure payment of approved expenses. The lien has a higher priority than any other lien against the state trust company.

(c) Notwithstanding any other provision of this subchapter, the state trust company may employ an attorney and other persons the state trust company selects to assist the state trust company in contesting or satisfying the requirements of an order of supervision or conservatorship. The banking commissioner shall authorize the payment of reasonable fees and expenses from the state trust company for the attorney or other persons as expenses of the supervision or conservatorship.

(d) The banking commissioner may defer collection of assessment and examination fees by the department from the state trust company during a period of supervision or conservatorship if deferral appears to aid prospects for rehabilitation. As a condition of release from supervision or conservatorship, the banking commissioner may require the rehabilitated state trust company to pay or develop a reasonable plan for payment of deferred fees.

Sec. 185.110. Review of Supervisor or Conservator Decisions. (a) Notwithstanding Section 185.107(b), a majority of the state trust company's board, acting directly or through counsel who affirmatively represents that the requisite majority has been obtained, may request in writing that the banking commissioner review an action taken or proposed by the supervisor or conservator. The request must specify why the action would not be in the best interest of the state trust company. The banking commissioner shall investigate to the extent necessary and make a prompt written ruling on the request. If the action has not yet been taken or if the effect of the action can be postponed, the banking commissioner may stay the action on request pending review.

(b) If a majority of the state trust company's board objects to the banking commissioner's ruling, the majority may request a hearing before the banking commissioner. The request must be made not later than the 10th day after the date the state trust company is notified of the ruling.

(c) The banking commissioner shall give the board notice of the time and place of the hearing by personal delivery or by registered or certified mail, return receipt requested. The hearing may not be held later than the 10th day after the date the banking commissioner receives the request for a hearing unless the parties agree to a later hearing date. At the hearing the board has the burden of proof to demonstrate that the action is not in the best interest of the state trust company.[10]

(d) After the hearing, the banking commissioner may affirm, modify, or set aside in whole or part the prior ruling. An order supporting the action contested by the board is immediately final for purposes of appeal. The order may be appealed as provided by Sections 181.202-181.204. If the order is appealed to the finance commission, the finance commission may:

(1) affirm, terminate, or modify the order;

(2) continue or end supervision or conservatorship; and

(3) order further relief as justice, equity, and protection of clients, creditors, and the public require.[11]

Sec. 185.111. Suit Filed Against or on Behalf of State Trust Company under Supervision or Conservatorship. (a) A suit filed against a state trust company while the state trust company is under conservatorship, or against a person in connection with an action taken or decision made by that person as a supervisor or conservator of a state trust company, must be brought in Travis County regardless of whether the state trust company remains under an order of supervision or conservatorship.

(b) A conservator may sue a person on the trust company's behalf to preserve, protect, or recover state trust company assets, including claims or causes of action. The suit may be in:

(1) Travis County; or

(2) another location where jurisdiction and venue against that person may be obtained under law.

Sec. 185.112. Duration. A supervisor or conservator serves for the period necessary to accomplish the purposes of the supervision or conservatorship as intended by this subchapter. A rehabilitated state trust company shall be returned to its former or new management under conditions reasonable and necessary to prevent recurrence of the conditions causing the supervision or conservatorship.

Sec. 185.113. Administrative Election of Remedies. The banking commissioner may take any action authorized under Chapter 186 regardless of the existence of supervision or conservatorship. A period of supervision or conservatorship is not required before a trust company is closed for liquidation or other remedial action is taken.

Sec. 185.114. Release Before Hearing. This subchapter does not prevent release of a state trust company from supervision or conservatorship before a hearing if the banking commissioner is satisfied that requirements for abatement have been adequately satisfied.

Subchapter C. Unauthorized Trust Activity: Investigation and Enforcement

Sec. 185.201. Investigation of Unauthorized Trust Activity. (a) If the banking commissioner has reason to believe that a person has engaged, is engaging, or is likely to engage in an unauthorized trust activity, the banking commissioner may:

(1) investigate as necessary within or outside this state to:

(A) determine whether the unauthorized trust activity has occurred or is likely to occur; or

(B) aid in the enforcement of the laws administered by the banking commissioner;

(2) initiate appropriate disciplinary action as provided by this subchapter; and

[10] See 7 TAC §§9.11-9.39, relating to procedure in contested case hearings.

[11] See 7 TAC §§9.51-9.57, relating to procedure for appeals to the finance commission.

(3) report any unauthorized trust activity to a law enforcement agency or another regulatory agency with appropriate jurisdiction.

(b) The banking commissioner may:

(1) on written request furnish to a law enforcement agency evidence the banking commissioner has compiled in connection with the unauthorized activity, including materials, documents, reports, and complaints; and

(2) assist the law enforcement agency or other regulatory agency as requested.

(c) A person acting without malice, fraudulent intent, or bad faith is not subject to liability, including liability for libel, slander, or other relevant tort, because the person files a report or furnishes, orally or in writing, information concerning a suspected, anticipated, or completed unauthorized activity to a law enforcement agency, the banking commissioner or another regulatory agency with appropriate jurisdiction, or an agent or employee of a law enforcement agency, the banking commissioner, or other regulatory agency. The person is entitled to attorney's fees and court costs if the person prevails in an action for libel, slander, or any other relevant tort based on the report or other information the person furnished as provided by this subchapter.

(d) This section does not:

(1) affect or modify a common law or statutory privilege or immunity;

(2) preempt the authority or relieve the duty of a law enforcement agency or other regulatory agency with appropriate jurisdiction to investigate and prosecute suspected criminal acts;

(3) prohibit a person from voluntarily disclosing information to a law enforcement agency or other regulatory agency; or

(4) limit a power or duty granted to the banking commissioner under this subtitle or other law.

Sec. 185.202. Subpoena Authority. (a) This section applies only to an investigation of an unauthorized trust activity as provided by Section 185.201, and does not affect the conduct of a contested case under Chapter 2001, Government Code.

(b) The banking commissioner may issue a subpoena to compel the attendance and testimony of a witness or the production of a book, account, record, paper, or correspondence relating to a matter that the banking commissioner has authority to consider or investigate at the department's offices in Austin or at another place the banking commissioner designates.

(c) The subpoena must be signed and issued by the banking commissioner or a deputy banking commissioner.

(d) A person who is required by subpoena to attend a proceeding before the banking commissioner is entitled to receive:

(1) reimbursement for mileage, in the amount provided for travel by a state employee, for traveling to or returning from a proceeding that is more than 25 miles from the witness's residence; and

(2) a fee for each day or part of a day the witness is necessarily present as a witness in an amount equal to the per diem travel allowance of a state employee.

(e) The banking commissioner may serve the subpoena or have it served by an authorized agent of the banking commissioner, a sheriff, or a constable. The sheriff or constable's fee for serving the subpoena is the same as the fee paid the sheriff or constable for similar services.

(f) A person possessing materials located outside this state that are requested by the banking commissioner may make the materials available to the banking commissioner or a representative of the banking commissioner for examination at the place where the materials are located. The banking commissioner may:

(1) designate a representative, including an official of the state in which the materials are located, to examine the materials; and

(2) respond to a similar request from an official of another state, the United States, or a foreign country.

(g) A subpoena issued under this section to a financial institution is not subject to Section 59.006.

Sec. 185.203. Enforcement of Subpoena. (a) If necessary, the banking commissioner may apply to a district court in Travis County or in the county in which the subpoena was served for enforcement of the subpoena, and the court may issue an order compelling compliance.

(b) If the court orders compliance with the subpoena or finds the person in contempt for failure to obey the order, the banking commissioner, or the attorney general if representing the banking commissioner, may recover reasonable court costs, attorney's fees, and investigative costs incurred in the proceeding.

Sec. 185.204. Confidentiality of Subpoenaed Records. (a) A book, account, record, paper, correspondence, or other document subpoenaed and produced under Section 185.202 that is otherwise made privileged or confidential by law remains privileged or confidential unless admitted into evidence at an administrative hearing or in a court. The banking commissioner may issue an order protecting the confidentiality or privilege of the document and restricting its use or distribution by any person or in any proceeding, other than a proceeding before the banking commissioner.

(b) Subject to Subchapter D, Chapter 181,[12] and confidentiality provisions of other law administered by the banking commissioner, information or material acquired under Section 185.202 under a subpoena is not a public record for the period the banking commissioner considers reasonably necessary to complete the investigation, protect the person being investigated from unwarranted injury, or serve the public interest. The information or material is not subject to a subpoena, except a grand jury subpoena, until released for public inspection by the banking commissioner or, after notice and a hearing, a district court determines that the public interest and any investigation by the banking commissioner would not be jeopardized by obeying the subpoena. The district court order may not apply to:

(1) a record or communication received from another law enforcement or regulatory agency except on compliance with the confidentiality laws governing the records of the other agency; or

(2) an internal note, memorandum, report, or communication made in connection with a matter that the banking commissioner has the authority to consider or investigate, except on good cause and compliance with applicable confidentiality laws.

Sec. 185.205. Evidence. (a) On certification by the banking commissioner, a book, record, paper, or document produced or testimony taken as provided by Section 185.202 and held by the department is admissible as evidence in any case without prior proof of its correctness and without other proof. The certified book, record, document, or paper, or a certified copy, is prima facie evidence of the facts it contains.

(b) This section does not limit another provision of this subtitle or a law that provides for the admission of evidence or its evidentiary value.

Sec. 185.206. Cease and Desist Order Regarding Unauthorized Trust Activity. (a) The banking commissioner may serve a proposed cease and desist order on a person the banking commissioner believes is engaging or is likely to engage in an unauthorized trust activity. The order must:

(1) be delivered by personal delivery or registered or certified mail, return receipt requested, to the person's last known address;

(2) state the acts or practices alleged to be an unauthorized activity; and

(3) state the effective date of the order, which may not be earlier than the 21st day after the date the proposed order is mailed or delivered.

(b) Unless the person against whom the proposed order is directed requests a hearing in writing before the effective date of the proposed order, the order takes effect and is final and nonappealable as to that person.

(c) A requested hearing on a proposed order shall be held not later than the 30th day after the date the first written request for a hearing on the order is received by the banking commissioner unless the parties agree to a later hearing date. At the hearing, the banking commissioner has the burden of proof and must present evidence in support of the order. Each person against whom the order is directed may cross-examine witnesses and show cause why the order should not be issued.[13]

(d) After the hearing, the banking commissioner shall issue or decline to issue a cease and desist order. The proposed order may be modified as necessary to conform to the findings at the hearing. An order issued under this subsection:

(1) is immediately final for purposes of enforcement and appeal; and

[12] See 7 TAC §3.111, relating to confidential information.

[13] See 7 TAC §§9.11-9.39, relating to procedure in contested case hearings.

(2) must require the person to immediately cease and desist from the unauthorized trust activity.

(e) The banking commissioner may release a final cease and desist order issued under this section or information relating to the existence of the order to the public if the banking commissioner finds that the release would enhance the effective enforcement of the order or will serve the public interest.

Sec. 185.207. Emergency Cease and Desist Order. (a) The banking commissioner may issue an emergency cease and desist order to a person who the banking commissioner reasonably believes is engaging in a continuing unauthorized trust activity that is fraudulent or threatens immediate and irreparable public harm.

(b) The order must:

(1) be delivered on issuance to each person affected by the order by personal delivery or registered or certified mail, return receipt requested, to the person's last known address;

(2) state the specific charges and require the person immediately to cease and desist from the unauthorized activity; and

(3) contain a notice that a request for hearing may be filed under this section.

(c) Unless a person against whom the emergency order is directed requests a hearing in writing before the 11th day after the date it is served on the person, the emergency order is final and nonappealable as to that person. A request for a hearing must:

(1) be in writing and directed to the banking commissioner; and

(2) state the grounds for the request to set aside or modify the order.

(d) On receiving a request for a hearing, the banking commissioner shall serve notice of the time and place of the hearing by personal delivery or registered or certified mail, return receipt requested. The hearing must be held not later than the 10th day after the date the banking commissioner receives the request for a hearing unless the parties agree to a later hearing date. At the hearing, the banking commissioner has the burden of proof and must present evidence in support of the order. The person requesting the hearing may cross-examine witnesses and show cause why the order should not be affirmed.[14]

(e) After the hearing, the banking commissioner shall affirm, modify, or set aside in whole or part the emergency cease and desist order. An order affirming or modifying the emergency cease and desist order is immediately final for purposes of enforcement and appeal.

(f) An order continues in effect unless the order is stayed by the banking commissioner. The banking commissioner may impose any condition before granting a stay of the order.

(g) The banking commissioner may release a final cease and desist order issued under this section or information regarding the existence of the order to the public if the banking commissioner finds that the release would enhance the effective enforcement of the order or will serve the public interest.

Sec. 185.208. Appeal of Cease and Desist Order. (a) A person affected by a cease and desist order issued, affirmed, or modified after a hearing may file a petition for judicial review.

(b) A filed petition for judicial review does not stay or vacate the order unless the court, after hearing, specifically stays or vacates the order.

Sec. 185.209. Violation of Final Cease and Desist Order. (a) If the banking commissioner reasonably believes that a person has violated a final and enforceable cease and desist order, the banking commissioner may:

(1) initiate administrative penalty proceedings under Section 185.210;

(2) refer the matter to the attorney general for enforcement by injunction and any other available remedy; or

(3) pursue any other action the banking commissioner considers appropriate under applicable law.

(b) If the attorney general prevails in an action brought under Subsection (a)(2), the attorney general is entitled to reasonable attorney's fees.

[14] See 7 TAC §§9.11-9.39, relating to procedure in contested case hearings.

Sec. 185.210. Administrative Penalty. (a) The banking commissioner may initiate an action for an administrative penalty against a person for a violation of a cease and desist order by serving on the person notice of the time and place of a hearing on the penalty. The notice must be delivered by personal delivery or registered or certified mail, return receipt requested, to the person's last known address. The hearing may not be held earlier than the 20th day after the date the notice is served.[15] The notice must contain a statement of the facts or conduct alleged to be in violation of the cease and desist order.

(b) In determining whether a cease and desist order has been violated, the banking commissioner shall consider the maintenance of procedures reasonably adopted to ensure compliance with the order.

(c) If the banking commissioner after the hearing determines that a cease and desist order has been violated, the banking commissioner may:

(1) impose an administrative penalty in an amount not to exceed $25,000 for each separate act of unauthorized activity;

(2) direct the person against whom the order was issued to make complete restitution, in the form and amount and within the period determined by the banking commissioner, to each resident of this state and entity operating in this state damaged by the violation; or

(3) both impose the penalty and direct restitution.

(d) In determining the amount of the penalty and whether to impose restitution, the banking commissioner shall consider:

(1) the seriousness of the violation, including the nature, circumstances, extent, and gravity of any prohibited act;

(2) the economic harm caused by the violation;

(3) the history of previous violations;

(4) the amount necessary to deter future violations;

(5) efforts to correct the violation;

(6) whether the violation was intentional or unintentional;

(7) the financial ability of the person against whom the penalty is to be assessed; and

(8) any other matter that justice may require.

Sec. 185.211. Payment and Appeal of Administrative Penalty. (a) When an administrative penalty order under Section 185.210 becomes final, a person affected by the order, within the time permitted by law for appeal, shall:

(1) pay the amount of the penalty;

(2) pay the amount of the penalty and file a petition for judicial review contesting the occurrence of the violation, the amount of the penalty, or both; or

(3) without paying the amount of the penalty, file a petition for judicial review contesting the occurrence of the violation, the amount of the penalty, or both.

(b) Within the time permitted by law for appeal, a person who acts under Subsection (a)(3) may:

(1) stay enforcement of the penalty by:

(A) paying the amount of the penalty to the court for placement in an escrow account; or

(B) giving the court a supersedeas bond that is approved by the court for the amount of the penalty and that is effective until all judicial review of the order is final; or

(2) request the court to stay enforcement of the penalty by:

(A) filing with the court a sworn affidavit of the person stating that the person is financially unable to pay the amount of the penalty and is financially unable to give the supersedeas bond; and

(B) giving a copy of the affidavit to the banking commissioner by certified mail.

(c) Not later than the fifth day after the date the banking commissioner receives a copy of an affidavit under Subsection (b)(2), the banking commissioner may file with the court a contest to the affidavit. The

[15] See 7 TAC §§9.11-9.39, relating to procedure in contested case hearings.

court shall hold a hearing on the facts alleged in the affidavit as soon as practicable and shall stay the enforcement of the penalty on finding that the alleged facts are true. The person who files an affidavit has the burden of proving that the person is financially unable to pay the amount of the penalty and to give a supersedeas bond.

(d) If the person does not pay the amount of the penalty and the enforcement of the penalty is not stayed, the banking commissioner may refer the matter to the attorney general for collection of the amount of the penalty.

Sec. 185.212. Judicial Review of Administrative Penalty. (a) If on judicial review the court sustains the penalty order, the court shall order the person to pay the full amount of the penalty or a lower amount determined by the court. If the court does not sustain the order, a penalty is not owed.

(b) When the judgment of the court becomes final, if the person paid the amount of the penalty and if that amount is reduced or is not upheld by the court, the court shall order that the appropriate amount plus accrued interest computed at the annual rate of 10 percent be remitted to the person. The interest shall be paid for the period beginning on the date the penalty was paid and ending on the date the penalty is remitted. If the person gave a supersedeas bond and the amount of the penalty is not upheld by the court, the court shall order the release of the bond. If the person gave a supersedeas bond and the amount of the penalty is reduced, the court shall order the release of the bond after the person pays the amount of the penalty.

(c) If the judgment of the court requires payment of a penalty that has not previously been paid, the court shall order as part of its judgment that interest accrues on the penalty at the annual rate of 10 percent, beginning on the date the judgment is final and ending on the date the penalty and interest are paid.

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CHAPTER 186. DISSOLUTION AND RECEIVERSHIP

Subchapter A. General Provisions

Subchapter B. Voluntary Dissolution

Subchapter C. Involuntary Dissolution and Liquidation

Subchapter D. Claims Against Receivership Estate

CHAPTER 186. DISSOLUTION AND RECEIVERSHIP

Subchapter A. General Provisions

Sec. 186.001. Definition. In this chapter, "administrative expense" means:

(1) an expense designated as an administrative expense by Subchapter C or D;

(2) court costs and expenses of operation and liquidation of a state trust company estate;

(3) wages owed to an employee of a state trust company for services rendered within three months before the date the state trust company was closed for liquidation and not exceeding:

(A) $2,000 to each employee; or

(B) another amount set by rules adopted under this subtitle;

(4) current wages owed to a state trust company employee whose services are retained by the receiver for services rendered after the date the state trust company is closed for liquidation;

(5) an unpaid expense of supervision or conservatorship of the state trust company before its closing for liquidation; and

(6) any unpaid fees or assessments owed to the department.

Sec. 186.002. Remedies Exclusive. (a) Unless the banking commissioner so requests, a court may not:

(1) order the closing or suspension of operation of a state trust company; or

(2) appoint for a state trust company a receiver, supervisor, conservator, or liquidator, or other person with similar responsibility.

(b) A person may not be designated receiver, supervisor, conservator, or liquidator without the voluntary approval and concurrence of the banking commissioner.

(c) This chapter prevails over any other conflicting law of this state.

Sec. 186.003. Federal Deposit Insurance Corporation as Liquidator. (a) The banking commissioner without court action may tender a state trust company that has been closed for liquidation to the Federal Deposit Insurance Corporation or its successor as receiver and liquidating agent if the trust deposits of the state trust company were insured by the Federal Deposit Insurance Corporation or its successor on the date of closing.

(b) After acceptance of tender of the state trust company, the Federal Deposit Insurance Corporation or its successor shall perform the acts and duties as receiver of the state trust company that it considers necessary or desirable and that are permitted or required by federal law or this chapter.

(c) If the Federal Deposit Insurance Corporation or its successor refuses to accept tender of the state trust company, the banking commissioner shall act as receiver.

Sec. 186.004. Appointment of Independent Receiver. (a) On request of the banking commissioner, the court in which a liquidation proceeding is pending may:

(1) appoint an independent receiver; and

(2) require a suitable bond of the independent receiver.

(b) On appointment of an independent receiver, the banking commissioner is discharged as receiver and remains a party to the liquidation proceeding with standing to initiate or contest any motion. The views of the banking commissioner are entitled to deference unless they are inconsistent with the plain meaning of this chapter.

Sec. 186.005. Succession of Trust Powers. (a) If a state trust company in the process of voluntary or involuntary dissolution and liquidation is acting as trustee, guardian, executor, administrator, or escrow agent, or in another fiduciary or custodial capacity, the banking commissioner may authorize the sale of the state trust company's administration of fiduciary accounts to a successor entity with fiduciary powers.

(b) The successor entity, without the necessity of action by a court or the creator or a beneficiary of the fiduciary relationship, shall:

(1) continue the office, trust, or fiduciary relationship; and

(2) perform all the duties and exercise all the powers connected with or incidental to the fiduciary relationship as if the successor entity had been originally designated as the fiduciary.

(c) This section applies to all fiduciary relationships, including a trust established for the benefit of a minor by court order under Section 142.005, Property Code. This section does not affect any right of a court or a party to the instrument governing the fiduciary relationship to subsequently designate another trustee as the successor fiduciary.

Subchapter B. Voluntary Dissolution

Sec. 186.101. Initiating Voluntary Dissolution. (a) A state trust company may initiate voluntary dissolution and surrender its charter as provided by this subchapter:

(1) with the approval of the banking commissioner;

(2) after complying with the provisions of the Business Organizations Code regarding board and shareholder approval for voluntary dissolution; and

(3) by filing the notice of dissolution as provided by Section 186.102.

(b) The shareholders or participants of a state trust company initiating voluntary dissolution by resolution shall appoint one or more persons to act as liquidating agent or committee. The liquidating agent or committee shall conduct the liquidation as provided by law and under the supervision of the board. The board, in consultation with the banking commissioner, shall require the liquidating agent or committee to give a suitable bond.

Sec. 186.102. Filing Resolutions with Banking Commissioner. After resolutions to dissolve and liquidate a state trust company have been adopted by the board and shareholders or participants, a majority of the directors, managers, or managing participants shall verify and file with the banking commissioner certified copies of:

(1) the resolutions of the shareholders or participants that:

(A) are adopted at a meeting for which proper notice was given or by unanimous written consent; and

(B) approve the dissolution and liquidation of the state trust company;

(2) the resolutions of the board approving the dissolution and liquidation of the state trust company if the trust company is operated by a board of directors or managers;

(3) the notice to the shareholders or participants informing them of the meeting described by Subdivision (1)(A); and

(4) a plan of liquidation.

Sec. 186.103. Banking Commissioner Investigation and Consent. The banking commissioner shall review the documentation submitted under Section 186.102 and conduct any necessary investigation or examination. If the proceedings appear to have been properly conducted and the bond to be given by the liquidating agent or committee is adequate for its purposes, the banking commissioner shall consent to dissolution and direct the state trust company to publish notice of its pending dissolution.

Sec. 186.104. Notice of Pending Dissolution. (a) A state trust company shall publish notice of its pending dissolution in a newspaper of general circulation in each community where its home office or an additional trust office is located:

(1) at least once each week for eight consecutive weeks; or

(2) at other times specified by the banking commissioner or rules adopted under this subtitle.

(b) The notice must:

(1) be in the form and include the information required by the banking commissioner; and

(2) state that:

(A) the state trust company is liquidating;

(B) clients, depositors, and creditors must present their claims for payment on or before a specific date; and

(C) all safe deposit box holders and bailors of property left with the state trust company should remove their property on or before a specified date.

(c) The dates selected by the state trust company under Subsection (b) must:

(1) be approved by the banking commissioner;

(2) allow the affairs of the state trust company to be wound up as quickly as feasible; and

(3) allow creditors, clients, and owners of property adequate time for presentation of claims, withdrawal of accounts, and redemption of property.

(d) The banking commissioner may adjust the dates under Subsection (b) with or without republication of notice if additional time appears needed for the activities to which the dates pertain.

(e) At the time of or promptly after publication of the notice, the state trust company shall mail to each of the state trust company's known clients, depositors, creditors, safe deposit box holders, and bailors of property left with the state trust company, at the mailing address shown on the state trust company's records, an individual notice containing:

(1) the information required in a notice under Subsection (b); and

(2) specific information pertinent to the account or property of the addressee.

Sec. 186.105. Safe Deposits and Other Bailments. (a) A contract between the state trust company and a person for bailment, of deposit for hire, or for the lease of a safe, vault, or box, ceases on the date specified in the notice as the date for removal of property or a later date approved by the banking commissioner. A person who has paid rental or storage charges for a period extending beyond the date designated for removal of property has an unsecured claim against the state trust company for a refund of the unearned amount paid.

(b) If the property is not removed by the date the contract ceases, an officer of the state trust company shall inventory the property. In making the inventory, the officer may open a safe, vault, box, package, parcel, or receptacle in the custody or possession of the state trust company. The inventory must be made in the presence of a notary public who is not an officer or employee of the state trust company and who is bonded in an amount and by sureties approved by the banking commissioner. The property shall be marked to identify, to the extent possible, its owner or the person who left it with the state trust company.

(c) After all property belonging to others that is in the state trust company's custody and control has been inventoried, a master list certified by the state trust company officer and the notary public shall be furnished to the banking commissioner. The master list shall be kept in a place and dealt with in a manner the banking commissioner specifies pending delivery of the property to its owner or to the comptroller as unclaimed property.

Sec. 186.106. Offices to Remain Open. Unless the banking commissioner directs or consents otherwise, the home office and all additional trust offices of a state trust company initiating voluntary dissolution shall remain open for business during normal business hours until the last date specified in published notices for presentation of claims, withdrawal of accounts, and redemption of property.

Sec. 186.107. Fiduciary Activities. (a) As soon as practicable after publication of the notice of dissolution, the state trust company shall:

(1) terminate all fiduciary positions it holds;

(2) surrender all property held by it as a fiduciary; and

(3) settle its fiduciary accounts.

(b) Unless all fiduciary accounts are settled and transferred by the last date specified in published notices or by the banking commissioner and unless the banking commissioner directs otherwise, the state trust company shall mail a notice to each trustor and beneficiary of any remaining trust, escrow arrangement, or other fiduciary relationship. The notice must state:

(1) the location of an office open during normal business hours where administration of the remaining fiduciary accounts will continue until settled or transferred; and

(2) a telephone number at that office.

Sec. 186.108. Final Liquidation. (a) After the state trust company has taken all of the actions specified by Sections 186.102, 186.104, 186.105, and 186.107, paid all its debts and obligations, and transferred all property for which a legal claimant has been found after the time for presentation of claims has expired, the state trust company shall make a list from its books of the names of each depositor, creditor, owner of personal property in the state trust company's possession or custody, or lessee of any safe, vault, or box, who has not claimed or has not received a deposit, debt, dividend, interest, balance, or other amount or property due to the person. The list must be sworn to or affirmed by a majority of the board or managing participants of the state trust company.

(b) The state trust company shall:

(1) file the list and any necessary identifying information with the banking commissioner;

(2) pay any unclaimed money and deliver any unclaimed property to the comptroller as provided by Chapter 74, Property Code; and

(3) certify to the banking commissioner that the unclaimed money has been paid and unclaimed property has been delivered to the comptroller.

(c) After the banking commissioner has reviewed the list and has reconciled the unclaimed cash and property with the amounts of money and property reported and transferred to the comptroller, the banking commissioner shall allow the state trust company to distribute the state trust company's remaining assets, if any, among its shareholders, participants, or participant-transferees as their ownership interests appear.

(d) After distribution of all remaining assets under Subsection (c), the state trust company shall file with the department:

(1) an affidavit and schedules sworn to or affirmed by a majority of the board or managing participants, showing the distribution to each shareholder, participant, or participant-transferee;

(2) all copies of reports of examination of the state trust company in its possession;

(3) its original charter or an affidavit stating that the original charter is lost; and

(4) any certificates of authority for additional trust offices.

(e) After verifying the submitted information and documents, the banking commissioner shall issue a certificate canceling the charter of the state trust company.

Sec. 186.109. Application of Law to State Trust Company in Dissolution. A state trust company in the process of voluntary dissolution and liquidation remains subject to this subtitle, including provisions for examination by the banking commissioner, and the state trust company shall furnish reports required by the banking commissioner.

Sec. 186.110. Authorization of Deviation from Procedures. The banking commissioner may authorize a deviation from the procedures for voluntary dissolution provided by this subchapter if the banking commissioner determines that the interests of claimants are not jeopardized by the deviation.

Sec. 186.111. Closure by Banking Commissioner for Involuntary Dissolution and Liquidation. The banking commissioner may close the state trust company for involuntary dissolution and liquidation under this chapter if the banking commissioner determines that:

(1) the voluntary liquidation is:

(A) being conducted in an improper or illegal manner; or

(B) not in the best interests of the state trust company's clients and creditors; or

(2) the state trust company is insolvent or imminently insolvent.

Sec. 186.112. Application for New Charter. After a state trust company's charter has been voluntarily surrendered and canceled, the state trust company may not resume business or reopen except on application for and approval of a new charter.

Subchapter C. Involuntary Dissolution and Liquidation

Sec. 186.201. Action to Close State Trust Company. (a) The banking commissioner may by written order close and liquidate a state trust company on finding that:

(1) the interests of its clients and creditors are jeopardized by the state trust company's insolvency or imminent insolvency; and

(2) the best interests of clients and creditors would be served by requiring that the state trust company be closed and its assets liquidated.

(b) A majority of the state trust company's directors, managers, or managing participants may voluntarily close the state trust company and place it with the banking commissioner for liquidation.

Sec. 186.202. Notice and Effect of Closure; Appointment of Receiver. (a) After closing a state trust company under Section 186.201, the banking commissioner shall attach to or otherwise display at its main entrance a copy of the written closing order issued under Section 186.201(a) and containing the findings on which the closing of the state trust company is based. A correspondent bank of the closed state trust company may not pay an item drawn on the account of the closed state trust company that is presented for payment after the correspondent has received actual notice of closing unless it previously certified the item for payment.

(b) As soon as practicable after posting the closing order at the state trust company's main entrance, the banking commissioner shall tender the state trust company to the Federal Deposit Insurance Corporation as provided by Section 186.003 or initiate a receivership proceeding by filing a certified copy of the closing order in district court in Travis County, subject to Subsection (c). The court in which the closing order is filed shall docket it as a case styled, "In re liquidation of ____" (inserting the name of the state trust company). When the closing order is filed, the court has constructive custody of all the state trust company's assets and any action that seeks to directly or indirectly affect state trust company assets is considered an intervention in the receivership proceeding and subject to this subchapter and Subchapter D.

(c) Venue for an action instituted to effect, contest, or intervene in the liquidation of a state trust company is in Travis County, except that on motion filed and served concurrently with or before the filing of the answer, the court may, on a finding of good cause, transfer the action to the county of the state trust company's home office.

Sec. 186.203. Nature and Duration of Receivership. (a) The court may not require a bond from the banking commissioner as receiver.

(b) A reference in this chapter to the receiver is a reference to the banking commissioner as receiver and to any successors in office, the Federal Deposit Insurance Corporation if acting as receiver as provided by Section 186.003 and federal law, or an independent receiver appointed at the request of the banking commissioner as provided by Section 186.004.

(c) The receiver has all the powers of the directors, managers, managing participants, officers, and shareholders or participants of the state trust company as necessary to support an action taken on behalf of the state trust company.

(d) The receiver and all employees and agents acting on behalf of the receiver are acting in an official capacity and are protected by Section 12.106. An act of the receiver is an act of the state trust company in liquidation. This state or a political subdivision of this state is not liable and may not be held accountable for any debt or obligation of a state trust company in receivership.

(e) Section 64.072, Civil Practice and Remedies Code, applies to the receivership of a state trust company except as provided by this subsection. A state trust company receivership shall be administered continuously for the length of time necessary to complete its purposes, and a period prescribed by other law limiting the time for the administration of a receivership or of corporate affairs generally, including Section 64.072(d), Civil Practice and Remedies Code, does not apply.

Sec. 186.204. Contest of Liquidation. (a) A state trust company, acting through a majority of its directors, managers, or managing participants, may intervene in an action filed by the banking commissioner closing a state trust company to challenge the banking commissioner's closing of the state trust company and to enjoin the banking commissioner or other receiver from liquidating its assets. The state trust company must file the intervention not later than the second business day after the closing of the state trust company, excluding legal holidays. The court may issue an ex parte order restraining the receiver from liquidating state trust company assets pending a hearing on the injunction. The receiver shall comply with the restraining order but may petition the court for permission to liquidate an asset as necessary to prevent its loss or diminution pending the outcome of the injunction action.

(b) The court shall hear an action under Subsection (a) as quickly as possible and shall give it priority over other business.

(c) The state trust company or receiver may appeal the court's judgment as in other civil cases, except that the receiver shall retain all state trust company assets pending a final appellate court order even if the banking commissioner does not prevail in the trial court. If the banking commissioner prevails in the trial court, liquidation of the state trust company may proceed unless the trial court or appellate court orders otherwise. If liquidation is enjoined or stayed pending appeal, the trial court retains jurisdiction to permit liquidation of an asset as necessary to prevent its loss or diminution pending the outcome of the appeal.

Sec. 186.205. Notice of State Trust Company Closing. (a) As soon as reasonably practicable after initiation of the receivership proceeding, the receiver shall publish notice, in a newspaper of general circulation in each community where the state trust company's home office or any additional trust office is located. The notice must state that:

(1) the state trust company has been closed for liquidation;

(2) clients and creditors must present their claims for payment on or before a specific date; and

(3) all safe deposit box holders and bailors of property left with the state trust company should remove their property not later than a specified date.

(b) A date that the receiver selects under Subsection (a):

(1) may not be earlier than the 121st day after the date of the notice; and

(2) must allow:

(A) the affairs of the state trust company to be wound up as quickly as feasible; and

(B) creditors, clients, and owners of property adequate time for presentation of claims, withdrawal of accounts, and redemption of property.

(c) The receiver may adjust the dates under Subsection (a) with the approval of the court and with or without republication of notice if additional time appears needed for those activities.

(d) As soon as reasonably practicable given the state of state trust company records and the adequacy of staffing, the receiver shall mail to each of the state trust company's known clients, creditors, safe deposit box holders, and bailors of property left with the state trust company, at the mailing address shown on the state trust company's records, an individual notice containing the information required in a notice under Subsection (a) and specific information pertinent to the account or property of the addressee.

(e) The receiver may determine the form and content of notices under this section.

Sec. 186.206. Inventory. As soon as reasonably practicable given the state of state trust company records and the adequacy of staffing, the receiver shall prepare a comprehensive inventory of the state trust company's assets for filing with the court. The inventory is open to inspection.

Sec. 186.207. Receiver's Title and Priority. (a) The receiver has the title to all the state trust company's property, contracts, and rights of action, wherever located, beginning on the date the state trust company is closed for liquidation.

(b) The rights of the receiver have priority over a contractual lien or statutory landlord's lien under Chapter 54, Property Code, judgment lien, attachment lien, or voluntary lien that arises after the date of the closing of the state trust company for liquidation.

(c) The filing or recording of a receivership order in a record office of this state gives the same notice that would be given by a deed, bill of sale, or other evidence of title filed or recorded by the state trust company in liquidation. The recording clerk shall index a recorded receivership order in the records to which the order relates.

Sec. 186.208. Rights Fixed. The rights and liabilities of the state trust company in liquidation and of a client, creditor, officer, director, manager, managing participant, employee, shareholder, participant, participant-transferee, agent, or other person interested in the state trust company's estate are fixed on the date of closing of the state trust company for liquidation except as otherwise directed by the court or as expressly provided otherwise by this subchapter or Subchapter D.

Sec. 186.209. Depositories. (a) The receiver may deposit money collected on behalf of the state trust company estate in:

(1) the Texas Treasury Safekeeping Trust Company in accordance with procedures established by the comptroller; or

(2) one or more depository institutions in this state, the deposits of which are insured by the Federal Deposit Insurance Corporation or its successor, if the receiver, using sound financial judgment, determines that it would be advantageous to do so.

(b) If receivership money deposited in an account at a state bank exceeds the maximum insured amount, the receiver shall require the excess deposit to be adequately secured through pledge of securities or otherwise, without approval of the court. The depository bank may secure the deposits of the state trust company in liquidation on behalf of the receiver, notwithstanding any other provision of this subtitle.

Sec. 186.210. Pending Lawsuit. (a) A judgment or order of a court of this state or of another jurisdiction in an action pending by or against the state trust company, rendered after the date the state trust company was closed for liquidation, is not binding on the receiver unless the receiver was made a party to the suit.

(b) Before the first anniversary of the date the state trust company was closed for liquidation, the receiver may not be required to plead to any suit pending against the state trust company in a court in this state on the date the state trust company was closed for liquidation and in which the receiver is a proper plaintiff or defendant.

(c) Sections 64.052, 64.053, and 64.056, Civil Practice and Remedies Code, do not apply to a state trust company estate being administered under this subchapter and Subchapter D.

Sec. 186.211. New Lawsuit. (a) Except as otherwise provided by this section, the court in which a receivership proceeding is pending under this subchapter has exclusive jurisdiction to hear and determine all actions or proceedings instituted by or against the state trust company or receiver after the receivership proceeding begins.

(b) The receiver may file in any jurisdiction an ancillary suit that may be helpful to obtain jurisdiction or venue over a person or property.

(c) Exclusive venue lies in Travis County for an action or proceeding instituted against the receiver or the receiver's employee, including an employee of the department, that asserts personal liability on the part of the receiver or employee.

Sec. 186.212. Obtaining Record or Other Property in Possession of Other Person. (a) Each state trust company affiliate, officer, director, manager, managing participant, employee, shareholder, participant, participant-transferee, trustee, agent, servant, employee, attorney, attorney-in-fact, or correspondent shall immediately deliver to the receiver, without cost to the receiver, any record or other property of the state trust company or that relates to the business of the state trust company.

(b) If by contract or otherwise a record or other property that can be copied is the property of a person listed in Subsection (a), it shall be copied and the copy shall be delivered to the receiver. The owner shall retain the original until notification by the receiver that it is no longer required in the administration of the state trust company's estate or until another time the court, after notice and hearing, directs. The copy is considered to be a record of the state trust company in liquidation under Section 186.225.

Sec. 186.213. Injunction in Aid of Liquidation. (a) On application by the receiver, the court with or without notice may issue an injunction:

(1) restraining each state trust company officer, director, manager, managing participant, employee, shareholder, participant, participant-transferee, trustee, agent, servant, employee, attorney, attorney-in-fact, accountant or accounting firm, correspondent, or other person from transacting the state trust company's business or wasting or disposing of its property; or

(2) requiring the delivery of the state trust company's property or assets to the receiver subject to the further order of the court.

(b) At any time during a proceeding under this subchapter, the court may issue another injunction or order considered necessary or desirable to prevent:

(1) interference with the receiver or the proceeding;

(2) waste of the assets of the state trust company;

(3) the beginning or prosecution of an action;

(4) the obtaining of a preference, judgment, attachment, garnishment, or other lien; or

(5) the making of a levy against the state trust company or against its assets.

Sec. 186.214. Subpoena. (a) The receiver may request the court ex parte to issue a subpoena to compel the attendance and testimony of a witness before the receiver and the production of a record relating to the receivership estate. For that purpose the receiver or the receiver's designated representative may administer an oath or affirmation, examine a witness, or receive evidence. The court has statewide subpoena power and may compel attendance and production of a record before the receiver at the state trust company, the office of the receiver, or another location.

(b) A person served with a subpoena under this section may file a motion with the court for a protective order as provided by Rule 166b, Texas Rules of Civil Procedure. In a case of disobedience of a subpoena or the contumacy of a witness appearing before the receiver or the receiver's designated representative, the receiver may request and the court may issue an order requiring the person subpoenaed to obey the subpoena, give evidence, or produce a record relating to the matter in question.

(c) A witness who is required to appear before the receiver is entitled to receive:

(1) reimbursement for mileage, in the amount for travel by a state employee, for traveling to or returning from a proceeding that is more than 25 miles from the witness's residence; and

(2) a fee for each day or part of a day the witness is necessarily present as a witness in an amount set by the receiver with the approval of the court of not less than $10 a day and not more than an amount equal to the per diem travel allowance of a state employee.

(d) A payment of fees under Subsection (c) is an administrative expense.

(e) The receiver may serve the subpoena or have it served by the receiver's authorized agent, a sheriff, or a constable. The sheriff's or constable's fee for serving a subpoena must be the same as the fee paid the sheriff or constable for similar services.

(f) A subpoena issued under this section to a financial institution is not subject to Section 59.006.

(g) On certification by the receiver under official seal, a record produced or testimony taken as provided by this section and held by the receiver is admissible in evidence in any case without proof of its correctness or other proof, except the certificate of the receiver that the record or testimony was received from the person producing the record or testifying. The certified record or a certified copy of the record is prima facie evidence of the facts it contains. This section does not limit another provision of this subchapter, Subchapter D, or another law that provides for the admission of evidence or its evidentiary value.

Sec. 186.215. Executory Contract; Oral Agreement. (a) Not later than six months after the date the receivership proceeding begins, the receiver may terminate any executory contract to which the state trust company is a party or any obligation of the state trust company as a lessee. A lessor who receives notice of the receiver's election to terminate the lease before the 60th day before the termination date is not entitled to rent or damages for termination, other than rent accrued to the date of termination.

(b) An agreement that tends to diminish or defeat the interest of the estate in a state trust company asset is not valid against the receiver unless the agreement:

(1) is in writing;

(2) was executed by the state trust company and any person claiming an adverse interest under the agreement, including the obligor, when the state trust company acquired the asset;

(3) was approved by the board of the state trust company or its designated committee, and the approval is reflected in the minutes of the board or committee; and

(4) has been continuously since its execution an official record of the state trust company.

Sec. 186.216. Preferences. (a) A transfer of or lien on the property or assets of a state trust company is voidable by the receiver if the transfer or lien:

(1) was made or created after:

(A) four months before the date the state trust company is closed for liquidation; or

(B) one year before the date the state trust company is closed for liquidation if the receiving creditor was at the time an affiliate, officer, director, manager, managing participant, principal shareholder, or participant of the state trust company or an affiliate of the trust company;

(2) was made or created with the intent of giving to a creditor or depositor, or enabling a creditor or depositor to obtain, a greater percentage of the claimant's debt than is given or obtained by another claimant of the same class; and

(3) is accepted by a creditor or depositor having reasonable cause to believe that a preference will occur.

(b) Each state trust company officer, director, manager, managing participant, employee, shareholder, participant, participant-transferee, trustee, agent, servant, employee, attorney-in-fact, or correspondent, or other person acting on behalf of the state trust company, who has participated in implementing a voidable transfer or lien, and each person receiving property or the benefit of property of the state trust company as a result of the voidable transfer or lien, is personally liable for the property or benefit received and shall account to the receiver for the benefit of the clients and creditors of the state trust company.

(c) The receiver may avoid a transfer of or lien on the property or assets of a state trust company that a client, creditor, shareholder, participant, or participant-transferee of the state trust company could have avoided and may recover the property transferred or its value from the person to whom it was transferred or from a person who has received it unless the transferee or recipient was a bona fide holder for value before the date the state trust company was closed for liquidation.

Sec. 186.217. Employees of Receiver. The receiver may employ agents, legal counsel, accountants, appraisers, consultants, and other personnel the receiver considers necessary to assist in the performance of the receiver's duties. The receiver may use personnel of the department if the receiver considers the use to be advantageous or desirable. The expense of employing those persons is an administrative expense.

Sec. 186.218. Disposal of Property; Settling of Claim. (a) In liquidating a state trust company, the receiver on order of the court entered with or without hearing may:

(1) sell all or part of the property of the state trust company;

(2) borrow money and pledge all or part of the assets of the state trust company to secure the debt created, except that the receiver may not be held personally liable to repay borrowed funds;

(3) compromise or compound a doubtful or uncollectible debt or claim owed by or owing to the state trust company; and

(4) enter another agreement on behalf of the state trust company that the receiver considers necessary or proper to the management, conservation, or liquidation of its assets.

(b) If the amount of a debt or claim owed by or owing to the state trust company or the value of an item of property of the trust company does not exceed $20,000, excluding interest, the receiver may compromise or compound the debt or claim or sell the property on terms the receiver considers to be in the best interest of the state trust company estate without obtaining the approval of the court.

(c) With the approval of the court, the receiver may sell or offer or agree to sell an asset of the state trust company, other than a fiduciary asset, to a depositor or creditor of the state trust company. Payment may be in whole or in part out of distributions payable to the purchasing creditor or depositor on account of an approved claim against the state trust company's estate. On application by the receiver, the court may designate one or more representatives to act for certain clients or creditors as a class in the purchase, holding, and management of assets purchased by the class under this section, and the receiver may with the approval of the court advance the expenses of the appointed representative against the security of the claims of the class.

Sec. 186.219. Court Order; Notice and Hearing. If the court requires notice and hearing before entering an order, the court shall set the time and place of the hearing and prescribe whether the notice is to be given by service on specific parties, by publication, or by a combination of those methods. The court may not enter an order requested by a person other than the receiver without notice to the receiver and an opportunity for the receiver to be heard.

Sec. 186.220. Receiver's Reports; Expenses. (a) The receiver shall file with the court:

(1) a quarterly report showing the operation, receipts, expenditures, and general condition of the state trust company in liquidation; and

(2) a final report regarding the liquidated state trust company showing all receipts and expenditures and giving a full explanation and a statement of the disposition of all assets of the state trust company.

(b) The receiver shall pay all administrative expenses out of money or other assets of the state trust company. Each quarter the receiver shall swear to and submit to the court an itemized report of those expenses. The court shall approve the report unless an objection is filed before the 11th day after the date it is submitted. An objection may be made only by a party in interest and must specify each item objected to and the ground for the objection. The court shall set the objection for hearing and notify the parties of this action. The objecting party has the burden of proof to show that the item objected to is improper, unnecessary, or excessive.

(c) The court may prescribe whether the notice of the receiver's report is to be given by service on specific parties, by publication, or by a combination of those methods.

Sec. 186.221. Court-ordered Audit. (a) The court may order an audit of the books and records of the receiver that relate to the receivership. A report of an audit ordered under this section shall be filed with the court. The receiver shall make the books and records relating to the receivership available to the auditor as required by the court order.

(b) The receiver shall pay the expenses of an audit ordered under this section as an administrative expense.

Sec. 186.222. Safe Deposits and Other Bailments. (a) A contract between the state trust company and another person for bailment, of deposit for hire, or for the lease of a safe, vault, or box ceases on the date specified for removal of property in the notices that were published and mailed or a later date approved by the receiver or the court. A person who has paid rental or storage charges for a period extending beyond the date designated for removal of property has a claim against the state trust company estate for a refund of the unearned amount paid.

(b) If the property is not removed by the date the contract ceases, the receiver shall inventory the property. In making the inventory, the receiver may open a safe, vault, or box, or any package, parcel, or receptacle, in the custody or possession of the receiver. The property shall be marked to identify, to the extent possible, its owner or the person who left it with the state trust company. After all property belonging to others that is in the receiver's custody and control has been inventoried, the receiver shall compile a master list that is divided for each office of the state trust company that received property that remains unclaimed. The receiver shall publish, in a newspaper of general circulation in each community in which the state trust company had an office that received property that remains unclaimed, the list and the names of the owners of the property as shown in the state trust company's records. The published notice shall specify a procedure for claiming the property unless the court, on application of the receiver, approves an alternate procedure.

Sec. 186.223. Fiduciary Activities. (a) As soon after beginning the receivership proceeding as is practicable, the receiver shall:

(1) terminate all fiduciary positions the state trust company holds;

(2) surrender all property held by the state trust company as a fiduciary; and

(3) settle the state trust company's fiduciary accounts.

(b) The receiver shall release all segregated and identifiable fiduciary property held by the state trust company to successor fiduciaries.

(c) With the approval of the court, the receiver may sell the administration of all or substantially all remaining fiduciary accounts to one or more successor fiduciaries on terms that appear to be in the best interest of the state trust company's estate and the persons interested in the fiduciary accounts.

(d) If commingled fiduciary money held by the state trust company as trustee is insufficient to satisfy all fiduciary claims to the commingled money, the receiver shall distribute commingled money pro rata to all fiduciary claimants of commingled money based on their proportionate interests after payment of administrative expenses related solely to the fiduciary claims. The fictional tracing rule does not apply.

(e) The receiver may require a fiduciary claimant to file a proof of claim if the records of the state trust company are insufficient to identify the claimant's interest.

Sec. 186.224. Disposition and Maintenance of Records. (a) On approval by the court, the receiver may dispose of records of the state trust company in liquidation that are obsolete and unnecessary to the continued administration of the receivership proceeding.

(b) The receiver may devise a method for the effective, efficient, and economical maintenance of the records of the state trust company and of the receiver's office. The methods may include maintaining those records on any medium approved by the records management division of the Texas State Library.

(c) To maintain the records of the liquidated state trust company after the closing of the receivership proceeding, the receiver may reserve assets of an estate, deposit them in an account, and use them for maintenance, storage, and disposal of records in closed receivership estates.

(d) Records of a liquidated state trust company are not government records for any purpose, including

Chapter 552, Government Code, but shall be preserved and disposed of as if they were records of the department under Chapter 441, Government Code. Those records are confidential as provided by:

(1) Section 59.006;

(2) Subchapter D, Chapter 181; and

(3) rules adopted under this subtitle.

Sec. 186.225. Records Admitted. (a) A record of a state trust company in liquidation obtained by the receiver and held in the course of the receivership proceeding or a certified copy of the record under the official seal of the receiver is admissible in evidence in all cases without proof of correctness or other proof, except the certificate of the receiver that the record was received from the custody of the state trust company or found among its effects.

(b) The receiver may certify the correctness of a record of the receiver's office, including a record described by Subsection (a), and may certify any fact contained in the record. The record is admissible in evidence in all cases in which the original would be evidence.

(c) The original record or a certified copy of the record is prima facie evidence of the facts it contains.

(d) A copy of an original record or another record that is maintained on a medium approved by the records management division of the Texas State Library, within the scope of this section, and produced by the receiver or the receiver's authorized representative under this section:

(1) has the same effect as the original record; and

(2) may be used the same as the original record in a judicial or administrative proceeding in this state.

Sec. 186.226. Resumption of Business. (a) A state trust company closed under Section 186.201 may not be reopened without the approval of the banking commissioner unless a contest of liquidation under Section 186.204 is finally resolved adversely to the banking commissioner and the court authorizes its reopening.

(b) The banking commissioner may place temporary limits on the right of withdrawals by, or payments to, individual clients and creditors of a state trust company reopened under this section, in accordance with applicable law.

(c) As a depositor or creditor of a reopened state trust company, this state or a political subdivision of this state may agree to temporary limits that the banking commissioner places on payments or withdrawals.

Sec. 186.227. Assets Discovered after Close of Receivership. (a) The banking commissioner shall report to the court discovery of an asset having value that:

(1) the banking commissioner discovers after the receivership was closed by final order of the court; and

(2) was abandoned as worthless or unknown during receivership.

(b) The court may reopen the receivership proceeding for continued liquidation if the value of the after-discovered assets justifies the reopening.

(c) If the banking commissioner suspects that the information concerning after-disclosed assets may have been intentionally or fraudulently concealed, the banking commissioner shall notify appropriate civil and criminal authorities to determine any applicable penalties.

Subchapter D. Claims Against Receivership Estate

Sec. 186.301. Filing Claim. (a) This section applies only to a claim by a person, other than a shareholder, participant, or participant-transferee acting in that capacity, who has a claim against a state trust company in liquidation, including a claimant with a secured claim or a claimant under a fiduciary relationship that has been ordered by the receiver to file a claim pursuant to Section 186.223.

(b) To receive payment of a claim, the person must present proof of the claim to the receiver:

(1) at a place specified by the receiver; and

(2) within the period specified by the receiver under Section 186.205.

(c) Receipt of the required proof of claim by the receiver is a condition precedent to the payment of the claim.

(d) A claim that is not filed within the period specified by the receiver may not participate in a distribution of the assets by the receiver, except that, subject to court approval, the receiver may accept a claim filed not later than the 180th day after the date notice of the claimant's right to file a proof of claim is mailed to the claimant.

(e) A claim accepted under this section and approved is subordinate to an approved claim of a general creditor.

(f) Interest does not accrue on a claim after the date the state trust company is closed for liquidation.

Sec. 186.302. Proof of Claim. (a) A proof of claim must be in writing, be signed by the claimant, and include:

(1) a statement of the claim;

(2) a description of the consideration for the claim;

(3) a statement of whether collateral is held or a security interest is asserted against the claim and, if so, a description of the collateral or security interest;

(4) a statement of any right of priority of payment for the claim or other specific right asserted by the claimant;

(5) a statement of whether a payment has been made on the claim and, if so, the amount and source of the payment, to the extent known by the claimant;

(6) a statement that the amount claimed is justly owed by the state trust company in liquidation to the claimant; and

(7) any other matter that is required by the court.

(b) The receiver may designate the form of the proof of claim. A proof of claim must be filed under oath unless the oath is waived by the receiver. A proof of claim filed with the receiver is considered filed in an official proceeding for purposes of Chapter 37, Penal Code.

(c) If a claim is founded on a written instrument, the original instrument, unless lost or destroyed, must be filed with the proof of claim. After the instrument is filed, the receiver may permit the claimant to substitute a copy of the instrument until the final disposition of the claim. If the instrument is lost or destroyed, a statement of that fact and of the circumstances of the loss or destruction must be filed under oath with the claim.

Sec. 186.303. Judgment as Proof of Claim. (a) A judgment entered against a state trust company in liquidation before the date the state trust company was closed for liquidation may not be given higher priority than a claim of an unsecured creditor unless the judgment creditor in a proof of claim proves the allegations supporting the judgment to the receiver's satisfaction.

(b) A judgment against the state trust company taken by default or by collusion before the date the state trust company was closed for liquidation may not be considered as conclusive evidence of the liability of the state trust company to the judgment creditor or of the amount of damages to which the judgment creditor is entitled.

(c) A judgment against the state trust company entered after the date the state trust company was closed for liquidation may not be considered as evidence of liability or of the amount of damages.

Sec. 186.304. Secured Claim. (a) The owner of a secured deposit may file a claim as a creditor against a state trust company in liquidation. The value of security shall be determined under supervision of the court by converting the security into money.

(b) The owner of a secured claim against a state trust company in liquidation may:

(1) surrender the security and file a claim as a general creditor; or

(2) apply the security to the claim and discharge the claim.

(c) If the owner applies the security and discharges the claim under Subsection (b), any deficiency shall be treated as a claim against the general assets of the state trust company on the same basis as a claim of an unsecured creditor. The amount of the deficiency shall be determined as provided by Section 186.305, except that if the amount of the deficiency has been adjudicated by a court in a proceeding in which the receiver has had notice and an opportunity to be heard, the court's decision is conclusive as to the amount.

(d) The value of security held by a secured creditor shall be determined under supervision of the court by:

(1) converting the security into money according to the terms of the agreement under which the security was delivered to the creditor; or

(2) agreement, arbitration, compromise, or litigation between the creditor and the receiver.

Sec. 186.305. Unliquidated or Undetermined Claim. (a) A claim based on an unliquidated or undetermined demand shall be filed within the period provided by Subchapter C for the filing of a claim. The claim may not share in any distribution to claimants until the claim is definitely liquidated, determined, and allowed. After the claim is liquidated, determined, and allowed, the claim shares ratably with the claims of the same class in all subsequent distributions.

(b) For the purposes of this section, a demand is considered unliquidated or undetermined if the right of action on the demand accrued while a state trust company was closed for liquidation and the liability on the demand has not been determined or the amount of the demand has not been liquidated.

(c) If the receiver in all other respects is in a position to close the receivership proceeding, the proposed closing is sufficient grounds for the rejection of any remaining claim based on an unliquidated or undetermined demand. The receiver shall notify the claimant of the intention to close the proceeding. If the demand is not liquidated or determined before the 61st day after the date of the notice, the receiver may reject the claim.

Sec. 186.306. Set-Off. (a) Mutual credits and mutual debts shall be set off and only the balance allowed or paid, except that a set-off may not be allowed in favor of a person if:

(1) the obligation of a state trust company to the person on the date the state trust company was closed for liquidation did not entitle the person to share as a claimant in the assets of the state trust company;

(2) the obligation of the state trust company to the person was purchased by or transferred to the person after the date the state trust company was closed for liquidation or for the purpose of increasing set-off rights; or

(3) the obligation of the person or the state trust company is as a trustee or fiduciary.

(b) On request, the receiver shall provide a person with an accounting statement identifying each debt that is due and payable. A person who owes a state trust company an amount that is due and payable against which the person asserts set-off of mutual credits that may become due and payable from the state trust company in the future shall promptly pay to the receiver the amount due and payable. The receiver shall promptly refund, to the extent of the person's prior payment, mutual credits that become due and payable to the person by the state trust company in liquidation.

Sec. 186.307. Action on Claim. (a) Not later than six months after the last day permitted for the filing of claims or a later date allowed by the court, the receiver shall accept or reject in whole or in part each claim filed against the state trust company in liquidation, except for an unliquidated or undetermined claim governed by Section 186.305. The receiver shall reject a claim if the receiver doubts its validity.

(b) The receiver shall mail written notice to each claimant, specifying the disposition of the person's claim. If a claim is rejected in whole or in part, the receiver in the notice shall specify the basis for rejection and advise the claimant of the procedures and deadline for appeal.

(c) The receiver shall send each claimant a summary schedule of approved and rejected claims by priority class and notify the claimant:

(1) that a copy of a schedule of claims disposition including only the name of the claimant, the amount of the claim allowed, and the amount of the claim rejected is available on request; and

(2) of the procedure and deadline for filing an objection to an approved claim.

(d) The receiver or an agent or employee of the receiver, including an employee of the department, is not liable, and a cause of action may not be brought against the person, for an act or omission of the person relating to the adjustment, negotiation, or settlement of a claim.

Sec. 186.308. Objection to Approved Claim. The receiver with court approval shall set a deadline for an objection to an approved claim. On or before that date a depositor, creditor, other claimant, shareholder, participant, or participant-transferee of the state trust company may file an objection to an approved claim. The objection shall be heard and determined by the court. If the objection is sustained, the court shall direct an appropriate modification of the schedule of claims.

Sec. 186.309. Appeal of Rejected Claim. (a) The receiver's rejection of a claim may be appealed in the court in which the receivership proceeding is pending. The appeal must be brought within three months after the date of service of notice of the rejection.

(b) If the appeal is timely brought, review is de novo as if it were an action originally filed in the court, and is subject to the rules of procedure and appeal applicable to civil cases. An action to appeal rejection of a claim by the receiver is separate from the receivership proceeding, and may not be initiated by a claimant intervening in the receivership proceeding.

(c) If the action is not timely brought, the action of the receiver is final and not subject to review.

Sec. 186.310. Payment of Claim. (a) Except as expressly provided otherwise by this subchapter or

Subchapter C, without the approval of the court the receiver may not make a payment on a claim, other than a claim for an obligation incurred by the receiver for administrative expenses.

(b) The banking commissioner shall deposit in one or more banks located in this state all money available for the benefit of nonclaiming depositors and creditors. The banking commissioner shall pay the depositors or creditors on demand any amount held for their benefit.

(c) The receiver may periodically make partial distribution to the holders of approved claims if:

(1) all objections have been heard and decided as provided by Section 186.308;

(2) the time for filing appeals has expired as provided by Section 186.309;

(3) money has been made available to provide for the payment of all nonclaiming depositors and creditors in accordance with Subsection (b); and

(4) a proper reserve is established for the pro rata payment of:

(A) rejected claims that have been appealed; and

(B) any claims based on unliquidated or undetermined demands governed by Section 186.305.

(d) As soon as practicable after the determination of all objections, appeals, and claims based on previously unliquidated or undetermined demands governed by Section 186.305 and money has been made available to provide for the payment of all nonclaiming depositors and creditors in accordance with Subsection (b), the receiver shall distribute the assets of the state trust company in satisfaction of approved claims other than claims asserted in a person's capacity as a shareholder, participant, or participant-transferee.

Sec. 186.311. Priority of Claims Against Insured State Trust Company. The distribution of assets from the estate of a state trust company the trust deposits of which are insured by the Federal Deposit Insurance Corporation or its successor shall be made in the same order of priority as assets would be distributed on liquidation or purchase of assets and assumption of liabilities of a national bank under federal law.

Sec. 186.312. Priority of Claims Against Uninsured State Trust Company. (a) The priority of distribution of assets from the estate of a state trust company the trust deposits of which are not insured by the Federal Deposit Insurance Corporation or its successor shall be in accordance with the order of each class as provided by this section. Every claim in each class shall be paid in full, or adequate money shall be retained for that payment, before a member of the next class may receive any payment. A subclass may not be established within a class, except for a preference or subordination within a class expressly created by contract or other instrument or in the certificate of formation.

(b) Assets shall be distributed in the following order of priority:

(1) administrative expenses;

(2) approved claims of secured trust deposits to the extent of the value of the security as provided by Section 186.304(a);

(3) approved claims of secured creditors to the extent of the value of the security as provided by Section 186.304(b);

(4) approved claims by beneficiaries of insufficient commingled fiduciary money or missing fiduciary property and approved claims of clients of the state trust company;

(5) other approved claims of general creditors not falling within a higher priority under this section, including unsecured claims for taxes and debts due the federal government or a state or local government;

(6) approved claims of a type described by Subdivisions (1)-(5) that were not filed within the period prescribed by this subchapter; and

(7) claims of capital note or debenture holders or holders of similar obligations and proprietary claims of shareholders, participants, participant-transferees, or other owners according to the terms established by issue, class, or series.

(c) Subject to Sections 186.310 and 186.313, the banking commissioner may make a ratable distribution to approved claimants within a particular class or priority if:

(1) all timely filed and approved claims of a higher priority have been satisfied; and

(2) there is insufficient money to fully satisfy all of those claims, after reserving money for administrative expenses as necessary.

Sec. 186.313. Excess Assets. (a) If state trust company assets remain after the receiver has provided for unclaimed distributions and all of the liabilities of the state trust company in liquidation, the receiver shall distribute the remaining assets to the shareholders or participants of the state trust company.

(b) If the remaining assets are not liquid or if they otherwise require continuing administration, the receiver may call a meeting of the shareholders or participants and participant-transferees of the state trust company. The receiver shall give notice of the meeting:

(1) in a newspaper of general circulation in the county where the home office of the state trust company was located; and

(2) by written notice to the shareholders or participants and participant-transferees of record at their last known addresses.

(c) At the meeting, the shareholders or participants shall appoint one or more agents to take over the affairs to continue the liquidation for the benefit of the shareholders or participants and participant-transferees. Voting privileges are governed by the state trust company's bylaws and certificate of formation. If a quorum cannot be obtained at the meeting, the banking commissioner shall appoint an agent. An agent appointed under this subsection shall execute and file with the court a bond approved by the court, conditioned on the faithful performance of all the duties of the trust.

(d) Under order of the court the receiver shall transfer and deliver to one or more agents for continued liquidation under the court's supervision all assets of the state trust company remaining in the receiver's hands. The court shall discharge the receiver from further liability to the state trust company and its clients, creditors, shareholders, participants, and participant-transferees.

(e) The state trust company may not resume business and the charter of the state trust company is void on the date the court issues the order directing the receiver to transfer and deliver the remaining assets of the state trust company to one or more agents.

Sec. 186.314. Unclaimed Property. After completion of the liquidation, any unclaimed property remaining with the receiver shall be delivered to the comptroller as provided by Chapter 74, Property Code.

CHAPTER 187. MULTISTATE TRUST BUSINESS

Subchapter A. General Provisions

Subchapter B. Out-of-State Trust Company Trust Office

Subchapter C. Out-of-State Trust Institution Representative Trust Office

Subchapter D. Supervision of Out-of-State Trust Company

CHAPTER 187. MULTISTATE TRUST BUSINESS

Subchapter A. General Provisions

Sec. 187.001. Definitions. (a) In this chapter:

(1) "Acquire" means an act that results in direct or indirect control by an out-of-state trust company of a state trust institution, including an act that causes the company to:

(A) merge with the state trust institution;

(B) assume direct or indirect ownership of a controlling interest in any class of voting shares of the state trust institution; or

(C) assume direct ownership or control of all or substantially all of the accounts of a state trust institution.

(2) "Bank" means:

(A) a state bank chartered under Chapter 32 or the laws of another state;

(B) a national bank chartered under federal law; or

(C) a foreign bank that is organized under the laws of a territory of the United States, Puerto Rico, Guam, American Samoa, or the Virgin Islands and that has its deposits insured by the Federal Deposit Insurance Corporation.

(3) "Branch" has the meaning assigned by Section 31.002(a).

(4) "Credit union" means a credit union chartered under Chapter 122, the laws of another state, or federal law.

(5) "De novo trust office" means a trust office located in a host state that:

(A) is originally established by a trust company as a trust office; and

(B) does not become a trust office of the trust company as a result of an acquisition or conversion of another trust institution.

(6) "Foreign bank" has the meaning assigned by Section 1(b)(7), International Banking Act (12 U.S.C. Section 3101(7)), as amended.

(7) "Home state" means:

(A) with respect to a federally chartered trust institution or a foreign bank, the state in which the institution maintains its principal office; and

(B) with respect to another trust institution, the state that chartered the institution.

(8) "Home state regulator" means the supervisory agency with primary responsibility for chartering and supervising a trust company.

(9) "Host state" means a state, other than the home state of a trust company, or a foreign country in which the trust company maintains or seeks to acquire or establish an office.

(10) "Office" means, with respect to a trust company, the principal office, a trust office, or a representative trust office.

(11) "Out-of-state trust company" means a trust company:

(A) whose home state is another state; or

(B) that is chartered under the laws of a foreign country.

(12) "Principal office" means:

(A) with respect to a state trust company, its home office as defined by Section 181.002(a); and

(B) with respect to a bank, savings bank, savings association, foreign bank, or out-of-state trust company, its main office or principal place of business in the United States.

(13) "Representative trust office" means an office at which a trust company has been authorized by the banking commissioner to engage in activities other than acting as a fiduciary as provided by Subchapter C.

(14) "Savings association" means a savings and loan association chartered under Chapter 62, the laws of another state, or federal law.

(15) "Savings bank" means a savings bank chartered under Chapter 92, the laws of another state, or federal law.

(16) "State" means any state of the United States, the District of Columbia, any territory of the United States, Puerto Rico, Guam, American Samoa, the Trust Territory of the Pacific Islands, the Virgin Islands, and the Northern Mariana Islands.

(17) "State trust institution" means a trust institution whose home state is this state.

(18) "Supervisory agency" means:

(A) an agency of another state or a foreign country with primary responsibility for chartering and supervising a trust institution; and

(B) with respect to a federally chartered trust institution or foreign bank, the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the Board of Governors of the Federal Reserve System, the Office of Thrift Supervision, or the National Credit Union Administration, as applicable.

(19) "Trust company" means a state trust company or a company chartered under the laws of another state or a foreign country to conduct a trust business that is not a bank, credit union, savings association, savings bank, or foreign bank.

(20) "Trust institution" means a bank, credit union, foreign bank, savings association, savings bank, or trust company that is authorized by its charter to conduct a trust business.

(21) "Trust office" means an office, other than the principal office, at which a trust company is licensed by the banking commissioner to conduct a trust business.

(b) The definitions provided by Section 181.002(a) apply to this chapter to the extent not inconsistent with this chapter.

(c) The definitions shall be liberally construed to accomplish the purposes of this chapter.

(d) The finance commission by rule may adopt other definitions to accomplish the purposes of this chapter.

Sec. 187.002. Companies Authorized to Conduct a Trust Business. (a) A company may not conduct a trust business in this state unless the company is a trust institution and is:

(1) a state trust company chartered pursuant to this subtitle;

(2) a bank, savings association, savings bank, or credit union that maintains its principal office or a branch in this state in accordance with governing law, or another office in this state with the power to conduct a trust business to the extent permitted by rule;

(3) a trust company chartered under the laws of another state or a foreign country that has a trust office in this state licensed by the banking commissioner pursuant to this chapter; or

(4) a foreign bank with an office in this state that is authorized to act as a fiduciary pursuant to Section 204.106.

(b) Notwithstanding Subsection (a), a trust institution that does not maintain a principal office, branch, or trust office in this state may act as a fiduciary in this state to the extent permitted by Subchapter A, Chapter 505, Estates Code.

(c) A company does not engage in the trust business in this state in a manner requiring a charter or license under this subtitle by engaging in an activity identified in Section 182.021, except that the registration requirements of Section 187.202 may apply to a trust representative office engaging in the activity.

Sec. 187.003. Interstate Trust Business of State Trust Company. Subject to the approval of the banking commissioner pursuant to Section 182.203, a state trust company may engage in the trust business in another state or a foreign country at a trust office or a trust representative office to the extent permitted by and subject to applicable laws of the state or foreign country.

Sec. 187.004. Trust Business of Out-of-State Trust Company. (a) An out-of-state trust company that establishes or maintains an office in this state under this chapter may conduct any activity at the office that would be authorized under the laws of this state for a state trust company to conduct at the office.

(b) Before establishing an office in this state, an out-of-state trust company must comply with Section 201.102.

Sec. 187.005. Designation of Trustee and Governing Law. (a) Unless another law restricts the designation of trustee, a person residing in this state may designate a trust institution to act as a fiduciary on behalf of the person.

(b) Unless another law specifies governing law, if a trust or its subject matter bears a reasonable relation to this state and also to another state or a foreign country, a trust institution and its affected client may agree that the law of this state or of the other state or country governs their rights and duties, including the law of a state or a foreign country where the affected client resides or where the trust institution has its principal office.

(c) [Repealed][1]

Sec. 187.006. Taxation. An out-of-state trust institution doing business in this state is subject to the franchise tax to the extent provided by Chapter 171, Tax Code.

Sec. 187.007. Severability. The provisions of this chapter or applications of those provisions are severable as provided by Section 312.013, Government Code.

Subchapter B. Out-of-State Trust Company Trust Office

Sec. 187.101. Trust Offices in This State. An out-of-state trust company may engage in a trust business at an office in this state only if it establishes and maintains a trust office in this state as permitted by this subchapter.

Sec. 187.102. Establishing an Interstate Trust Office. (a) An out-of-state trust company that does not operate a trust office in this state may not establish and maintain a de novo trust office in this state unless:

(1) a state trust company would be permitted to establish a de novo trust office in the home state or foreign country of the out-of-state trust company; and

(2) a bank whose home state is this state would be permitted to establish a de novo branch in the home state or foreign country of the out-of-state trust company.

[1] Repealed eff. Sept. 1, 2007, by 80th Tex. Leg., ch. 451 (H.B. 564), §21.

(b) Subject to Subsection (a), a de novo trust office may be established in this state under this section through the acquisition of a trust office in this state of an existing trust institution.

Sec. 187.103. Acquiring an Interstate Trust Office. (a) An out-of-state trust company that does not operate a trust office in this state and that meets the requirements of this subchapter may acquire an existing trust institution in this state and after the acquisition operate and maintain the acquired institution as a trust office in this state, subject to Subchapter A, Chapter 183, or Subchapter A, Chapter 33, if applicable.

(b) An out-of-state trust institution that does not operate a trust office in this state may not establish and maintain a trust office in this state through the acquisition of a trust office of an existing trust institution except as provided by Section 187.102. This section does not affect or prohibit a trust institution or other person from chartering a state trust company pursuant to Section 182.001.

Sec. 187.104. Requirement of Notice. An out-of-state trust company desiring to establish and maintain a de novo trust office or acquire an existing trust institution in this state and to operate and maintain the acquired institution as a trust office pursuant to this subchapter shall provide written notice of the proposed transaction to the banking commissioner on or after the date on which the out-of-state trust company applies to the home state regulator for approval to establish and maintain or acquire the trust office. The filing of the notice shall be preceded or accompanied by a copy of the resolution adopted by the board authorizing the additional office and the filing fee, if any, prescribed by law. The written notice must contain sufficient information to enable an informed decision under Section 187.105.

Sec. 187.105. Conditions for Approval. (a) A trust office of an out-of-state trust company may be acquired or established in this state under this subchapter if:

(1) the out-of-state trust company confirms in writing to the banking commissioner that while it maintains a trust office in this state, it will comply with all applicable laws of this state;

(2) the out-of-state trust company provides satisfactory evidence to the banking commissioner of compliance with Section 201.102 and the applicable requirements of its home state regulator for acquiring or establishing and maintaining the office;

(3) all filing fees have been paid as required by law; and

(4) the banking commissioner finds that:

(A) applicable conditions of Section 187.102 or 187.103 have been met;

(B) if a state bank is being acquired, the applicable requirements of Subchapter A, Chapter 33 have been met, or if a state trust company is being acquired, the applicable requirements of Subchapter A, Chapter 183 have been met; and

(C) any conditions imposed by the banking commissioner pursuant to Subsection (b) have been satisfied.

(b) The banking commissioner may condition approval of a trust office on compliance by the out-of-state trust company with any requirement applicable to formation of a state trust company pursuant to Sections 182.003(b) and 182.007.

(c) If all requirements of Subsection (a) have been met, the out-of-state trust company may commence business at the trust office on the 61st day after the date the banking commissioner notifies the company that the notice required by Section 187.104 has been accepted for filing, unless the banking commissioner specifies an earlier or later date.

(d) The 60-day period of review may be extended by the banking commissioner on a determination that the written notice raises issues that require additional information or additional time for analysis. If the period of review is extended, the out-of-state trust company may establish the office only on prior written approval by the banking commissioner.

(e) If all requirements of Subsection (a) have been met, the banking commissioner may otherwise deny approval of the office if the banking commissioner finds that the out-of-state trust company lacks sufficient financial resources to undertake the proposed expansion without adversely affecting its safety or soundness or that the proposed office is contrary to the public interest. In acting on the notice, the banking commissioner shall consider the views of the appropriate supervisory agencies.

Sec. 187.106. Additional Trust Offices. An out-of-state trust company that maintains a trust office in this state under this subchapter may establish or acquire additional trust offices or representative trust offices in this state to the same extent that a state trust company may establish or acquire additional offices in this state pursuant to the procedures for establishing or acquiring the offices set forth in Section 182.203.

Subchapter C. Out-of-State Trust Institution Representative Trust Office

Sec. 187.201. Representative Trust Office Business. (a) An out-of-state trust institution may establish a representative trust office as permitted by this subchapter to:

(1) solicit, but not accept, fiduciary appointments;

(2) act as a fiduciary in this state to the extent permitted for a foreign corporate fiduciary by Subchapter A, Chapter 505, Estates Code;

(3) perform ministerial duties with respect to existing clients and accounts of the trust institution;

(4) engage in an activity permitted by Section 182.021; and

(5) to the extent the office is not acting as a fiduciary:

(A) receive for safekeeping personal property of every description;

(B) act as assignee, bailee, conservator, custodian, escrow agent, registrar, receiver, or transfer agent; and

(C) act as financial advisor, investment advisor or manager, agent, or attorney-in-fact in any agreed capacity.

(b) Except as provided by Subsection (a), a trust representative office may not act as a fiduciary or otherwise engage in the trust business in this state.

(c) Subject to the requirements of this subchapter, an out-of-state trust institution may establish and maintain representative trust offices anywhere in this state.

Sec. 187.202. Registration of Representative Trust Office. (a) Except as provided by Subsection (e) with respect to a credit union, a savings association, or a savings bank, an out-of-state trust institution that does not maintain a branch or trust office in this state and that desires to establish or acquire and maintain a representative trust office shall:

(1) file a notice on a form prescribed by the banking commissioner, setting forth:

(A) the name of the out-of-state trust institution;

(B) the location of the proposed office; and

(C) satisfactory evidence that the notificant is a trust institution;

(2) pay the filing fee, if any, prescribed by law; and

(3) submit a copy of the resolution adopted by the board authorizing the representative trust office and a copy of the trust institution's registration filed with the secretary of state pursuant to Section 201.102.

(b) The notificant may commence business at the representative trust office on the 31st day after the date the banking commissioner receives the notice unless the banking commissioner specifies an earlier or later date.

(c) The 30-day period of review may be extended by the banking commissioner on a determination that the written notice raises issues that require additional information or additional time for analysis. If the period of review is extended, the out-of-state trust institution may establish the representative trust office only on prior written approval by the banking commissioner.

(d) The banking commissioner may deny approval of the representative trust office if the banking commissioner finds that the notificant lacks sufficient financial resources to undertake the proposed expansion without adversely affecting its safety or soundness or that the proposed office would be contrary to the public interests. In acting on the notice, the banking commissioner shall consider the views of the appropriate supervisory agencies.

(e) A credit union, savings association, or savings bank that does not maintain a branch in this state and desires to establish or acquire and maintain a representative trust office shall comply with this section, except that the notice required by Subsection (a) must be filed with, and the duties and responsibilities of the banking commissioner under Subsections (b)-(d) shall be performed by:

(1) the Texas credit union commissioner, with respect to a credit union; or

(2) the Texas savings and mortgage lending commissioner, with respect to a savings association or savings bank.

(f) An out-of-state trust institution that fails to register as required by this section is subject to Subchapter C, Chapter 185.

Subchapter D. Supervision of Out-of-State Trust Company

Sec. 187.301. Cooperative Agreements; Fees. (a) To carry out the purposes of this subtitle, the banking commissioner may:

(1) enter into cooperative, coordinating, or information sharing agreements with another supervisory agency or an organization affiliated with or representing one or more supervisory agencies;

(2) with respect to periodic examination or other supervision or investigation, accept reports of examination or investigation by, and reports submitted to, another supervisory agency in lieu of conducting examinations or investigations or receiving reports as might otherwise be required or permissible under this subtitle;

(3) enter into contracts with another supervisory agency having concurrent regulatory or supervisory jurisdiction to engage the services of the agency for reasonable compensation to assist with the banking commissioner's performance of official duties under this subtitle or other law, or to provide services to the agency for reasonable compensation in connection with the agency's performance of official duties under law, except that Chapter 2254, Government Code, does not apply to those contracts;

(4) enter into joint examinations or joint enforcement actions with another supervisory agency having concurrent regulatory or supervisory jurisdiction, except that the banking commissioner may independently take action under Section 187.305 if the banking commissioner determines that the action is necessary to carry out the banking commissioner's responsibilities under this subtitle or to enforce compliance with the laws of this state; and

(5) assess supervisory and examination fees to be paid by an out-of-state trust company that maintains one or more offices in this state in connection with the banking commissioner's performance of duties under this subtitle.

(b) Supervisory or examination fees assessed by the banking commissioner in accordance with this subtitle may be shared with another supervisory agency or an organization affiliated with or representing one or more supervisory agencies in accordance with an agreement between the banking commissioner and the agency or organization. The banking commissioner may also receive a portion of supervisory or examination fees assessed by another supervisory agency in accordance with an agreement between the banking commissioner and the agency.

Sec. 187.302. Examinations; Periodic Reports. (a) To the extent consistent with Section 187.301, the banking commissioner may make examinations of a trust office or trust representative office established and maintained in this state by an out-of-state trust company pursuant to this chapter as the banking commissioner considers necessary to determine whether the office is being operated in compliance with the laws of this state and in accordance with safe and sound fiduciary practices. Sections 181.104-181.106 apply to the examinations.

(b) The finance commission may by rule prescribe requirements for periodic reports regarding a trust office or trust representative office in this state. The required reports must be provided by the trust institution maintaining the office. Reporting requirements under this subsection must be appropriate for the purpose of enabling the banking commissioner to discharge the responsibilities of the banking commissioner under this chapter.

Sec. 187.303. Interpretive Statements and Opinions. (a) Subject to Subsection (b), to encourage the effective coordination and implementation of home state laws and host state laws with respect to interstate trust business, the banking commissioner, directly or through a deputy banking commissioner or department attorney in the manner provided by Sections 181.101 and 181.102, and with the effect provided by Section 181.103, may issue:

(1) an interpretive statement for the general guidance of trust institutions in this state and the public; or

(2) an opinion interpreting or determining the applicability of the laws of this state to the trust business and the operation of a branch, trust office, or another office in this state of an out-of-state trust institution, or in other states by state trust companies.

(b) With respect to the trust business of a credit union, savings association, or savings bank, the duties and responsibilities of the banking commissioner under Subsection (a) shall be performed by:

(1) the Texas credit union commissioner, with respect to a credit union; or

(2) the Texas savings and mortgage lending commissioner, with respect to a savings association or savings bank.

Sec. 187.304. Confidential Information. Information obtained directly or indirectly by the banking commissioner relative to the financial condition or business affairs of a trust institution, other than the public portions of a report of condition or income statement, or a present, former, or prospective shareholder, participant, officer, director, manager, affiliate, or service provider of the trust institution, whether obtained through application, examination, or otherwise, and each related file or record of the department is confidential and may not be disclosed by the banking commissioner or an employee of the department except as expressly provided by Subchapter D, Chapter 181.

Sec. 187.305. Enforcement; Appeals. (a) If the banking commissioner determines that an out-of-state trust company has violated this subtitle or other applicable law of this state, the banking commissioner may take all enforcement actions the banking commissioner would be empowered to take if the out-of-state trust company were a state trust company, except that the banking commissioner shall promptly give notice to the home state regulator of each enforcement action to be taken against an out-of-state trust company and, to the extent practicable, shall consult and cooperate with the home state regulator in pursuing and resolving the enforcement action. An out-of-state trust company may appeal a final order or other decision of the banking commissioner under this subtitle as provided by Sections 181.202-181.204.

(b) Notwithstanding Subsection (a), the banking commissioner may enforce this subtitle against a trust institution by appropriate action in the courts, including an action for injunctive relief, if the banking commissioner concludes the action is necessary or desirable.

Sec. 187.306. Notice of Subsequent Event. Each out-of-state trust company that has established and maintains an office in this state pursuant to this subtitle shall give written notice, at least 30 days before the effective date of the event, or, in the case of an emergency transaction, a shorter period before the effective date consistent with applicable state or federal law, to the banking commissioner of:

(1) a merger or other transaction that would cause a change of control with respect to the trust company, with the result that an application would be required to be filed with the home state regulator or a federal supervisory agency;

(2) a transfer of all or substantially all of the trust accounts or trust assets of the out-of-state trust company to another person; or

(3) the closing or disposition of an office in this state.

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[The next chapter is Chapter 199]

CHAPTER 199. MISCELLANEOUS PROVISIONS

CHAPTER 199. MISCELLANEOUS PROVISIONS

Sec. 199.001. Slander or Libel of State Trust Company. (a) A person commits an offense if the person:

(1) knowingly makes, circulates, or transmits to another person an untrue statement that is derogatory to the financial condition of a state trust company located in this state; or

(2) intentionally, to injure the state trust company, counsels, aids, procures, or induces another person to knowingly make, circulate, or transmit to another person an untrue statement that is derogatory to the financial condition of a state trust company located in this state.

(b) An offense under this section is a state jail felony.

Sec. 199.002. Authority to Act as Notary Public. A notary public is not disqualified from taking an acknowledgement or proof of a written instrument as provided by Section 406.016, Government Code, solely because of the person's ownership of stock or participation interest in or employment by a trust institution that is an interested party in the underlying transaction, including a state trust company or a trust institution organized under the laws of another state that lawfully maintains an office in this state.

Sec. 199.003. Succession of Trust Powers. (a) If, at the time of a merger, reorganization, conversion, sale of substantially all of its assets under Chapter 182 or 187 or other applicable law, or sale of substantially all of its trust accounts and related activities at a separate branch or trust office, a reorganizing or selling state trust company is acting as trustee, guardian, executor, or administrator, or in another fiduciary capacity, a successor or purchasing trust institution with sufficient fiduciary authority may continue the office, trust, or fiduciary relationship:

(1) without the necessity of judicial action or action by the creator of the office, trust, or fiduciary relationship; and

(2) without regard to whether the successor or purchasing trust institution meets qualification requirements specified in an instrument creating the office, trust, or fiduciary relationship other than a requirement related to geographic locale of account administration, including requirements as to jurisdiction of incorporation, location of principal office, or type of financial institution.

(b) The successor or purchasing trust institution may perform all the duties and exercise all the powers connected with or incidental to the fiduciary relationship in the same manner as if the successor or purchasing trust institution had been originally designated as the fiduciary.

Sec. 199.004. Discovery of Client Records. Civil discovery of a client record maintained by a trust institution, including a state trust company or a trust institution organized under the laws of another state that lawfully maintains an office in this state, is governed by Section 59.006.

Sec. 199.005. Compliance Review Committee. A trust company may establish a compliance review committee as provided by Section 59.009.

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[The next chapter is Chapter 201]

SUBTITLE G. BANK HOLDING COMPANIES; INTERSTATE BANK OPERATIONS

CHAPTER 201. GENERAL PROVISIONS

Subchapter A. General Provisions

Subchapter B. Registration of Financial Institutions

CHAPTER 201. GENERAL PROVISIONS

Subchapter A. General Provisions

Sec. 201.001. Scope of Subtitle. (a) This subtitle:

(1) sets forth the conditions under which a company may acquire a Texas bank or a Texas bank holding company, pursuant to the provisions of Chapter 202;

(2) permits interstate branching under the Interstate Banking and Branching Efficiency Act pursuant to the provisions of Chapter 203; and

(3) provides for state regulation of the participation by foreign banks in the financial markets of this state, pursuant to the provisions of Chapter 204.

(b) This subtitle is not intended to discriminate against out-of-state banks and bank holding companies in a manner that would violate the Interstate Banking and Branching Efficiency Act.

Sec. 201.002. Definitions. (a) Unless the context requires otherwise, in this subtitle:

(1) “Acquire” means an act that results in direct or indirect control by a company of a bank holding company or a bank, including an act that causes:

(A) the company to merge with a bank holding company or a bank;

(B) the company to assume direct or indirect ownership or control of:

(i) more than 25 percent of any class of voting shares of a bank holding company or a bank, if the acquiring company was not a bank holding company before the acquisition;

(ii) more than five percent of any class of voting shares of a bank holding company or a bank, if the acquiring company was a bank holding company before the acquisition; or

(iii) all or substantially all of the assets of a bank holding company or a bank; or

(C) an application relating to control of a bank holding company or bank to be filed with a federal bank supervisory agency.

(2) “Affiliate” has the meaning assigned by Section 2(k), Bank Holding Company Act (12 U.S.C. Section 1841(k)).

(3) “Agency” when used in reference to an office of a foreign bank, has the meaning assigned by Section

1(b)(1), International Banking Act (12 U.S.C. Section 3101(1)).

(4) "Bank":

(A) for purposes of Chapter 202 and the laws of this state as they relate to Chapter 202, has the meaning assigned by Section 2(c), Bank Holding Company Act (12 U.S.C. Section 1841(c));

(B) for purposes of Chapter 203 and the laws of this state as they relate to Chapter 203, has the meaning assigned to the term "insured bank" by Section 3(h), Federal Deposit Insurance Act (12 U.S.C. Section 1813(h)), except that the term does not include a foreign bank unless it is organized under the laws of a territory of the United States, Puerto Rico, Guam, American Samoa, or the Virgin Islands and its deposits are insured by the Federal Deposit Insurance Corporation; and

(C) for purposes of Chapter 204 and the laws of this state as they relate to Chapter 204, has the meaning assigned by Section 2(c), Bank Holding Company Act (12 U.S.C. Section 1841(c)), or Section 3(a)(1), Federal Deposit Insurance Act (12 U.S.C. Section 1813(a)(1)), except that the term does not include a foreign bank or a branch or agency of a foreign bank.

(5) "Bank holding company" has the meaning assigned by Section 2(a), Bank Holding Company Act (12 U.S.C. Section 1841(a)), and includes a financial holding company.

(6) "Bank Holding Company Act" means the federal Bank Holding Company Act of 1956 (12 U.S.C. Section 1841 et seq.), as amended.

(7) "Bank supervisory agency" means any of the following:

(A) an agency of another state with primary responsibility for chartering and supervising banks;

(B) the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the Board of Governors of the Federal Reserve System, or the Bureau of Consumer Financial Protection, and any successor to these agencies; or

(C) an agency of a country, including a colony, dependency, possession, or political subdivision of a country, other than the United States with primary responsibility for chartering and supervising banks.

(8) "Branch" has the meaning assigned by Section 31.002(a), except that for purposes of Chapter 204 and the laws of this state as they relate to Chapter 204 the term:

(A) with respect to an office of a foreign bank, has the meaning assigned by Section 1(b)(3), International Banking Act (12 U.S.C. Section 3101(3)); and

(B) with respect to an office of a bank as defined by this section for the purposes of Chapter 204, has the meaning assigned to the term "domestic branch" by Section 3(o), Federal Deposit Insurance Act (12 U.S.C. Section 1813(o)).

(9) "Commissioner" has the meaning assigned to the term "banking commissioner" by Section 31.002(a), except that for purposes of Chapter 203 and the laws of this state as they relate to Chapter 203, with respect to a state savings bank, the term means the savings and mortgage lending commissioner of Texas.

(10) "Company" has the meaning assigned by Section 2(b), Bank Holding Company Act (12 U.S.C. Section 1841(b)), and includes a bank holding company.

(11) "Control" shall be construed consistently with Section 2(a)(2), Bank Holding Company Act (12 U.S.C. Section 1841(a)(2)), and regulations and interpretive rulings of the Board of Governors of the Federal Reserve System.

(12) "De novo branch" means a branch of a bank located in a host state that:

(A) is originally established by the bank as a branch; and

(B) does not become a branch of the bank as a result of:

(i) the acquisition of another bank or a branch of another bank; or

(ii) the merger or conversion involving the bank or branch.

(13) "Deposit" has the meaning assigned by Section 3(l), Federal Deposit Insurance Act (12 U.S.C. Section 1813(l)).

(14) "Depository institution" means an institution included for any purpose within the definitions of "insured depository institution" as assigned by Sections 3(c)(2) and 3(c)(3), Federal Deposit Insurance Act (12 U.S.C. Sections 1813(c)(2) and 1813(c)(3)).

(15) “Federal agency” means an agency of a foreign bank that is licensed by the Comptroller of the Currency pursuant to Section 4, International Banking Act (12 U.S.C. Section 3102).

(16) “Federal branch” means a branch of a foreign bank that is licensed by the Comptroller of the Currency pursuant to Section 4, International Banking Act (12 U.S.C. Section 3102).

(17) “Federal Deposit Insurance Act” means the Federal Deposit Insurance Act (12 U.S.C. Section 1811 et seq.), as amended.

(18) “Foreign bank” has the meaning assigned by Section 1(b)(7), International Banking Act (12 U.S.C. Section 3101(7)).

(19) “Foreign bank holding company” means a bank holding company that is organized under the laws of a country other than the United States or a territory or possession of the United States, and includes a foreign financial holding company.

(20) “Foreign person” means a natural or juridical person who is a citizen or national of one or more countries, including any colonies, dependencies, or possessions of the countries, other than the United States.

(21) “Home state” means:

(A) with respect to a national bank, the state in which the main office of the bank is located;

(B) with respect to a state bank, the state by which the bank is chartered;

(C) with respect to a foreign bank, the state determined to be the home state of the foreign bank under Section 5(c), International Banking Act (12 U.S.C. Section 3103(c)); and

(D) with respect to a bank holding company, the state in which the total deposits of all bank subsidiaries of the company are the largest on the later of July 1, 1966, or the date on which the company became a bank holding company.

(22) “Home state regulator” means:

(A) with respect to an out-of-state bank holding company, the bank supervisory agency of the home state of the bank holding company; and

(B) with respect to an out-of-state state bank, the bank supervisory agency of the state in which the bank is chartered.

(23) “Host state” means:

(A) with respect to a bank, a state other than the home state of the bank in which the bank maintains or seeks to establish and maintain a branch; and

(B) with respect to a bank holding company, a state other than the home state of the company in which the company controls or seeks to control a bank subsidiary.

(24) “International Banking Act” means the federal International Banking Act of 1978 (12 U.S.C. Section 3101 et seq.), as amended.

(25) “Interstate Banking and Branching Efficiency Act” means the federal Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994, Public Law No. 103-328, codified at various sections of Title 12, United States Code.

(26) “Interstate branch” means a branch of a bank or a branch of a foreign bank, as the context requires, established, acquired, or retained pursuant to the Interstate Banking and Branching Efficiency Act, outside the home state of the bank or foreign bank. The term does not include, with respect to a foreign bank, a limited branch as that term is defined by this section.

(27) “Interstate merger transaction” means:

(A) the merger of banks with different home states and the conversion of branches of a bank involved in the merger into branches of the resulting bank; or

(B) the purchase of all or substantially all of the assets, including all or substantially all of the branches, of a bank whose home state is different from the home state of the acquiring bank.

(28) “Limited branch” means a branch of a foreign bank that accepts only the deposits that would be permissible for a corporation organized under Section 25A, Federal Reserve Act (12 U.S.C. Section 611 et seq.), in accordance with Section 5(a)(7), International Banking Act (12 U.S.C. Section 3103(a)(7)).

(29) “Out-of-state bank” means a bank whose home state is another state.

(30) “Out-of-state bank holding company” means a bank holding company whose home state is

another state, and includes an out-of-state financial holding company.

(31) "Out-of-state foreign bank" means a foreign bank whose home state is another state.

(32) "Out-of-state state bank" means a bank chartered under the laws of another state.

(33) "Representative office" has the meaning assigned by Section 1(b)(15), International Banking Act (12 U.S.C. Section 3101(15)).

(34) "Resulting bank" means a bank that results from an interstate merger transaction.

(35) "State" means a state of the United States, the District of Columbia, a territory of the United States, Puerto Rico, Guam, American Samoa, the Trust Territory of the Pacific Islands, the Virgin Islands, or the Northern Mariana Islands, except that for purposes of Chapter 202 and the laws of this state as they relate to Chapter 202 the term means a state, territory, or other possession of the United States, including the District of Columbia.

(36) "State bank" means a Texas state bank or an out-of-state state bank, including an out-of-state state savings bank.

(37) "State savings bank" has the meaning assigned to the term "savings bank" by Section 3(g), Federal Deposit Insurance Act (12 U.S.C. Section 1813(g)), and includes a savings bank organized under Subtitle C or under similar laws of another state.

(38) "Subsidiary" has the meaning assigned by Section 2(d), Bank Holding Company Act (12 U.S.C. Section 1841(d)).

(39) "Texas bank" means a bank whose home state is this state, except that for purposes of Chapter 202 and the laws of this state as they relate to Chapter 202 the term means a Texas state bank or a national bank organized under federal law with its main office in this state.

(40) "Texas bank holding company" means a bank holding company whose home state is this state and that is not controlled by a bank holding company other than a Texas bank holding company, and includes a Texas financial holding company.

(41) "Texas representative office" means a representative office that is located in this state and registered pursuant to Subchapter C, Chapter 204.

(42) "Texas state agency," means, when used in reference to an office of a foreign bank, an agency of a foreign bank that is located in this state and licensed pursuant to Subchapter B, Chapter 204.

(43) "Texas state bank" means a bank that is organized under Subtitle A.

(44) "Texas state branch," means, when used in reference to an office of a foreign bank, a branch of a foreign bank that is located in this state and licensed pursuant to Subchapter B, Chapter 204.

(45) "United States" means:

(A) when used in a geographical sense, the several states, the District of Columbia, Puerto Rico, Guam, American Samoa, the American Virgin Islands, the Trust Territory of the Pacific Islands, and other territories of the United States; and

(B) when used in a political sense, the federal government of the United States.

(46) "Financial holding company" means a bank holding company that has elected to be treated as a financial holding company under 12 U.S.C. Section 1843(1).

(47) "Functional regulatory agency" means a department or agency of this state, another state, the United States, or a foreign government with whom the United States currently maintains diplomatic relations that regulates and charters, licenses, or registers persons engaged in financial activities or activities incidental or complementary to financial activities, including activities related to banking, insurance, or securities.

(b) The definitions provided by Section 31.002 apply to this subtitle to the extent not inconsistent with this section and as the context requires.

(c) The definitions shall be liberally construed to accomplish the purposes of this subtitle.

(d) The finance commission by rule may adopt other definitions to accomplish the purposes of this subtitle.

Sec. 201.003. Rules. (a) The finance commission may adopt rules to accomplish the purposes of this subtitle, including rules necessary or reasonable to:

(1) implement and clarify this subtitle in a manner consistent with and to the extent permitted by applicable federal law;

(2) preserve or protect the safety and soundness of banking in this state;

(3) grant at least the same rights and privileges to Texas state banks that are or may be granted to other depository institutions;

(4) recover the cost of maintaining and operating the department and the cost of enforcing this subtitle by imposing and collecting ratable and equitable fees for supervision and regulation, including fees for notices, applications, and examinations; and

(5) facilitate the fair hearing and adjudication of matters before the commissioner and the finance commission.

(b) In adopting rules, the finance commission shall consider the need to:

(1) coordinate with applicable federal law;

(2) promote a stable banking environment;

(3) provide the public with convenient, safe, and competitive banking services;

(4) preserve and promote the competitive position of Texas state banks with regard to other depository institutions consistent with the safety and soundness of Texas state banks and the Texas state bank system; and

(5) allow for economic development in this state.

(c) The presence or absence in this subtitle of a specific reference to rules regarding a particular subject does not enlarge or diminish the rulemaking authority provided by this section.

Sec. 201.004. Law Applicable to Interstate Branches. (a) The laws of this state, including laws regarding community reinvestment, consumer protection, fair lending, and establishment of intrastate branches, apply to an interstate branch located in this state to the same extent the laws of this state would apply if the branch in this state were a branch of an out-of-state national bank in this state, except to the extent otherwise provided under federal law. An out-of-state state bank that establishes an interstate branch in this state under this subtitle may conduct any activity at the branch in this state that is permissible under the laws of the bank's home state, to the extent the activity is permissible for a Texas state bank or for a branch of an out-of-state national bank in this state.

(b) To the extent provided by Section 4.102(c), Business & Commerce Code, the laws of this state govern a deposit contract between a bank and a consumer account holder if the branch or separate office of the bank that accepts the deposit contract is located in this state.

(c) Without limiting Subsection (a), for purposes of the laws of this state relating to authority to act as a fiduciary, depository of public funds, or custodian of securities pledged to secure public funds, or authority to engage in repurchase transactions with public entities, a legally operating interstate branch in this state is considered to be in, within, located in, authorized to do business in, domiciled in, and chartered in this state.

(d) This subtitle does not limit or affect the authority of:

(1) the home state regulator of a bank's home state to enforce any law applicable to a branch of an out-of-state state bank;

(2) a law enforcement officer, a regulatory supervisor, other than the commissioner, or another official of this state to enforce the laws of this state applicable to a branch of an out-of-state state bank; or

(3) this state to adopt, apply, or administer any tax or method of taxation to a bank, bank holding company, or foreign bank, or any affiliate of a bank, bank holding company, or foreign bank, to the extent that the tax or tax method is otherwise permissible by or under the United States Constitution or other federal law.

Sec. 201.005. Cooperative Agreements; Fees. (a) To carry out the purposes of this subtitle, to the extent permitted by federal law, the commissioner may:

(1) enter into cooperative, coordinating, or information sharing agreements with another bank supervisory agency, a functional regulatory agency, or an organization affiliated with or representing one or more bank supervisory agencies;

(2) with respect to periodic examination or other supervision or investigation, accept reports of examination or investigation by, and reports submitted to, another bank supervisory agency or functional regulatory agency in lieu of conducting examinations or investigations or receiving reports as might otherwise be required or permissible under this subtitle;

(3) enter into contracts with another bank supervisory agency or functional regulatory agency having concurrent regulatory or supervisory jurisdiction to engage the services of the agency for reasonable

compensation to assist in connection with the commissioner's performance of official duties under this subtitle or other law, or to provide services to the agency for reasonable compensation in connection with the agency's performance of official duties under law, except that Chapter 2254, Government Code, does not apply to the contracts;

(4) enter into joint examinations or joint enforcement actions with another bank supervisory agency or functional regulatory agency having concurrent regulatory or supervisory jurisdiction, except that the commissioner may independently take action under Section 201.009 if the commissioner determines that the action is necessary to carry out the commissioner's responsibilities under this subtitle or to enforce compliance with the laws of this state; and

(5) assess supervisory and examination fees to be paid by a state bank, state savings bank, bank holding company, or foreign bank in connection with the commissioner's performance of duties under this subtitle.[1]

(b) Supervisory or examination fees assessed by the commissioner in accordance with this subtitle may be shared with another bank supervisory agency, a functional regulatory agency, or an organization affiliated with or representing one or more bank supervisory agencies in accordance with an agreement between the commissioner and the agency or organization. The commissioner may also receive a portion of supervisory or examination fees assessed by another bank supervisory agency or functional regulatory agency in accordance with an agreement between the commissioner and the agency.

(c) A cooperative agreement entered into by the commissioner under this section does not limit the authority of a law enforcement officer, regulatory supervisor, or other official of this state who is not a party to the agreement to enforce the laws of this state applicable to a branch of an out-of-state state bank located in this state.

Sec. 201.006. Issuance of Interpretive Statements and Opinions. (a) To encourage the effective coordination and implementation of home state laws and host state laws with respect to interstate branching, the commissioner, directly or through a deputy commissioner or department attorney, may:

(1) issue interpretive statements containing matters of general policy to guide the public and banks and bank holding companies subject to this subtitle;

(2) amend or repeal a published interpretive statement by issuing an amended statement or notice of repeal of a statement and publishing the statement or notice;

(3) issue, in response to specific requests from the public or the banking industry, opinions interpreting this subtitle or determining the applicability of laws of this state to the operation of interstate branches or other offices in this state by out-of-state banks or in other states by Texas banks; and

(4) amend or repeal an opinion by issuing an amended opinion or notice of repeal of an opinion, except that the requesting party may rely on the original opinion if:

(A) all material facts were originally disclosed to the commissioner;

(B) the safety and soundness of the affected bank or bank holding company will not be affected by further reliance on the original opinion; and

(C) the text and interpretation of relevant, governing provisions of applicable home state, host state, and federal law have not been changed by legislative or judicial action.

(b) An interpretive statement or opinion may be disseminated by newsletter, via electronic medium such as the internet, in a volume of statutes or related materials published by the commissioner or others, or by other means reasonably calculated to notify persons affected by the interpretive statement or opinion. An opinion may be disseminated to the public if the commissioner determines that the opinion is useful for the general guidance and convenience of the public or banks or bank holding companies. A published opinion must be redacted to preserve the confidentiality of the requesting party unless the requesting party consents to be identified in the published opinion. Notice of an amended or withdrawn statement or opinion must be disseminated in a substantially similar manner as the affected statement or opinion was originally disseminated.

(c) An interpretive statement or opinion issued under this subtitle does not have the force of law and is not a rule for the purposes of Chapter 2001, Government Code, unless adopted by the finance commission as provided by Chapter 2001, Government Code. An interpretive statement or opinion is an administrative construction of

[1] See 7 TAC §3.36(h), relating to annual assessments and specialty examination fees.

this subtitle entitled to great weight if the construction is reasonable and does not conflict with this subtitle.

Sec. 201.007. Confidentiality. Except as expressly provided otherwise in this subtitle, confidentiality of information obtained by the commissioner under this subtitle is governed by Subchapter D, Chapter 31,[2] or, with respect to a state savings bank, Subtitle C, and may not be disclosed by the commissioner or an employee of the commissioner's department except as provided by Subchapter D, Chapter 31, or, with respect to a state savings bank, Subtitle C.

Sec. 201.008. Notice of Subsequent Event. Each out-of-state state bank that has established and maintains an interstate branch in this state pursuant to this subtitle shall give written notice to the commissioner, at least 30 days before the effective date of the event, or in the case of an emergency transaction, within a shorter period consistent with applicable state or federal law, of a merger or other transaction that would cause a change of control with respect to the bank or a bank holding company that controls the bank, with the result that an application would be required to be filed with the bank's home state regulator or a federal bank supervisory agency, including an application filed pursuant to the Change in Bank Control Act of 1978 (12 U.S.C. Section 1817(j)), as amended, or the Bank Holding Company Act (12 U.S.C. Section 1841 et seq.).

Sec. 201.009. Enforcement; Appeals. (a) If the commissioner determines that a bank holding company or a foreign bank has violated this subtitle or other applicable law of this state, the commissioner may take any enforcement action the commissioner would be empowered to take if the bank holding company or foreign bank were a Texas state bank,[3] except that the commissioner shall promptly give notice to the home state regulator of each enforcement action taken against an out-of-state bank holding company or foreign bank and, to the extent practicable, shall consult and cooperate with the home state regulator in pursuing and resolving the enforcement action. A bank holding company or foreign bank may appeal a final order or other decision of the commissioner under this subtitle as provided by Sections 31.202, 31.203, and 31.204.

(b) If the commissioner determines that an interstate branch maintained by an out-of-state state bank in this state is being operated in violation of a law of this state that is applicable to the branch under Section 24(j), Federal Deposit Insurance Act (12 U.S.C. Section 1831a(j)), including a law that governs community reinvestment, fair lending, or consumer protection, the commissioner, with written notice to the home state regulator and subject to the terms of any applicable cooperative agreement with the home state regulator, may take any enforcement action the commissioner would be empowered to take if the branch were a Texas state bank[4] or state savings bank, as the case may be. An out-of-state state bank may appeal a final order or other decision of the commissioner under this subtitle as provided by Sections 31.202, 31.203, and 31.204, or as provided under Subtitle C with respect to a state savings bank.

(c) *[Repealed by Acts 2013, 83rd Leg., R.S., Ch. __ (HB 1664), §26, eff. June 14, 2013]*.

Sec. 201.010. Taxation. A bank subject to this subtitle is subject to the franchise tax to the extent provided by Chapter 171, Tax Code.

Sec. 201.011. Severability. The provisions of this subtitle or the applications of those provisions are severable as provided by Section 311.032(c), Government Code.

Subchapter B. Registration of Financial Institutions[5]

Sec. 201.101. Definitions. In this subchapter:

(1) "Financial institution" means:

(A) a bank as defined for any purpose by Section 201.002(a)(4), whether chartered under the laws of this state, another state, the United States, or another country, including a state savings bank;

(B) a savings and loan association chartered under Chapter 62 or similar laws of another state;

(C) a federal savings and loan association, federal savings bank, or federal credit union;

(D) a credit union chartered under Chapter 122 or similar laws of another state; or

(E) a trust company chartered under the laws of this state or another state.

(2) "Out-of-state financial institution" means a financial institution that:

[2] See 7 TAC §3.111, relating to confidential information.

[3] See Subchapters A-B, Chapter 35, Finance Code.

[4] *Id.*

[5] Also see Section 59.007(b), (d), Finance Code.

(A) is not chartered under the laws of this state; and

(B) has its main or principal office in another state or country.

(3) "Texas financial institution" means a financial institution that:

(A) is chartered under the laws of this state or under federal law; and

(B) has its main or principal office in this state.

Sec. 201.102. Registration to Do Business. An out-of-state financial institution must file an application for registration with the secretary of state, before operating a branch or other office in this state, by complying with the law of this state relating to foreign corporations doing business in this state, notwithstanding a provision in that law that purports to limit or prohibit its applicability to financial institutions.[6]

Sec. 201.103. Appointment of Agent to Receive Service of Process. (a) A Texas financial institution may file in the office of the secretary of state a statement appointing an agent authorized to receive service of process.

(b) A statement appointing an agent must set forth:

(1) the name of the Texas financial institution;

(2) the federal tax identification number of the Texas financial institution;

(3) the address, including the street address, of the principal office of the Texas financial institution; and

(4) the name of the agent in this state authorized to receive service of process and the agent's address, including the street address, in this state.

(c) The agent named under Subsection (b) must be:

(1) an individual resident of this state;

(2) a domestic corporation, limited partnership, partnership, limited liability company, professional association, cooperative, or real estate investment trust; or

(3) a foreign entity registered with the secretary of state to transact business in this state.

(d) A statement appointing an agent must be signed by an officer of the Texas financial institution. The statement must also be signed by the person appointed agent, who by signing accepts the appointment. The appointed agent may resign by filing a resignation in the office of the secretary of state and giving notice to the Texas financial institution.

(e) The secretary of state shall collect for the use of the state:

(1) a fee of $25 for indexing and filing the original statement appointing an agent; and

(2) a fee of $15 for filing an amendment to or cancellation of a statement appointing an agent.

(f) An amendment to a statement appointing an agent to receive service of process must meet the requirements for execution of an original statement.

(g) A statement appointing an agent may be canceled by filing with the secretary of state a written notice of cancellation executed by an officer of the Texas financial institution. A notice of cancellation must contain:

(1) the name of the Texas financial institution;

(2) the federal tax identification number of the Texas financial institution;

(3) the date of filing of the statement appointing the agent; and

(4) the current street address of the principal office of the Texas financial institution.

(h) Service of process on a registered agent appointed under this section is an alternate method of service in addition to other methods provided by law unless other law specifically requires service to be made on the registered agent. A resignation or notice of cancellation is effective immediately on acknowledgement of filing by the secretary of state, and after the acknowledgement the financial institution is subject to service of process as otherwise provided by law.

(i) The secretary of state may adopt forms and procedural rules for filing of documents under this section.

[6] Pursuant to Acts 1999, 76th Leg., ch. 344, §9.001(a), an interstate branch or other office of an out-of-state financial institution that existed in this state on September 1, 1999, regardless of whether the out-of-state financial institution had previously filed a designation pursuant to or was not previously subject to Sections 39.003 or 59.001, Finance Code, as those sections existed before September 1, 1999, the out-of-state financial institution must file the documentation and information required by Section 201.102, Finance Code, before January 1, 2000.

CHAPTER 202. BANK HOLDING COMPANIES

CHAPTER 202. BANK HOLDING COMPANIES

Sec. 202.001. Acquisition of Bank or Bank Holding Company. (a) A company intending to acquire a Texas bank holding company or a Texas bank shall submit to the commissioner a copy of the application for approval or notice submitted to the Board of Governors of the Federal Reserve System under Section 3, Bank Holding Company Act (12 U.S.C. Section 1842). The copy must be:

(1) submitted to the commissioner when the application is submitted to the board of governors;

(2) accompanied by any additional information required under Subsection (b); and

(3) accompanied by any filing fee required by law.[1]

(b) An applicant or notificant that is an out-of-state bank holding company shall provide satisfactory evidence to the commissioner of compliance with or inapplicability of:

(1) the requirements of Section 202.003; and

(2) if the applicant or notificant is not incorporated under the laws of this state, the laws of this state relating to registration of foreign corporations to do business in this state.

(c) On receipt of the notice prescribed by Section 3(b), Bank Holding Company Act (12 U.S.C. Section 1842(b)), the commissioner shall state in writing within the period prescribed by that subsection the commissioner's:

(1) views and recommendations concerning the proposed transaction;

(2) opinion regarding whether the proposed transaction complies with this chapter and the Interstate Banking and Branching Efficiency Act; and

(3) opinion regarding whether the proposed transaction complies with the Community Reinvestment Act of 1977 (12 U.S.C. Section 2901 et seq.), as amended.

(d) The commissioner is not required to disapprove the application or notice solely because of the opinion stated under Subsection (c)(3).

(e) If the commissioner's response disapproves an application for or notice of an acquisition of a Texas state bank or a Texas bank holding company controlling a Texas state bank, the commissioner may:

(1) appear at the hearing held as provided by Section 3(b), Bank Holding Company Act (12 U.S.C. Section 1842(b)); and

(2) present evidence at the hearing regarding the reasons the application or notice should be denied.

(f) If the commissioner's response disapproves an application for or notice of an acquisition other than as described by Subsection (e), the commissioner may request that a hearing be held as provided by Section 3(b), Bank Holding Company Act (12 U.S.C. Section 1842(b)). If the board of governors grants the request, the commissioner shall appear and present evidence at the hearing regarding the reasons the application or notice should be denied.

(g) If the board of governors approves an application or notice that the commissioner disapproved, the commissioner may accept the decision or attempt to overturn the decision on appeal as provided by Section 9, Bank Holding Company Act (12 U.S.C. Section 1848).

[1] See 7 TAC §15.2, relating to filing fees and cost deposits.

Sec. 202.002. Limitation on Control of Deposits. (a) The commissioner may not approve an acquisition if, on consummation of the transaction, the applicant, including all depository institution affiliates of the applicant, would control 20 percent or more of the total amount of deposits in this state held by depository institutions in this state.

(b) The commissioner may request and the applicant shall provide supplemental information to the commissioner to aid in a determination under this section, including information that is more current than or in addition to information in the most recently available summary of deposits, reports of condition, or similar reports filed with or produced by state or federal authorities.

Sec. 202.003. Required Age of Acquired Bank. (a) An out-of-state bank holding company may not make an acquisition under this chapter if the Texas bank to be acquired, or any Texas bank subsidiary of the bank holding company to be acquired, has not been in existence and in continuous operation for at least five years as of the effective date of acquisition.

(b) For purposes of this section:

(1) a bank that is the successor as a result of merger or acquisition of all or substantially all of the assets of a prior bank is considered to have been in existence and continuously operated during the period of its existence and continuous operation as a bank and during the period of existence and continuous operation of the prior bank; and

(2) a bank effecting a purchase and assumption, merger, or similar transaction with or supervised by the Federal Deposit Insurance Corporation or its successor is considered to have been in existence and continuously operated during the existence and continuous operation of the bank with respect to which the transaction was consummated.

Sec. 202.004. Nonbanking Acquisition, Election, or Activity. (a) A bank holding company doing business in this state that submits an application, election, or notice to the Board of Governors of the Federal Reserve System under Section 4, Bank Holding Company Act (12 U.S.C. Section 1843), that involves or will involve an office location in this state shall submit to the commissioner a copy of the application, election, or notice when the application, election, or notice is submitted to the board of governors, including a notice or application to acquire a nonbanking institution, an election to be treated as a financial holding company, or a request, proposal, or application to engage in an activity that is or may be a financial activity or an activity incidental or complementary to a financial activity. The bank holding company shall submit other information reasonably requested by the commissioner to determine the manner in which the acquisition, election, or activity will directly or indirectly affect residents of this state.[2]

(b) To assist in determining whether to disapprove the proposed acquisition, election, or activity, the commissioner may hold a public hearing as provided by Section 31.201, regardless of whether requested to do so by a person, regarding the proposed acquisition, election, or activity and its effect on this state. The commissioner shall convene a hearing if the bank holding company requests a hearing in writing when it submits the application, election, or notice to the commissioner.[3]

(c) The commissioner shall disapprove the proposed acquisition, election, or activity if the commissioner determines that the acquisition, election, or activity would be detrimental to the public interest as a result of probable adverse effects, including undue concentration of resources, decreased or unfair competition, conflicts of interest, or unsound banking practices.

(d) If the commissioner determines to disapprove the proposed acquisition, election, or activity, the commissioner may prepare and file a response to the application, election, or notice with the board of governors and may request that a hearing be held. If the board of governors grants the request, the commissioner shall appear and present evidence at the hearing regarding the reasons the proposed acquisition, election, or activity should be denied.

(e) If the board of governors approves a proposed acquisition, election, or activity that the commissioner disapproved, the commissioner may accept the decision or seek to overturn the decision on appeal as provided by Section 9, Bank Holding Company Act (12 U.S.C. Section 1848).

Sec. 202.005. Applicable Laws. (a) The commissioner may:

[2] See 7 TAC §15.2, relating to filing fees and cost deposits.

[3] See 7 TAC §§9.11-9.39, relating to procedure for contested case hearings.

(1) examine a bank holding company that controls a Texas bank to the same extent as if the bank holding company were a Texas state bank;[4] and

(2) bring an enforcement proceeding under Chapter 35 against a bank holding company or other person that violates or participates in a violation of Subtitle A, an agreement filed with the commissioner under this chapter, or a rule adopted by the finance commission or order issued by the commissioner under Subtitle A, as if the bank holding company were a Texas state bank.

(a-1) The grounds, procedures, and effects of an enforcement proceeding brought under this section apply to a bank holding company, an officer, director, or employee of a bank holding company, or a controlling shareholder or other person participating in the affairs of a bank holding company in the same manner as the grounds, procedures, and effects apply to a state bank, an officer, director, or employee of a state bank, or a controlling shareholder or other person participating in the affairs of a state bank.

(b) A Texas bank that is controlled by a bank holding company that is not a Texas bank holding company shall be subject to all laws of this state that are applicable to Texas banks that are controlled by Texas bank holding companies.

Sec. 202.006. Financial Activities. (a) A financial holding company may engage in a financial activity or an activity incidental or complementary to a financial activity if the activity has been authorized by:

(1) the Board of Governors of the Federal Reserve System under 12 U.S.C. Section 1843(k); or

(2) a rule adopted by the finance commission under Subsection (b).

(b) The finance commission by rule may determine that an activity not otherwise approved or authorized under this chapter, federal law, or other law is:

(1) a financial activity;

(2) incidental to a financial activity; or

(3) complementary to a financial activity.

(c) In adopting a rule under Subsection (b), the finance commission shall consider:

(1) the purposes of this subtitle and the Gramm-Leach-Bliley Act (Pub. L. No. 106-102);

(2) changes or reasonably expected changes in the marketplace in which financial holding companies compete;

(3) changes or reasonably expected changes in the technology for delivering financial services;

(4) whether the activity is necessary or appropriate to allow a financial holding company to:

(A) compete effectively with another company seeking to provide financial services;

(B) efficiently deliver information and services that are financial in nature through the use of technological means, including an application necessary to protect the security or efficacy of systems for the transmission of data or financial transactions; or

(C) offer customers available or emerging technological means for using financial services or for the document imaging of data; and

(5) if otherwise determined to be permissible, whether the conduct of the activity by a financial holding company should be qualified through the imposition of reasonable and necessary conditions to protect the public and require appropriate regard for safety and soundness of the holding company's subsidiary banks and the financial system generally.

(d) A determination by the board of governors under federal law or by a rule of the finance commission under this section does not alter or negate applicable licensing and regulatory requirements administered by a functional regulatory agency of this state.

[4] See 7 TAC §3.36(h), relating to specialty examinations.

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CHAPTER 203. INTERSTATE BANK MERGERS AND BRANCHING

CHAPTER 203. INTERSTATE BANK MERGERS AND BRANCHING

Sec. 203.001. Interstate Branching by Texas State Banks. (a) With the prior approval of the commissioner, a Texas state bank may establish and maintain a de novo branch or acquire a branch in a state other than Texas pursuant to Section 32.203.[1]

(b) With the prior approval of the commissioner, a Texas state bank may establish, maintain, and operate one or more branches in another state pursuant to an interstate merger transaction in which the Texas state bank is the resulting bank. Not later than the date on which the required application for the interstate merger transaction is filed with the responsible federal bank supervisory agency, the applicant Texas state bank shall file an application on a form prescribed by the commissioner and pay the fee prescribed by law. The applicant shall also comply with the applicable provisions of Sections 32.301-32.303. The commissioner shall approve the interstate merger transaction and the operation of branches outside of this state by the Texas state bank if the commissioner makes the findings required by Section 32.302(b). An interstate merger transaction may be consummated only after the applicant has received the commissioner's written approval.[2]

Sec. 203.002. Conditions for Entry by De Novo Branching. (a) An out-of-state bank may establish a de novo branch in this state if:

(1) the out-of-state bank confirms in writing to the commissioner that as long as it maintains a branch in this state, it will comply with all applicable laws of this state;

(2) the applicant provides satisfactory evidence to the commissioner of compliance with the applicable requirements of Section 201.102; and

(3) the commissioner, acting on or before the 30th day after the date the commissioner receives notice of an application under Subsection (b), certifies to the responsible federal bank supervisory agency that the requirements of this subchapter have been met.

(b) An out-of-state bank desiring to establish and maintain a de novo branch shall provide written notice of the proposed transaction to the commissioner not later than the date on which the bank applies to the responsible federal bank supervisory agency for approval to establish the branch. The filing of the notice must be accompanied by the filing fee, if any, prescribed by the commissioner.

(c) A de novo branch may be established in this state through the acquisition of a branch of an existing Texas bank if the acquiring out-of-state bank complies with this section.[3]

(d) A depository institution may not establish or maintain a branch in this state on the premises or property of an affiliate if the affiliate engages in commercial activities, except as provided by Section 92.063(d).

Sec. 203.003. Entry by Interstate Merger Transaction. (a) Subject to Section 203.004, one or more Texas banks may enter into an interstate merger transaction with one or more out-of-state banks under this chapter, and an out-of-state bank resulting from the transaction may maintain and operate the branches in this state of a Texas bank that participated in the transaction. An out-of-state bank that will be the resulting bank in the interstate merger transaction shall comply with Section 201.102.

[1] See 7 TAC §§15.2 and 15.42, relating to establishing branch offices.

[2] See 7 TAC §§15.2, 15.104, and 15.105, relating to application for merger or share exchange, and application for purchase of assets.

[3] See 7 TAC §§15.2 and 15.106, relating to application for sale of assets.

(b) An out-of-state bank that will be the resulting bank pursuant to an interstate merger transaction involving a Texas state bank shall notify the commissioner of the proposed merger not later than the date on which it files an application for an interstate merger transaction with the responsible federal bank supervisory agency, and shall submit a copy of that application to the commissioner and pay the filing fee, if any, required by the commissioner. A Texas state bank that is a party to the interstate merger transaction shall comply with Chapter 32 and with other applicable state and federal laws.[4] An out-of-state bank that will be the resulting bank in the interstate merger transaction shall provide satisfactory evidence to the commissioner of compliance with Section 201.102.

(c) *[Repealed by Acts 2013, 83rd Leg., R.S., Ch. __ (HB 1664), §26, eff. June 14, 2013]*

Sec. 203.004. Limitation on Control of Deposits. (a) An interstate merger transaction is not permitted if, on consummation of the transaction, the resulting bank, including all depository institution affiliates of the resulting bank, would control 20 percent or more of the total amount of deposits in this state held by all depository institutions in this state.

(b) The commissioner may request and the applicant shall provide supplemental information to the commissioner to aid in a determination under this section, including information that is more current than or in addition to information in the most recently available summary of deposits, reports of condition, or similar reports filed with or produced by state or federal authorities.

Sec. 203.005. *[Repealed by Acts 2013, 83rd Leg., R.S., Ch. __ (HB 1664), §26, eff. June 14, 2013]*

Sec. 203.006. Additional Branches. An out-of-state bank that has established or acquired a branch in this state under this chapter may establish or acquire additional branches in this state to the same extent that a Texas state bank may establish or acquire a branch in this state under applicable state and federal law.

Sec. 203.007. Examinations. (a) With respect to an interstate branch maintained by an out-of-state state bank in this state, the banking commissioner:

(1) with written notice to the home state regulator and subject to the terms of any applicable cooperative agreement with the home state regulator, may examine the branch for the purpose of determining whether the branch is in compliance with the laws of this state that are applicable under Section 24(j), Federal Deposit Insurance Act (12 U.S.C. Section 1831a(j)), including laws governing community reinvestment, fair lending, and consumer protection; and

(2) if expressly permitted under and subject to the terms of any cooperative agreement with the home state regulator, or if the bank has been determined to be in a troubled condition by the home state regulator or the bank's appropriate federal banking agency, may participate in the examination of the bank by the home state regulator to ascertain whether the activities of the branch in this state are being conducted in an unsafe or unsound manner.[5]

(b) For purposes of this section, a bank is considered to be in a troubled condition if the bank:

(1) has a composite rating, as determined in the bank's most recent report of examination, of four or five under the Uniform Financial Institutions Ratings System;

(2) is subject to a proceeding initiated by the Federal Deposit Insurance Corporation for termination or suspension of deposit insurance; or

(3) is subject to a proceeding initiated by the home state regulator to:

(A) vacate, revoke, or terminate the bank's charter;

(B) liquidate the bank; or

(C) appoint a receiver for the bank.

[4] See 7 TAC §15.107, relating to notice of merger or conversion into another form of financial institution

[5] See 7 TAC §3.36(h), relating to specialty examinations.

CHAPTER 204. FOREIGN BANKS

Subchapter A. General Provisions

Subchapter B. Direct Branch and Agency Offices of Foreign Banks

Subchapter C. Representative Offices of Foreign Bank

CHAPTER 204. FOREIGN BANKS

Subchapter A. General Provisions

Sec. 204.001. Transacting Business. (a) A foreign bank may not transact business in this state except to the extent permitted by this chapter.

(b) Subsection (a) does not prohibit a foreign bank:

(1) from transacting business at a licensed federal branch or agency in this state in accordance with federal law;

(2) that does not maintain a branch or agency in this state or conduct business from an office or location in this state from making unsecured loans in this state or loans secured by liens on real or personal property located in this state, enforcing those loans in this state, or transacting trust business in this state, to the extent permitted by other law; or

(3) organized under the laws of a territory of the United States, Puerto Rico, Guam, American Samoa, or the Virgin Islands, the deposits of which are insured by the Federal Deposit Insurance Corporation, from establishing and operating an interstate branch in this state in its capacity as a state bank pursuant to Chapter 203.

(c) For purposes of Subsection (a), a foreign bank is not considered to be transacting business in this state merely because a subsidiary or affiliate transacts business in this state, including business that a depository institution subsidiary or affiliate may lawfully conduct in this state as an agent for the foreign bank to the extent authorized by the laws of this state.

Sec. 204.002. Books, Accounts, and Records. Each Texas state branch, agency, or representative office shall maintain and make available appropriate books, accounts, and records reflecting:

(1) all transactions effected by or on behalf of the office; and

(2) all other actions taken in this state by employees of the foreign bank located in this state to effect transactions on behalf of an office of the foreign bank located outside this state.[1]

Sec. 204.003. Examination; Fees. (a) The commissioner may make examinations of a Texas state branch, agency, or representative office as the commissioner considers necessary to determine whether the office is being operated in compliance with the laws of this state and in accordance with safe and sound banking practices. Sections 31.105-31.107 apply to the examinations.

(b) A foreign bank that maintains a Texas state branch, agency, or representative office shall pay fees to the commissioner in accordance with Section 201.005 or rules adopted under this subtitle.[2]

Sec. 204.004. Reports. (a) A foreign bank doing business in this state through a Texas state branch, agency, or representative office shall make written reports to the commissioner that:

(1) are in English;

(2) are submitted at the times and in the form specified by the commissioner or by rules adopted under this subtitle;[3]

(3) are under oath of one of the foreign bank's officers, managers, or agents transacting business in this state;

(4) show the amount of the foreign bank's assets and liabilities, expressed in United States currency;

(5) with respect to a Texas state branch or agency, show the amount of the branch or agency's assets and liabilities, expressed in United States currency; and

(6) contain other information that the commissioner requires.

(b) A license or registration of a foreign bank under this chapter may be revoked or the foreign bank may be subject to an enforcement action under Chapter 35 if the foreign bank fails to make a report required under Subsection (a) or makes a material false or misleading statement in the report.

[1] See 7 TAC §§3.42 and 3.45, relating to records of foreign bank agencies and representative offices.

[2] See 7 TAC §§3.36 and 3.38, relating to assessment and examination fees.

[3] See 7 TAC §§3.41 and 3.44, relating to reports of foreign bank agencies and representative offices.

Sec. 204.005. Change of Control of Foreign Bank. A foreign bank licensed to establish and maintain a Texas state branch or agency pursuant to Subchapter B, or which has registered a Texas representative office pursuant to Subchapter C, shall file with the commissioner a notice of change of control, in the form and containing the information the commissioner requires, not later than the 14th day after the date of a merger or other transaction that results or will result in a change of control.

Sec. 204.006. Operations in this State of Banks Owned or Controlled by Foreign Banks and Other Foreign Persons. (a) Except as provided in Subsection (b):

(1) the laws of this state governing the acquisition or ownership of interests in Texas banks or out-of-state banks seeking to establish and maintain interstate branches in this state do not prohibit ownership of those institutions by, or otherwise discriminate against, foreign banks or other foreign persons; and

(2) the laws of this state governing the powers and activities of Texas banks and out-of-state banks maintaining interstate branches in this state do not discriminate among those banks on the basis of their ownership or control by foreign banks or other foreign persons.

(b) Notwithstanding Subsection (a), the commissioner may apply the laws of this state governing the ownership, control, or operations of Texas banks, even if applicable specifically or exclusively to foreign banks or other foreign persons, to the extent those laws are determined by the commissioner to be:

(1) substantially equivalent to or consistent with the standards or requirements governing the ownership, control, or operations of Texas banks by foreign banks or other foreign persons under applicable federal law; or

(2) otherwise consistent with the laws and policies of the United States, including its international agreements governing financial services.

Sec. 204.007. Establishment of Interstate Branch in this State by an Out-of-State Foreign Bank. (a) An out-of-state foreign bank may establish an interstate Texas state branch in the same manner as, and subject to the same criteria, standards, conditions, requirements, and procedures applicable to, the establishment of an interstate branch in this state by an out-of-state bank having the same home state in the United States, including by acquisition of or merger with a Texas bank, or establishment of a de novo branch in the manner provided by Section 203.002, notwithstanding another law of this state to the contrary other than Subsection (b).

(b) With respect to establishment of an initial interstate Texas state branch and subsequent intrastate branches of an out-of-state foreign bank, the commissioner:

(1) shall apply the same criteria, standards, conditions, requirements, and procedures applicable under Subchapter B to the establishment of an initial Texas state branch and subsequent intrastate branches in this state;

(2) may apply other criteria, standards, conditions, requirements, or provisions of the laws of this state that are determined by the commissioner to be substantially equivalent to or consistent with federal law generally applicable to the establishment of a branch in the United States by a foreign bank or specifically applicable to the establishment of a branch in the United States by the applicant foreign bank; and

(3) may allow an out-of-state foreign bank to:

(A) acquire or merge with another foreign bank maintaining a Texas branch or agency and after the acquisition or merger continue the operations as its own;

(B) acquire or establish an interstate Texas branch through another means not inconsistent with Section 5, International Banking Act (12 U.S.C. Section 3103); or

(C) convert a state agency to a state branch as provided by Section 204.008.

Sec. 204.008. Conversion of Existing Office. (a) For purposes of this section, foreign bank offices in this state are divided into classes and ranked in ascending order as:

(1) representative office;

(2) Texas state agency; and

(3) Texas state branch.

(b) A foreign bank may change a lower class office into a higher class office by applying for the higher class office pursuant to Section 204.101. On approval of the application to establish the higher class office and after all conditions to the approval have been fulfilled, the foreign bank may change the lower class office into the higher class office and the commissioner shall issue a license authorizing the bank to maintain the higher class office.

The foreign bank shall promptly surrender any license or registration previously issued by the commissioner in connection with the lower class office.

(c) A foreign bank may change a higher class office into a lower class office by applying for approval to close the higher class office pursuant to Section 204.115. On approval of the application to close the higher class office and after conditions precedent to the closing have been fulfilled, the foreign bank may change the higher class office into the lower class office, and the commissioner shall issue a license or registration authorizing the bank to maintain the lower class office.

Subchapter B. Direct Branch and Agency Offices of Foreign Banks

Sec. 204.101. Application to Establish Branch or Agency. (a) A foreign bank that desires to establish and maintain a Texas state branch or agency shall submit an application to the commissioner. The application must:[4]

(1) be accompanied by all application fees and deposits required by applicable rules;

(2) be in the form specified by the commissioner;

(3) be subscribed and acknowledged by an officer of the foreign bank;

(4) have attached:

(A) a complete copy of the foreign bank's application to the Board of Governors of the Federal Reserve System under Section 7(d), International Banking Act (12 U.S.C. Section 3105(d));

(B) an authenticated copy of the foreign bank's certificate of formation and bylaws or other constitutive documents and, if the copy is in a language other than English, an English translation of the document, under the oath of the translator; and

(C) evidence of compliance with Section 201.102;

(5) be submitted when the federal application is submitted to the board of governors; and

(6) include on its face or in accompanying documents:

(A) the name of the foreign bank;

(B) the street address where the principal office of the Texas state branch or agency is to be located and, if different, the Texas state branch or agency's mailing address;

(C) the name and qualifications of each officer and director of the foreign bank who will have control of all or part of the business and affairs of the Texas state branch or agency;

(D) a detailed statement of the foreign bank's financial condition as of a date not more than 360 days before the date of the application; and

(E) other information that:

(i) is necessary to enable the commissioner to make the findings listed in Section 204.103;

(ii) is required by rules adopted under this subtitle; or

(iii) the commissioner reasonably requests.

(b) The finance commission may adopt rules prescribing abbreviated application procedures and standards applicable to applications by foreign banks that have already established an initial Texas state branch or agency to establish additional intrastate branches or agencies.

Sec. 204.102. Hearing and Decision on Application. (a) After the application is complete and accepted for filing and all required fees and deposits have been paid, the commissioner shall determine from the application and the initial investigation whether the conditions set forth by Section 204.103 have been established. The commissioner shall approve the application or set the application for hearing.

(b) If the commissioner sets the application for hearing:

(1) the commissioner shall notify the Board of Governors of the Federal Reserve System that the application has been set for hearing as provided by federal regulations;

[4] See 7 TAC §§15.2 and 3.41, relating to applications by foreign banks.

(2) the department shall participate as the opposing party; and

(3) the commissioner shall conduct the hearing and one or more prehearing conferences and opportunities for discovery as the commissioner considers advisable and consistent with applicable law.[5]

(c) Information relating to the financial condition and business affairs of the foreign bank and financial information relating to its management and shareholders, except for previously published statements and information, is confidential and may not be considered in the public portion of the hearing or disclosed by the commissioner or an employee of the department except as provided by Subchapter D, Chapter 31.[6]

(d) The commissioner shall make a finding from the record of the hearing on each condition listed in Section 204.103 and enter an order granting or denying the license. If the license is denied, the commissioner shall inform the Board of Governors of the Federal Reserve System of the order and the reasons the federal application should be denied.

(e) The commissioner may make approval of an application conditional. The commissioner shall include any conditions in the order granting the license but may not issue the license until the Texas state branch or agency has received the approval of the Board of Governors of the Federal Reserve System. If the approval is conditioned on a written commitment from the applicant offered to and accepted by the commissioner, the commitment is enforceable against the applicant.

Sec. 204.103. Issuance of License. (a) The commissioner shall issue a license to a foreign bank to establish and maintain a Texas state branch or agency if the commissioner finds after reasonable inquiry that:

(1) all members of the management of the Texas state branch or agency have sufficient banking experience, ability, standing, competence, trustworthiness, and integrity to justify a belief that the agency will operate in compliance with state law;

(2) the foreign bank has sufficient standing to justify a belief that the Texas state branch or agency will be free from improper or unlawful influence or interference with respect to the office's operation in compliance with state law; and

(3) the foreign bank is acting in good faith and the application does not contain a material misrepresentation.

(b) Each Texas state branch or agency shall post its license in a conspicuous place at its office. A license issued under this subchapter is not transferable or assignable.

Sec. 204.104. No Concurrent Federal Branch or Agency. (a) A foreign bank licensed under this subchapter to establish and maintain a Texas state branch or agency may not concurrently maintain a federal branch or federal agency in this state.

(b) A foreign bank which maintains a federal branch or federal agency in this state may not concurrently be licensed under this subchapter to maintain a Texas state branch or agency.

Sec. 204.105. Powers of Branch and Agency. (a) A Texas state branch or agency is subject to this subtitle and other laws of this state applicable to banks as if the Texas state branch or agency were a Texas state bank unless:

(1) this chapter or a rule adopted under this subtitle provides otherwise; or

(2) the context of a provision or other information indicates that a provision applies only to a bank organized under the laws of a state or the United States.

(b) Among other exceptions to Subsection (a) that may be required or authorized by the commissioner provided by this subchapter or by rules adopted under this subtitle:

(1) a Texas state branch may not accept deposits of less than $100,000 from citizens or residents of the United States, other than credit balances that are incidental to or arise out of its exercise of other lawful banking powers, unless the Federal Deposit Insurance Corporation determines that specific deposit taking activities in lesser amounts do not constitute domestic retail deposit activities requiring deposit insurance protection within the meaning of Section 6, International Banking Act (12 U.S.C. Section 3104);

[5] See 7 TAC §§9.11-9.39, relating to procedure for contested case hearings.

[6] See 7 TAC §3.111, relating to confidential information.

(2) a Texas state agency may not accept deposits from citizens or residents of the United States, other than credit balances that are incidental to or arise out of its exercise of other lawful banking powers, but may accept deposits from persons who are neither citizens nor residents of the United States; and

(3) a limitation or restriction based on the capital and surplus of a Texas state bank is considered to refer, as applied to a Texas state branch or agency, to the dollar equivalent of the capital and surplus of the foreign bank, and if the foreign bank has more than one Texas state branch or agency in this state, the business transacted by all the branches and agencies must be aggregated in determining compliance with the limitation.

(c) Subject to Subsections (a) and (b), a foreign bank licensed to transact business in this state through a Texas state branch or agency may:

(1) borrow and lend money with or without property as security;

(2) purchase, sell, and make loans regardless of whether the loans are secured by bonds or mortgages on real property;

(3) engage in a foreign exchange transaction;

(4) issue, advise, confirm, and otherwise deal with a letter of credit and pay, accept, or negotiate a draft drawn under a letter of credit;

(5) accept a bill of exchange or draft;

(6) buy or acquire and sell or dispose of a bill of exchange, draft, note, acceptance, or other obligation for the payment of money;

(7) maintain a credit balance of money received at the Texas state branch or agency incidental to or arising out of the exercise of its authorized activities in this state if the money is not intended to be a deposit and does not remain in the Texas state branch or agency after the completion of all transactions to which it relates;

(8) accept deposits to the extent permitted by Subsection (b);

(9) receive money for transmission and transmit the money from its authorized place of business in this state to any other place;

(10) act as an indenture trustee or as a registrar, paying agent, or transfer agent, on behalf of the issuer, for equity or investment securities; and

(11) perform other activities that:

(A) are authorized by rules adopted to accomplish the purposes of this subtitle; or

(B) the commissioner determines are analogous or incidental to specific activities authorized by this section for a Texas state branch or agency.

(d) A foreign bank licensed to transact business in this state through a Texas state branch or agency may share the premises of the Texas state branch or agency with another authorized office of the foreign bank or a direct or indirect subsidiary of the foreign bank if the books and records of the Texas state branch or agency are kept separately from the books and records of the other office.

(e) For purposes of this section, the term “resident of the United States” means:

(1) an individual residing in the United States;

(2) a corporation, partnership, association, or other entity organized in the United States; or

(3) a branch or office located in the United States of an entity that is not organized in the United States.

Sec. 204.106. Application to Act as Fiduciary. (a) Except as provided by Section 204.105(c)(10), a foreign bank may not act as a fiduciary at a Texas state branch or agency except by obtaining a fiduciary license as provided by this section. A foreign bank that intends to act as a fiduciary at a Texas state branch or agency shall submit an application to the commissioner. The application must:

(1) be accompanied by all application fees and deposits required by applicable rules;

(2) be in the form specified by the commissioner;

(3) be subscribed and acknowledged by an officer of the foreign bank;

(4) describe in detail:

(A) the proposed fiduciary activities;

(B) the names and relevant expertise of its officers and employees that will conduct the fiduciary activities; and

(C) the manner in which the fiduciary activities will be captured in the books and records of the Texas state branch or agency with due regard for separation of beneficial and legal interests; and

(5) contain other information that:

(A) is necessary to enable the commissioner to make the findings required by Subsection (c);

(B) is required by rules adopted under this subtitle; or

(C) the commissioner reasonably requests.

(b) On or before the 60th day after the date the application is complete and accepted for filing and all required fees and deposits have been paid, the commissioner shall approve the application or set the application for hearing. If the commissioner sets the application for hearing, the department shall participate as the opposing party and the commissioner shall conduct the hearing and one or more prehearing conferences and opportunities for discovery as the commissioner considers advisable and consistent with applicable law.

(c) The commissioner may issue a license permitting the foreign bank to engage in fiduciary activities if the commissioner finds that the foreign bank will exercise its fiduciary powers in accordance with the laws of this state and has sufficient fiduciary and accounting expertise and controls to protect beneficial interests under its control. The commissioner may make approval of an application conditional by including conditions and limitations in the order granting the license. If the approval is conditioned on a written commitment from the applicant offered to and accepted by the commissioner, the commitment is enforceable against the applicant.

(d) A foreign bank that obtains the approval of the commissioner under this section may engage in fiduciary activities at its Texas state branch or agency to the same extent and in the same manner as a Texas state bank could do so at the same location, subject to any conditions or limitations applicable to the license.

(e) The commissioner may initiate an enforcement action under Chapter 35 or may suspend or revoke the authority of a foreign bank to engage in fiduciary activities in this state in the same manner as a revocation of license under Section 204.118 if the commissioner finds in writing that:

(1) conditions exist related to the fiduciary activities of the foreign bank in this state which would authorize the commissioner to revoke or suspend its license pursuant to Section 204.117; or

(2) a fact or condition exists which, if it had existed at the time of the foreign bank's original notice to engage in fiduciary activities, would have resulted in the commissioner denying authority to engage in fiduciary activities.

Sec. 204.107. Filing of Amendments to Certificate of Formation. If the certificate of formation of a foreign bank licensed to maintain a Texas state branch or agency is amended, the foreign bank shall promptly file with the commissioner a copy of the amendment, duly authenticated by the proper officer of the country of the foreign bank's organization. The filing does not enlarge or alter the business the foreign bank is authorized to pursue in this state, authorize the foreign bank to transact business in this state under a name other than the name set forth in its license, or extend the duration of its corporate existence.

Sec. 204.108. Amended License for Branch or Agency. (a) A foreign bank licensed to establish and maintain a Texas state branch or agency shall apply to the commissioner for an amended license if it changes its corporate name, changes the duration of its corporate existence, or desires to pursue in this state other or additional purposes than those set forth in its prior application for the foreign bank's license or amended license then in effect.

(b) The requirements with respect to the form and contents of an application under Subsection (a), the manner of its execution, the issuance of an amended license, and the effect of the amended license are the same as in the case of an initial application for a license to establish and maintain a Texas state branch or agency.

Sec. 204.109. Relocation of Office. (a) With the prior written approval of the commissioner, a foreign bank licensed to establish and maintain a Texas state branch or agency may relocate the branch or agency office. A foreign bank that intends to relocate a Texas state branch or agency office shall submit a letter to the commissioner describing the address of the proposed location, the reasons for relocation, and the manner of notifying its customers of the relocation.

(b) On or before the 30th day after the date the foreign bank's letter has been accepted for filing and any required fee has been paid, the commissioner shall approve or deny the relocation. The commissioner may not permit the foreign bank to relocate its Texas state branch or agency office if the commissioner finds that the proposed location and the manner of relocation and notification will be deceptive or that the relocation will impede or tend to impede the foreign bank's depositors and creditors in this state.

Sec. 204.110. Separate Assets. (a) Each foreign bank licensed to establish and maintain a Texas state branch or agency in this state shall keep the assets of its business in this state separate and apart from the assets of its business outside this state.

(b) The depositors and creditors of a foreign bank arising out of transactions with, and recorded on the books of, its Texas state branch or agency are entitled to absolute preference and priority over the depositors and creditors of the foreign bank's offices located outside this state with respect to the assets of the foreign bank in this state.

Sec. 204.111. Disclosure of Lack of Deposit Insurance. Each foreign bank licensed to establish and maintain a Texas state branch or agency shall give notice that deposits and credit balances in the office are not insured by the Federal Deposit Insurance Corporation.

Sec. 204.112. Limitations on Payment of Interest on Deposits. A foreign bank licensed to establish and maintain a Texas state branch or agency is subject to the same limitations with respect to the payment of interest on deposits as a state bank that is a member of the Federal Reserve System.

Sec. 204.113. Pledge of Assets. (a) In accordance with rules adopted under this subtitle, a foreign bank licensed to establish and maintain a Texas state branch or agency may be required to keep on deposit, with unaffiliated banks in this state that the foreign bank designates and the commissioner approves, money and securities pledged to the commissioner in an aggregate amount to be determined by the commissioner, valued at the lower of principal amount or market value, consisting of:

(1) dollar deposits;

(2) bonds, notes, debentures, or other legally created, general obligations of a state, an agency or political subdivision of a state, the United States, or an instrumentality of the United States;

(3) securities that this state, an agency or political subdivision of this state, the United States, or an instrumentality of the United States has unconditionally agreed to purchase, insure, or guarantee;

(4) securities issued or guaranteed by the Federal Home Loan Mortgage Corporation, the Federal National Mortgage Association, the Government National Mortgage Association, the Federal Agricultural Mortgage Corporation, or the Federal Farm Credit Banks Funding Corporation;

(5) obligations of or issued or guaranteed by the International Bank for Reconstruction and Development, the African Development Bank, the Asian Development Bank, the InterAmerican Development Bank, or the North American Development Bank; or

(6) other assets as may be permitted by rule.

(b) The assets deposited and the amount of the assets to be maintained under Subsection (a) are subject to the conditions and limitations the commissioner considers necessary or desirable for the maintenance of a sound financial condition, the protection of depositors, creditors, and the public interest in this state, and the support of public confidence in the business of the Texas state branch or agency. The commissioner may give credit to reserves required to be maintained with a federal reserve bank in or outside this state pursuant to federal law, in accordance with rules adopted under this subtitle.

(c) While a foreign bank continues business in the ordinary course, the foreign bank may collect interest on the money and securities deposited under this section and from time to time exchange, examine, and verify the securities.

Sec. 204.114. Asset Maintenance. (a) In accordance with rules adopted under this subtitle, a foreign bank licensed to establish and maintain a Texas state branch or agency shall at all times satisfy the ratio of branch or agency assets to liabilities determined by the commissioner, in the commissioner's sole discretion, to be necessary or desirable with respect to the foreign bank. The type of assets to be held in this state are specified by Subsection (b) and the type of liabilities to be included in the ratio are specified by Subsection (c).

(b) Assets to be held in this state for the purpose of satisfying the ratio of assets to liabilities:

(1) include:

(A) currency, bonds, notes, debentures, drafts, bills of exchange, or other evidences of indebtedness, including loan participation agreements or certificates;

(B) other obligations payable in the United States or in United States funds or, with the prior approval of the commissioner, in funds freely convertible into United States funds; and

(C) other assets the commissioner permits or as may be specified by rule; and

(2) exclude obligations of a person for money borrowed to the extent that the total of the obligations of the person exceeds 10 percent of total assets considered for purposes of this section.

(c) Liabilities included for purposes of calculating the ratio of assets to liabilities:

(1) include all liabilities of the foreign bank appearing in the books, accounts, or records of its Texas state branch or agency, including acceptances; and

(2) exclude amounts due and other liabilities to other offices, agencies, branches, and wholly owned subsidiaries of the foreign bank, and other liabilities the commissioner determines. The existence of a nominal number of directors' shares outstanding does not cause a subsidiary to be considered less than wholly owned.

(d) Subject to rules adopted under this subtitle, the commissioner, in the commissioner's sole discretion, may vary the ratio of assets to liabilities required by this section for a foreign bank as may be necessary or desirable to reflect differences among Texas branches or Texas agencies because of:

(1) the financial condition of Texas branch or agency offices of the foreign bank;

(2) the financial condition of branch or agency offices of the foreign bank located in other states;

(3) the general economic conditions prevalent in the home country of the foreign bank; or

(4) the financial condition of the foreign bank itself, including:

(A) the financial condition of its branches and agencies located in other countries;

(B) the financial condition of its affiliated bank and nonbank subsidiaries in the United States; and

(C) the financial condition of the foreign bank on a worldwide consolidated basis or in its home country.

(e) For purposes of this section, assets must be valued at the lower of principal amount or market value. The commissioner may determine the value of a non-marketable security, loan, or other asset or obligation held or owed to the foreign bank or its Texas state branch or agency in this state. If the commissioner cannot determine the value of an non-marketable asset, the asset must be excluded from the ratio computation.

(f) The commissioner may require a foreign bank to deposit the assets required to be held in this state pursuant to this section with specific banks in this state designated by the commissioner if, because of the existence or the potential occurrence of unusual and extraordinary circumstances, the commissioner considers it necessary or desirable for the maintenance of a sound financial condition, the protection of depositors, creditors, and the public interest in this state, and the maintenance of public confidence in the business of a Texas state branch or agency.

Sec. 204.115. Voluntary Closure of Branch or Agency. (a) A foreign bank licensed to establish and maintain a Texas state branch or agency may not close the office without filing an application with, and obtaining the prior approval of, the commissioner. An application by a foreign bank under this section must be in the form and include the information the commissioner requires.

(b) The commissioner shall approve the application if the commissioner finds that the closing of the office will not be substantially detrimental to the foreign bank's depositors and creditors in this state. An application may be approved subject to conditions imposed by the commissioner for the continued protection of the foreign bank's depositors and creditors in this state, including a condition that the foreign bank pledge assets in the manner specified by Section 204.113 for a specified period of time.

(c) When an application by a foreign bank under this section has been approved and all conditions precedent to the closing have been fulfilled, the foreign bank may close the office and an officer, manager, or agent of the foreign bank shall deliver to the commissioner:

(1) all copies of examination reports or other property of the department;

(2) a statement under oath by an authorized officer, manager, or agent of the foreign bank that all

deposit and other liabilities of the Texas state branch or agency to depositors and creditors in this state have been properly discharged by payment or pledge or otherwise assumed or retained by a financial institution;

(3) the license issued by the commissioner;

(4) an appropriate board resolution closing the Texas state branch or agency; and

(5) a statement of the location where the records of the Texas state branch or agency will be kept after the closing.

Sec. 204.116. Enforcement. The commissioner may initiate an enforcement action under Chapter 35 or a proceeding to revoke the license of a Texas state branch or agency if the commissioner by examination or other credible evidence finds that the foreign bank:

(1) does not currently meet the criteria established by this chapter for the original issuance of a license;

(2) has refused to permit the commissioner to examine its books, papers, accounts, records, or affairs in accordance with Sections 204.002 and 204.003;

(3) has failed to make a report required under this chapter or made a material false or misleading statement in the report;

(4) has violated this subtitle, another law or rule applicable to a foreign bank or a Texas state branch or agency, or a final and enforceable order of the commissioner or the finance commission;

(5) has misrepresented or concealed a material fact in the original application for license;

(6) has violated a condition of its license or an agreement between the foreign bank and the commissioner or the department; or

(7) conducts business in an unsafe and unsound manner.

Sec. 204.117. Procedure for Revocation. (a) Notice of a revocation proceeding must:

(1) be in the form of a proposed order;

(2) be served on the foreign bank by personal delivery or registered or certified mail, return receipt requested, to a director, officer, manager, or employee of the foreign bank at a Texas state branch or agency location, or to the registered agent of the foreign bank;

(3) state the effective date of the proposed order, which may not be before the 21st day after the date the proposed order is mailed or delivered except as otherwise provided in Section 204.118; and

(4) state the grounds for the proposed revocation with reasonable certainty.

(b) Unless the foreign bank requests a hearing in writing on or before the effective date of the proposed order, the order takes effect as proposed and is final and nonappealable.

(c) A hearing requested on a proposed order shall be held not later than the 30th day after the date the written request for hearing is received by the department unless the parties agree to a later hearing date. The department shall participate as the opposing party, and the commissioner shall conduct the hearing and one or more prehearing conferences and opportunities for discovery as the commissioner considers advisable and consistent with applicable statutes and rules.[7] The foreign bank may not accept new business during the pendency of the hearing unless the commissioner gives prior written approval, except that it shall comply with any stricter requirements imposed by Section 7(e), International Banking Act (12 U.S.C. Section 3105(e)).

(d) Information relating to the financial condition and business affairs of the foreign bank, except previously published statements and information, is confidential and may not be considered in the public portion of the hearing or disclosed by the commissioner or an employee of the department except as provided by Subchapter D, Chapter 31.[8]

(e) Based on the record, the commissioner shall issue or refuse to issue the proposed order. An issued order may contain modifications indicated by the record to be necessary or desirable, including modifications to impose penalties available under Chapter 35 in lieu of license revocation.

Sec. 204.118. Immediate Suspension or Revocation. (a) If the commissioner finds that any of the factors set forth in Section 204.116 are true with respect to a foreign bank licensed to maintain a Texas state branch or agency and that it is necessary for the protection of the interests of creditors of the foreign

[7] See 7 TAC §§9.11-9.39, relating to procedure for contested case hearings.

[8] See 7 TAC §3.111, relating to confidential information.

bank's business in this state or for the protection of the public interest that the commissioner immediately suspend or revoke the license of the foreign bank, the commissioner may issue, without notice and hearing, an order suspending or revoking the license of the foreign bank for a period of up to 90 days, pending investigation or hearing under Section 204.117.

(b) An order issued under this section shall be served on the foreign bank in the manner required by Section 204.117(a)(2).

Sec. 204.119. Status of Revoked License. Unless stayed by the finance commission or district court that has jurisdiction over an appeal, a final order of the commissioner revoking a license is effective immediately and the foreign bank shall immediately cease all activity in this state requiring a license. Subject to Section 204.120, all functions requiring a license must be immediately transferred to a branch, affiliate, or agency of the foreign bank that is located outside of this state and that has the power to perform those functions under governing law. Continued activity in this state of an unlicensed foreign bank is subject to Subchapter C, Chapter 35.

Sec. 204.120. Seizure and Liquidation. (a) If the commissioner finds that any of the factors set forth in Section 204.116 are true with respect to a foreign bank licensed to establish and maintain a Texas state branch or agency, the commissioner may by order immediately take possession of the property and business of the foreign bank in this state if that action is necessary or desirable for the protection of the interests of the depositors and creditors of the foreign bank's business in this state or for the protection of the public. The commissioner shall retain possession until the foreign bank resumes business in this state or is finally liquidated, except that the commissioner may permit the foreign bank to resume business in this state on conditions the commissioner requires. An order issued under this section shall be served on the foreign bank in the manner required by Section 204.117(a)(2).

(b) As soon as practicable after taking possession of the property and business of a foreign bank pursuant to Subsection (a), the commissioner shall initiate a receivership proceeding by filing a copy of the order issued under this section in a district court in Travis County to be governed by Chapter 36 as if the foreign bank were a Texas state bank, except as otherwise provided by this section. Notwithstanding the priorities established by Chapter 36, the depositors and creditors of the Texas state branch or agency, arising out of transactions with and recorded on the books of the Texas state branch or agency, have an absolute preference and priority over the creditors of the foreign bank's offices located outside this state.

(c) An action initiated that seeks to directly or indirectly affect the assets of the Texas state branch or agency is considered to be an intervention in the receivership proceeding. Venue for an action instituted to effect, contest, or otherwise intervene in the liquidation of a Texas state branch or agency is in Travis County, except that on motion filed and served concurrently with or before the filing of the answer, the court may, on a finding of good cause, transfer the action to the county of the Texas state branch or agency location.

(d) The foreign bank may contest the commissioner's actions as provided by this subsection. On or before the 10th day after the date the commissioner has taken possession of the property and business of a foreign bank pursuant to Subsection (a), the foreign bank, acting through a majority of its directors, may intervene in the action filed by the banking commissioner to challenge the commissioner's closing of the foreign bank's Texas state branch or agency and to enjoin the commissioner or other receiver from liquidating its assets. The court may issue an ex parte order restraining the commissioner or other receiver from liquidating the foreign bank's assets pending a hearing on the injunction. The commissioner or other receiver shall comply with the restraining order but may petition the court for permission to liquidate an asset as necessary to prevent its loss or diminution pending the outcome of the injunction. The commissioner or other receiver may not be required to post bond. The court shall hear this action as quickly as possible and shall give it priority over other business. The foreign bank or the commissioner or other receiver may appeal the court's judgment as in other civil cases, except that the commissioner or other receiver shall retain all seized foreign bank assets pending a final appellate court order even if the commissioner does not prevail in the trial court. If the commissioner prevails in the trial court, liquidation of the state trust company may proceed unless the trial court or appellate court orders otherwise. If liquidation is enjoined or stayed pending appeal, the trial court retains jurisdiction to permit liquidation of an asset as necessary to prevent its loss or diminution pending the outcome of the appeal.

(e) After the commissioner or other receiver has completed the liquidation of the property and business of a foreign bank, the commissioner or other receiver shall transfer any remaining assets to the foreign bank in accordance with the court's orders, except that:

(1) if the foreign bank has an office in another state of the United States that is in liquidation and the assets of the office appear to be insufficient to pay in full the creditors of that office, the court shall order the commissioner or other receiver to transfer to the liquidator of that office the amount of the remaining assets that appears to be necessary to cover the insufficiency; or

(2) if the foreign bank has two or more such offices in liquidation and the amount of remaining assets is less than the aggregate amount of insufficiencies with respect to the offices, the court shall order the commissioner or other receiver to distribute the remaining assets among the liquidators of the offices in the manner the court finds equitable.

Sec. 204.121. Dissolution. (a) If a foreign bank licensed to maintain a Texas state branch or agency in this state is dissolved, has its authority or existence terminated or canceled in the jurisdiction of its incorporation, or has its authority to maintain a branch or agency in this state terminated by the Board of Governors of the Federal Reserve System under Section 7(e), International Banking Act (12 U.S.C. Section 3105(e)), an officer, manager, or agent of the foreign bank shall deliver to the commissioner:

(1) a certified copy of:

(A) a certificate of the official responsible for records of banking corporations of the foreign bank's jurisdiction of incorporation attesting to the occurrence of dissolution or of termination or cancellation of authority or existence;

(B) an order or decree of a court directing the dissolution of the foreign bank or the termination or cancellation of its authority or existence; or

(C) an order of the Board of Governors of the Federal Reserve System terminating its authority under Section 7(e), International Banking Act (12 U.S.C. Section 3105(e)); and

(2) the documents and information required by Section 204.115(c).

(b) The filing of the certificate, order, or decree has the same effect provided by Section 204.119 as if the license issued under this subchapter were revoked by the commissioner as of the effective date of termination or cancellation specified in the certificate, order, or decree unless the commissioner orders an earlier effective date, subject to the procedural protections of Section 204.117 or 204.118.

Subchapter C. Representative Offices of Foreign Bank

Sec. 204.201. Registration of Representative Office. (a) A foreign bank may establish a Texas representative office if the foreign bank files with the commissioner a verified statement of registration.[9] A statement of registration must:

(1) be accompanied by all registration fees and deposits required by rule;

(2) be in the form specified by the commissioner;

(3) be subscribed and acknowledged by an officer of the foreign bank;

(4) contain as an exhibit or attachment:

(A) a copy of the foreign bank's notice or application submitted to the Board of Governors of the Federal Reserve System under Section 10, International Banking Act (12 U.S.C. Section 3107), and, when issued, the order or notification from the board of governors indicating that the representative office has been approved;

(B) an authenticated copy of the foreign bank's certificate of formation and bylaws or other constitutive documents and, if the copy is in a language other than English, an English translation of the document, under the oath of the translator; and

(C) evidence of compliance with Section 201.102;

(5) be submitted when the federal notice or application is submitted to the board of governors; and

(6) directly or in exhibits or attachments contain:

(A) the name of the foreign bank;

(B) the street address and post office address where each Texas representative office is to be located in this state;

(C) the name and qualifications of each officer and director of the foreign bank who will have

[9] See 7 TAC §3.44, relating to registration, notices, and filings by representative offices.

charge of any aspect of the business and affairs of the Texas representative office;

(D) a complete and detailed statement of the financial condition of the foreign bank as of a date not more than 360 days before the date of the filing; and

(E) other information the commissioner requires.

(b) The finance commission may adopt rules prescribing abbreviated registration procedures and standards for foreign banks that have already established an initial Texas representative office to establish additional Texas representative offices.

(c) A foreign bank that maintains a Texas state or federal branch or agency in this state is not prohibited from establishing or maintaining one or more Texas representative offices.

Sec. 204.202. Place of Business. A Texas representative office may engage in the business authorized by this subchapter at each place of business registered with the commissioner. A Texas representative office may change its location in this state by filing a notice with the commissioner containing the street address and post office address of the new location.

Sec. 204.203. Permissible Activities of Representative Office. (a) A registered Texas representative office of a foreign bank may:

(1) solicit loans and in connection with a loan:

(A) assemble credit information about the borrower;

(B) inspect and appraise property;

(C) obtain property title information; and

(D) prepare a loan application;

(2) solicit purchasers for loans from the foreign bank;

(3) solicit persons to contract for servicing the foreign bank loans;

(4) conduct research;

(5) perform services as liaison for customers and correspondents of the foreign bank;

(6) execute loan documents relating to permitted loans with the written approval of the foreign bank;

(7) perform back office administrative functions as may be more specifically defined by rule; and

(8) engage in other activities approved by the commissioner or permitted by rule.

(b) A representative office may not solicit or accept credit balances or deposits or make final credit decisions.

(c) A Texas representative office that is or becomes a regional administrative office of the foreign bank, as may be defined more fully by rule, may engage in credit approval activities if:

(1) the foreign bank gives prior written notice to the commissioner not later than the 30th day before the date the Texas representative office engages in credit approval activities; and

(2) the commissioner does not object within the 30-day period to the conduct of the activities by the Texas representative office.

(d) Written notice under Subsection (c) must be in a form and contain the information the commissioner requires.

Sec. 204.204. Enforcement. The commissioner may initiate an enforcement action under Chapter 35 or a proceeding to revoke the registration of a representative office if the commissioner by examination or other credible evidence finds that the foreign bank:

(1) has refused to permit the commissioner to examine the books, papers, accounts, records, or affairs of a Texas representative office in accordance with Sections 204.002 and 204.003;

(2) has violated this subtitle, another law or rule applicable to a foreign bank or a Texas representative office, or a final and enforceable order of the commissioner or the finance commission;

(3) has misrepresented or concealed a material fact in the original registration;

(4) has violated a condition of an agreement between the foreign bank and the commissioner, a bank supervisory agency, or another state regulatory agency; or

(5) conducts business in an unsafe and unsound manner.

Sec. 204.205. Procedure for Revocation. (a) Notice of a revocation proceeding must:

(1) be in the form of a proposed order;

(2) be served on the foreign bank by personal delivery or registered or certified mail, return receipt requested, to a director, officer, or employee of the foreign bank at a Texas representative office location, or to the registered agent of the foreign bank;

(3) state the effective date of the proposed order, which may not be before the 21st day after the date the proposed order is mailed or delivered; and

(4) state the grounds for the proposed revocation with reasonable certainty.

(b) Unless the foreign bank requests a hearing in writing on or before the effective date of the proposed order, the order takes effect as proposed and is final and nonappealable.

(c) A hearing requested on a proposed order shall be held not later than the 30th day after the date the written request for hearing is received by the commissioner unless the parties agree to a later hearing date. The department shall participate as the opposing party, and the commissioner shall conduct the hearing and one or more prehearing conferences and opportunities for discovery as the commissioner considers advisable and consistent with applicable statutes and rules. During the pendency of the hearing and unless the commissioner gives prior written approval, the foreign bank may not accept new business from this state.[10]

(d) Information relating to the financial condition and business affairs of the foreign bank, except previously published statements and information, is confidential and may not be considered in the public portion of the hearing or disclosed by the commissioner or an employee of the department except as provided by Subchapter D, Chapter 31.[11]

(e) Based on the record, the commissioner shall issue or refuse to issue the proposed order. An issued order may contain modifications indicated by the record to be necessary or desirable, including modifications to impose penalties available under Chapter 35 in lieu of revocation of registration.

Sec. 204.206. Effect of Revoked Registration. A foreign bank that has had its registration under this subchapter revoked shall cease all activities in this state. Continued activity in this state of an unregistered foreign bank is subject to Subchapter C, Chapter 35.

Sec. 204.207. Dissolution. (a) If a foreign bank with a registered Texas representative office is dissolved, has its authority or existence terminated or canceled in the jurisdiction of its incorporation, or has its authority to maintain its Texas representative office terminated by the Board of Governors of the Federal Reserve System under Section 10(b), International Banking Act (12 U.S.C. Section 3107(b)), an officer, manager, or agent of the foreign bank shall deliver to the commissioner a certified copy of:

(1) a certificate of the official responsible for records of banking corporations of the foreign bank's jurisdiction of incorporation attesting to the occurrence of dissolution or of termination or cancellation of authority or existence;

(2) an order or decree of a court directing the dissolution of the foreign bank or the termination or cancellation of its authority or existence; or

(3) an order of the Board of Governors of the Federal Reserve System terminating its authority under Section 10(b), International Banking Act (12 U.S.C. Section 3107(b)).

(b) The filing of the certificate, order, or decree has the same effect under Section 204.206 as if the registration made under this subchapter were revoked by the commissioner.

[The next chapter is Chapter 271]
[The next page is 1601]

[10] See 7 TAC §§9.11-9.39, relating to procedure for contested case hearings.

[11] See 7 TAC §3.111, relating to confidential information.

SUBTITLE Z. MISCELLANEOUS PROVISIONS RELATING TO FINANCIAL INSTITUTIONS AND BUSINESSES

CHAPTER 271. FINANCIAL TRANSACTION REPORTING REQUIREMENTS

CHAPTER 271. FINANCIAL TRANSACTION REPORTING REQUIREMENTS

Sec. 271.001. Reporting Requirement for Crimes and Suspected Crimes and Currency and Foreign Transactions. (a) A financial institution that is required to file a report with respect to a transaction in this state under the Currency and Foreign Transactions Reporting Act (31 U.S.C. Section 5311 et seq.), 31 C.F.R. Part 103, or 12 C.F.R. Section 21.11, and their subsequent amendments, shall file a copy of the report with the attorney general.

(b) A financial institution that timely files the report described by Subsection (a) with the appropriate federal agency as required by federal law complies with that subsection unless the attorney general:

(1) notifies the financial institution that the report is not of a type that is regularly and comprehensively transmitted by the federal agency to the attorney general following the attorney general's request to that agency;

(2) requests that the financial institution provide the attorney general with a copy of the report; and

(3) reimburses the financial institution for the actual cost of duplicating and delivering the report or 25 cents for each page, whichever is less.

(c) In this section, "financial institution" has the meaning assigned by 31 U.S.C. Section 5312 and its subsequent amendments.

Sec. 271.002. Reporting Requirement for Cash Receipts of More than $10,000. (a) A person engaged in a trade or business who, in the course of the trade or business, receives more than $10,000 in one transaction or in two or more related transactions in this state and who is required to file a return under Section 6050I, Internal Revenue Code of 1986 (26 U.S.C. Section 6050I), or 26 C.F.R. Section 1.6050I-1, and their subsequent amendments, shall file a copy of the return with the attorney general.

(b) A person who timely files the return described by Subsection (a) with the appropriate federal agency as required by federal law complies with that subsection unless the attorney general:

(1) notifies the person that the return is not of a type that is regularly and comprehensively transmitted by the federal agency to the attorney general; and

(2) requests that the person provide the attorney general with a copy of the return.

Sec. 271.003. Use of Reported Information. The attorney general may report a possible violation indicated by analysis of a report or return described by this chapter or information obtained under this chapter to an appropriate law enforcement agency for use in the proper discharge of the agency's official duties.

Sec. 271.004. Failure to Comply with Reporting Requirements; Criminal Penalty. (a) A person commits an offense if the person:

(1) is requested by the attorney general to submit information required by Section 271.001 or 271.002 to the attorney general; and

(2) knowingly fails to provide the requested information to the attorney general before the 30th day after the date of the request.

(b) An offense under this section is a Class A misdemeanor.

Sec. 271.005. Suppression of Physical Evidence; Criminal Penalty. (a) A person commits an offense if the person knowingly suppresses physical evidence connected with information contained in a report or return required by this chapter through concealment, alteration, or destruction.

(b) An offense under this section is a Class A misdemeanor.

Sec. 271.006. Notification to Target of Criminal Investigation; Criminal Penalty. (a) A person commits an offense if the person:

(1) is required to submit a report or return under this chapter; and

(2) knowingly notifies an individual who is the target of a criminal investigation involving an offense under Chapter 34, Penal Code, that:

(A) the attorney general has requested the person to provide information required by this chapter related to the targeted individual; or

(B) the individual may be subject to impending criminal prosecution.

(b) An offense under this section is a Class A misdemeanor.

[The next chapter is Chapter 274]

CHAPTER 274. SUBSTITUTE OR SUCCESSOR FIDUCIARY

Subchapter A. General Provisions

Subchapter B. Subsidiary Trust Companies as Substitute or Successor Fiduciaries

Subchapter C. Banks Affiliated with Subsidiary Trust Companies

CHAPTER 274. SUBSTITUTE OR SUCCESSOR FIDUCIARY

Subchapter A. General Provisions

Sec. 274.001. Definitions. In this chapter:

(1) "Bank" has the meaning assigned by Section 31.002(a)(2), excluding a bank that does not have its main office or a branch located in this state.

(2) "Bank holding company" has the meaning assigned by Section 2(a), Bank Holding Company Act of 1956 (12 U.S.C. Section 1841(a)), as amended.

(3) "Commissioner" means the banking commissioner of Texas.

(4) "Fiduciary" means an entity responsible for managing a fiduciary account.

(5) "Fiduciary account" means an account with a situs of administration in this state involving the exercise of a corporate purpose specified by Section 182.001(b).

Sec. 274.002. Affiliated Bank. A bank is affiliated with a subsidiary trust company if more than 50 percent of the bank's voting stock is directly or indirectly owned by a bank holding company that owns more than 50 percent of the voting stock of the subsidiary trust company.

Sec. 274.003. Subsidiary Trust Company. An entity is a subsidiary trust company of a bank holding company if:

(1) the entity is a:

(A) trust company organized under Subchapter A, Chapter 182; or

(B) bank that is organized to conduct a trust business and any incidental business or to exercise trust powers; and

(2) more than 50 percent of the voting stock of the entity is directly or indirectly owned by the bank holding company.

Subchapter B. Subsidiary Trust Companies as Substitute or Successor Fiduciaries

Sec. 274.101. Agreement to Substitute Fiduciaries. (a) A subsidiary trust company may enter into an agreement with an affiliated bank of the company to substitute the company as fiduciary for the bank in each fiduciary account listed in the agreement, provided the situs of account administration is not moved outside of this state without the express written consent of all persons entitled to notice under Sections 274.103(a) and (c).

(b) The agreement must include:

(1) a list of each fiduciary account for which substitution is requested;

(2) a statement of whether the substitution will cause a change in the situs of administration of each fiduciary account; and

(3) the effective date of the substitution, which may not be before the 91st day after the date of the agreement.

(c) The agreement must be filed with the commissioner before the date the substitution takes effect.

(d) A fiduciary account may be removed from the operation of the agreement by the filing of an amendment to the agreement with the commissioner before the effective date stated in the agreement.

Sec. 274.102. Situs of Account Administration. The situs of administration of a fiduciary account is the county in this state in which the fiduciary maintains the office that is primarily responsible for dealing with the parties involved in the account.

Sec. 274.103. Notice of Substitution. (a) Not later than the 91st day before the effective date of a substitution under Section 274.101, the parties to the substitution agreement shall send notice of the substitution to:

(1) any other fiduciary;

(2) each surviving settlor of a trust relating to the fiduciary account;

(3) each issuer of a security for which the affiliated bank administers the fiduciary account;

(4) the plan sponsor of each employee benefit plan relating to the fiduciary account;

(5) the principal of each agency account; and

(6) the guardian of the person of each ward that has the fiduciary account resulting from a guardianship.

(b) If the substitution does not cause a change in the situs of administration of a fiduciary account, the parties to the substitution agreement shall also send notice of the substitution to each person who is readily ascertainable as a beneficiary of the account because the person has received account statements or because a parent, conservator, or guardian of a minor beneficiary has received account statements on the minor’s behalf.

(c) If the substitution causes a change in the situs of administration of a fiduciary account, the parties to the substitution agreement shall also send notice of the substitution to:

(1) each adult beneficiary of a trust relating to the account;

(2) each parent, conservator, or guardian of a minor beneficiary receiving or entitled to receive current distributions of income or principal from the account; and

(3) each person who individually or jointly has the power to remove the fiduciary being substituted.

(d) The notice must be sent by United States mail to the person’s current address as shown on the fiduciary’s records. The fiduciary shall make a reasonable attempt to ascertain the address of a person who does not have an address shown on the fiduciary’s records.

Sec. 274.104. Form of Notice of Substitution. The notice required under Section 274.103 must be in writing and disclose:

(1) the effect the substitution of fiduciary will have on the situs of administration of the fiduciary account;

(2) the person’s rights with respect to objecting to the substitution; and

(3) the liability of the existing fiduciary and the substitute fiduciary for their actions.

Sec. 274.105. Failure to Send Notice of Substitution; Defective Notice. (a) If the parties to a substitution agreement under Section 274.101 intentionally fail to send the required notice under Section 274.103, the substitution of the fiduciary is ineffective.

(b) If the parties unintentionally fail to send the required notice, the substitution of the fiduciary is not impaired.

(c) If a substitution of a fiduciary is ineffective because of a defect in the required notice, any action taken by a subsidiary trust company before the substitution is determined to be ineffective is valid if the action would have been valid if performed by the affiliated bank.

Sec. 274.106. Effective Date of Substitution of Fiduciaries. (a) The substitution takes effect on the effective date stated in the substitution agreement unless, not later than the 16th day before the effective date:

(1) each party entitled to receive notice of the substitution under Sections 274.103(a) and (c) provides the affiliated bank with a written objection to the substitution; or

(2) a party entitled to receive notice of the substitution under Section 274.103 files a written petition in a court seeking to have the substitution denied under Section 274.107 and provides the affiliated bank with a copy of the petition.

(b) A substitution that is objected to under Subsection (a)(1) takes effect when:

(1) one of the parties objecting to the substitution removes the party's objection in writing; or

(2) the bank obtains a final court order approving the substitution.

(c) A substitution that is objected to under Subsection (a)(2) takes effect when:

(1) the petition is withdrawn or dismissed; or

(2) the court enters a final order denying the relief sought.

Sec. 274.107. Hearing on Agreement to Substitute Fiduciaries. (a) A court may deny the substitution if the court, after notice and hearing, determines:

(1) if the substitution will not cause a change in the situs of administration of a fiduciary account, that the substitution is materially detrimental to the account or to its beneficiaries; or

(2) if the substitution will cause a change in the situs of administration of a fiduciary account, that the substitution is not in the best interests of the account or its beneficiaries.

(b) The court shall allow a substitution that will cause the situs of administration of a fiduciary account to change if the court, after notice and hearing, determines that the substitution is in the best interests of the account and its beneficiaries.

(c) In a proceeding under this section, the court may award costs and reasonable and necessary attorney's fees as the court considers equitable and just.

Sec. 274.108. Subsidiary Trust Company as Substitute Fiduciary. On the effective date of the substitution as prescribed by Section 274.106, the subsidiary trust company:

(1) without the necessity of an instrument of transfer or conveyance, succeeds to all interest in property the affiliated bank holds for the fiduciary account being substituted; and

(2) without the necessity of judicial action or action by the creator of the fiduciary account, becomes fiduciary of the account and shall perform the duties and exercise the powers of a fiduciary in the same manner as if the company had originally been designated fiduciary.

Sec. 274.109. Notice of Change in Situs of Administration of Fiduciary Account Following Substitution. (a) If the fiduciary of a fiduciary account has changed as a result of a substitution agreement under Section 274.101, the substitute fiduciary shall send notice of a change in the situs of administration of the account after the substitution to each person entitled to notice under Sections 274.103(a) and (c) not later than the 91st day before the effective date of the change.

(b) The notice must be sent by United States mail to the person's current address as shown on the fiduciary's records. The fiduciary shall make a reasonable attempt to ascertain the address of a person who does not have an address shown on the fiduciary's records.

(c) The notice must disclose:

(1) the effect that the change will have on the situs of administration of the account;

(2) the effective date of the change; and

(3) the person's rights with respect to objecting to the change.

Sec. 274.110. Failure to Send Notice of Change in Situs of Administration. (a) If the substitute fiduciary of a fiduciary account intentionally fails to send the required notice under Section 274.109, the change in the situs of administration is ineffective.

(b) If the substitute fiduciary unintentionally fails to send the required notice, the change in the situs of administration is not impaired.

Sec. 274.111. Effective Date of Change in Situs of Administration of Fiduciary Account. (a) A change in the situs of administration takes effect on the effective date stated in the notice under Section 274.109 unless, not later than the 16th day before the effective date:

(1) each party entitled to receive notice for the fiduciary account provides the subsidiary trust company with a written objection to the change; or

(2) a party entitled to receive notice files a written petition in a court seeking to have the change denied under Section 274.112 and provides the subsidiary trust company with a copy of the petition.

(b) A change that is objected to under Subsection (a)(1) takes effect when:

(1) one of the parties objecting to the change removes the party's objection in writing; or

(2) the subsidiary trust company obtains a final court order approving the change.

(c) A change that is objected to under Subsection (a)(2) takes effect when:

(1) the petition is withdrawn or dismissed; or

(2) the court enters a final order denying the relief sought.

Sec. 274.112. Hearing on Change in Situs of Administration of Fiduciary Account. (a) A court may allow the change in the situs of administration if the court, after notice and hearing, determines that the change is in the best interests of the fiduciary account and its beneficiaries. The court may deny the change if the court, after notice and hearing, determines that the change is not in the best interests of the account or its beneficiaries.

(b) In a proceeding under this section, the court may award costs and reasonable and necessary attorney's fees as the court considers equitable and just.

Sec. 274.113. Venue. (a) An action under this subchapter for a fiduciary account resulting from a decedent's estate or guardianship must be brought in the county provided for by the Estates Code with respect to the probate of a will, issuance of letters testamentary or of administration, administration of a decedent's estate, appointment of a guardian, and administration of a guardianship.

(b) Except as provided by Subsection (c), an action under this subchapter regarding any other fiduciary account must be brought in the county of the situs of administration of the account, notwithstanding a statute that would set venue in the location of the fiduciary's principal office.

(c) A beneficiary of a fiduciary account described by Subsection (b) may elect to bring the action in the county in which the principal office of the first affiliated bank that transferred the account under this subchapter is located.

Sec. 274.114. Subsidiary Trust Company as Successor Fiduciary. For purposes of qualifying as successor fiduciary under a document creating a fiduciary account or a statute of this state relating to fiduciary accounts, a subsidiary trust company:

(1) is considered to have capital and surplus in an amount equal to the total of its capital and surplus and the capital and surplus of the bank holding company that owns the company; and

(2) is treated as a national bank unless it:

(A) is not a national bank under federal law; and

(B) has not entered into a substitution agreement with an affiliated bank of the company that is a national bank under federal law.

Sec. 274.115. Bond of Successor Fiduciary. If an affiliated bank of a subsidiary trust company has given bond to secure performance of its duties and the company qualifies as successor fiduciary, the company shall give bond to secure performance of its duties in the same manner as the bank.

Sec. 274.116. Responsibility for Subsidiary Trust Company. The bank holding company that owns a subsidiary trust company shall file with the commissioner an irrevocable undertaking to be fully responsible for the fiduciary acts and omissions of the subsidiary trust company.

Subchapter C. Banks Affiliated with Subsidiary Trust Companies

Sec. 274.201. Designation of Affiliated Bank as Fiduciary in Will. The prospective designation in a will or other instrument of an affiliated bank of a subsidiary trust company as fiduciary is also considered a designation of the company as fiduciary and confers on the company any discretionary power granted in the instrument unless:

(1) the bank and company agree in writing to have the designation of the bank as fiduciary be binding; or

(2) the creator of the fiduciary account, by appropriate language in the document creating the account, provides that the account is not eligible for substitution under this chapter.

Sec. 274.202. Liability of Affiliated Bank Acting as Fiduciary. After a substitution of a subsidiary trust company as fiduciary for an affiliated bank of the company, the bank remains liable for any action taken by the bank as a fiduciary.

Sec. 274.203. Deposit of Money with Affiliated Bank. (a) A subsidiary trust company may deposit with an affiliated bank of the company fiduciary money that is being held pending an investment, distribution, or payment of a debt if:

(1) the company maintains under its control as security for the deposit a separate fund of securities legal for trust investments pledged by the bank;

(2) the total market value of the securities is at all times at least equal to the amount of the deposit; and

(3) the fund of securities is designated as a separate fund.

(b) The bank may make periodic withdrawals from or additions to the fund of securities required by this section only if the required value is maintained.

(c) Income from securities in the fund belongs to the bank.

(d) Security for a deposit under this section is not required to the extent the deposit is insured or otherwise secured under law.

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CHAPTER 275. TEXAS MUTUAL TRUST INVESTMENT COMPANY ACT

Subchapter A. General Provisions

Subchapter B. Creation of Mutual Trust Investment Company

Subchapter C. Administrative Provisions

Subchapter D. Mutual Trust Investment Company Stock

Subchapter E. Investment in Mutual Trust Investment Company

CHAPTER 275. TEXAS MUTUAL TRUST INVESTMENT COMPANY ACT

Subchapter A. General Provisions

Sec. 275.001. Short Title. This chapter may be cited as the Texas Mutual Trust Investment Company Act.

Sec. 275.002. Definitions. In this chapter:

(1) "Fiduciary institution" means a:

(A) state bank with trust powers;

(B) national bank with trust powers; or

(C) trust company.

(2) "Stock" means a unit of participation in the net asset value of one or more of the investment funds of a mutual trust investment company.

Sec. 275.003. Application of General Corporation Law. Except as provided by this chapter, a mutual trust investment company must be incorporated under and is subject to the general corporation laws of this state.

Sec. 275.004. Investment of Corporation Assets. A mutual trust investment company may invest its assets only in investments in which a trustee may invest under the laws of this state.

Subchapter B. Creation of Mutual Trust Investment Company

Sec. 275.051. Creation of Mutual Trust Investment Company. (a) One or more fiduciary institutions may incorporate a mutual trust investment company as provided by this chapter to be a medium for the common investment of trust funds held in a fiduciary capacity for fiduciary purposes, by those entities alone or with one or more cofiduciaries.

(b) A mutual trust investment company must be an open-end investment company as defined by, and must be subject to, the Investment Company Act of 1940 (15 U.S.C. Section 80a-1 et seq.).

Sec. 275.052. Incorporators. (a) To incorporate, a mutual trust investment company must have five or more persons subscribe and acknowledge the company's articles of incorporation.

(b) A person subscribing and acknowledging the articles of incorporation of a mutual trust investment company must be an officer or director of a fiduciary institution causing the mutual trust investment company to be incorporated.

Sec. 275.053. Contents of Articles of Incorporation. In addition to the information required by the general corporation laws, the articles of incorporation shall state:

(1) the name of each fiduciary institution causing the corporation to be incorporated; and

(2) the amount of stock originally subscribed for by each fiduciary institution.

Subchapter C. Administrative Provisions

Sec. 275.101. Directors. (a) Except as provided by Subsection (b), a mutual trust investment company must have at least five directors, each of whom is not required to be a stockholder but must be an officer or director of a bank or trust company that is located in this state.

(b) An officer or director of a bank or trust company not located in this state may serve as a director of a mutual trust investment company only if that officer's or director's bank or trust company owns stock in a fiduciary capacity in the mutual trust investment company.

Sec. 275.102. Audits and Reports. (a) At least once each year, a mutual trust investment company shall cause an adequate audit to be made of the company by auditors responsible only to the board of directors of the company.

(b) A mutual trust investment company shall furnish annually a copy of the company's audited financial statement to each corporate fiduciary owning stock in the company.

(c) The mutual trust investment company shall pay the:

(1) reasonable expenses of an audit required by this section made by an independent public accountant or certified public accountant; and

(2) costs of preparing and distributing a report required by this section.

Subchapter D. Mutual Trust Investment Company Stock

Sec. 275.151. Ownership. The stock of a mutual trust investment company may be owned only by fiduciary institutions acting as fiduciaries and any of their cofiduciaries.

Sec. 275.152. Registration. The stock of a mutual trust investment company may be registered in the name of one or more nominees of the owner of the stock.

Sec. 275.153. Transfer and Assignment. The stock of a mutual trust investment company may not be transferred except to:

(1) the mutual trust investment company; or

(2) a fiduciary or cofiduciary that becomes successor to a stockholder and that is a bank or trust company qualified to hold the stock under this chapter.

Sec. 275.154. Ownership by Mutual Trust Investment Company. A mutual trust investment company may acquire its own stock and shall bind itself, by contract or its bylaws, to acquire its own stock, but may not vote on shares of its own stock.

Subchapter E. Investment in Mutual Trust Investment Company

Sec. 275.201. Purchase by Fiduciary; Authority and Restrictions. A fiduciary institution, alone or with one or more cofiduciaries, acting as a fiduciary for fiduciary purposes with the consent of any cofiduciaries, may invest and reinvest funds held in a fiduciary capacity, exercising the care of a prudent investor, in the shares of stock of a mutual trust investment company unless a will, trust indenture, or other instrument under which the fiduciary is acting prohibits that investment.

Sec. 275.202. Responsibility of Mutual Trust Investment Company. (a) A mutual trust investment company is not:

(1) required to determine the investment powers of a fiduciary that purchases its stock; or

(2) liable for accepting funds from a fiduciary in violation of the restrictions of a will, trust indenture, or other instrument under which the fiduciary is acting in the absence of actual knowledge of the violation.

(b) A mutual trust investment company is:

(1) accountable only to a fiduciary who is an owner of its stock; and

(2) permitted to rely on the written statement of any bank or trust company purchasing its stock that the purchase complies with Section 275.201.

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CHAPTER 276. FINANCIAL INSTITUTION ACCOUNTS

CHAPTER 276. FINANCIAL INSTITUTION ACCOUNTS

Sec. 276.001. Accounts for Candidates for Public Office. (a) A financial institution may not open an account in the name of a candidate without obtaining that candidate’s consent and signature. This subsection does not require that the candidate be a signatory to the account.

(b) In this section:

(1) “Candidate” has the meaning assigned by Section 251.001, Election Code.

(2) “Financial institution” means a bank, savings and loan association, savings bank, or credit union.

Sec. 276.002. Garnishment of Financial Institution Account. (a) Notwithstanding the Texas Rules of Civil Procedure, if a financial institution fails to timely file an answer to a writ of garnishment issued before or after a judgment is rendered in the case, a court may enter a default judgment against the financial institution solely as to the existence of liability and not as to the amount of damages.

(b) A financial institution against which a default judgment is entered under Subsection (a) is not deemed to have in the financial institution's possession or to have knowledge of sufficient debts, assets, or personal effects of the debtor to satisfy the debtor's obligations to the garnishor.

(c) After a default judgment is entered against a financial institution as to the existence of liability as provided by Subsection (a), the garnishor has the burden to establish the amount of actual damages proximately caused to the garnishor by the financial institution's default.

(d) The court may award to the garnishor:

(1) damages in the amount determined under Subsection (c); and

(2) for good cause shown, reasonable attorney's fees incurred by the garnishor in establishing damages under Subsection (c).

(e) Notwithstanding Section 22.004, Government Code, the supreme court may not amend or adopt rules in conflict with this section.

Sec. 276.003. Use of Proceeds of Extension of Credit for Financial Institution Account. (a) An obligor may use proceeds of an extension of credit made by a financial institution for business, commercial, investment, or similar purposes to establish collateral for the extension of credit by:

(1) making deposits;

(2) purchasing certificates of deposit; or

(3) establishing other accounts at the financial institution.

(b) The amount of the proceeds used as provided by Subsection (a) is not considered a reduction in the amount of the proceeds of the extension of credit for purposes of Title 4 or for any other purpose.

(c) A determination by the obligor that it is beneficial to use proceeds of an extension of credit in the manner described by Subsection (a) is conclusive.

(d) This section may not be construed to imply a contrary rule for transactions not covered by this section.

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CHAPTER 277. BUSINESS CHECKING ACCOUNTS

CHAPTER 277. BUSINESS CHECKING ACCOUNTS

Sec. 277.001. Definitions. In this chapter:

(1) "Business" means a legal entity, including a corporation, partnership, or sole proprietorship, that is formed for the purpose of making a profit.

(2) "Business checking account" means an account at a financial institution from which withdrawals may be made by a business by check or draft. The term includes a money market account, a negotiable order of withdrawal account, or other account at a financial institution in which the account holder has check writing privileges.

(3) "Financial institution" means a state or national bank, state or federal savings and loan association, state or federal savings bank, or state or federal credit union doing business in this state.

Sec. 277.002. Account Information Required. (a) A financial institution shall require, as a condition of opening or maintaining a business checking account, that the applicant or account holder provide:

(1) if the business is a sole proprietorship:

(A) the name of the business owner;

(B) the physical address of the business;

(C) the home address of the business owner; and

(D) the driver's license number of the business owner or the personal identification card number issued to the business owner by the Department of Public Safety; or

(2) if the business is a corporation or other legal entity, a copy of the business's certificate of incorporation or a comparable document and an assumed name certificate, if any.

(b) The financial institution shall request that the account holder inform the institution at least annually of any changes in the information the institution is required to obtain under Subsection (a).

Sec. 277.003. Disclosure of Information. (a) A financial institution may not unreasonably withhold the information described by Section 277.002 in response to a written request for the information that:

(1) is made by a person to whom the financial institution has returned a dishonored check or draft that was issued to the person by a business that maintains a business checking account; and

(2) includes a photocopy of the dishonored check or draft.

(b) A financial institution that assesses a reasonable research fee in the regular course of business may assess the fee on a person who requests information under this section.

(c) A financial institution is not liable to an account holder or other person for the disclosure of information under this section.

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[The next chapter is Chapter 279]

CHAPTER 279. BANKING AND CREDIT UNION DEVELOPMENT DISTRICTS

Subchapter A. General Provisions

Subchapter B. Banking Development Districts

Subchapter D. Deposit of Public Funds in District Depository

CHAPTER 279. BANKING AND CREDIT UNION DEVELOPMENT DISTRICTS

Subchapter A. General Provisions

Sec. 279.001. Definitions. In this chapter:

(1) "Credit union" means a state or federal credit union.

(2) "Finance commission" means the Finance Commission of Texas.

(3) "Financial institution" means a state or national bank, a state or federal savings bank, or a state or federal savings and loan association.

(4) "Local government" means a municipality or county.

Subchapter B. Banking Development Districts

Sec. 279.051. Administration of Program. The finance commission shall administer and monitor a banking development district program under this chapter to encourage the establishment of branches of a financial institution in geographic areas where there is a demonstrated need for banking services.

Sec. 279.052. Rules. (a) Subject to Subsection (b), the finance commission shall adopt rules to implement this subchapter and Subchapter D with respect to financial institutions in banking development districts.

(b) The finance commission, in consultation with the Texas Economic Development and Tourism Office, shall adopt rules regarding the criteria for the designation of banking development districts under this subchapter. The rules must require the finance commission to consider:

(1) the location, number, and proximity of sites where banking services are available in the proposed banking development district;

(2) consumer needs for banking services in the proposed district;

(3) the economic viability and local credit needs of the community in the proposed district;

(4) the existing commercial development in the proposed district; and

(5) the impact additional banking services would have on potential economic development in the proposed district.

Sec. 279.053. Application for Designation of Banking Development District. A local government, in conjunction with a financial institution, may submit an application to the finance commission for the designation of a banking development district.

Sec. 279.054. Application by Financial Institution to Open Branch in District. A financial institution may apply to open a branch in the proposed banking development district at the time the local government submits an application in conjunction with the institution under Section 279.053.

Sec. 279.055. Determination by Finance Commission. (a) Not later than the 120th day after the date an application for the designation of a banking development district is submitted under Section 279.053, the finance commission shall make a determination regarding whether to approve the application.

(b) If the finance commission approves the application, the finance commission shall notify the:

(1) local government;

(2) financial institution;

(3) comptroller;

(4) Texas Economic Development and Tourism Office;

(5) lieutenant governor; and

(6) speaker of the house of representatives.

Subchapter D. Deposit of Public Funds in District Depository

Sec. 279.151. Designation of District Depository. (a) The governing body of a local government in which a banking development district has been designated under Subchapter B may by resolution designate a financial institution located in the district as a banking district depository for purposes of this subchapter.

(b) The governing body of a local government in which a credit union development district has been designated under Subchapter C may by resolution designate a credit union located in the district as a credit union district depository for purposes of this subchapter.

(c) A resolution adopted under Subsection (a) or (b) must specify the maximum amount that may be kept on deposit with the banking district or credit union district depository, as appropriate.

(d) In calculating the yield under Section 2256.006, Government Code, of public funds deposited in a banking district or credit union district depository, the governing body of a local government may consider the benefit to this state of stimulating economic development.

Sec. 279.152. Deposit of Public Funds by Local Government. (a) A local government may deposit public funds with a financial institution designated as a banking district depository or a credit union designated as a credit union district depository under Section 279.151 regardless of whether the financial institution or credit union is designated by the comptroller as a state depository under Subchapter C, Chapter 404, Government Code.

(b) Subject to an agreement between the governing body and the banking district or credit union district depository, public funds deposited in the district depository may earn a fixed interest rate that is at or below the financial institution's or credit union's posted two-year certificate of deposit rate, as appropriate. The terms of the agreement must be specified in the applicable resolution adopted under Section 279.151.

Sec. 279.153. Deposit of Public Funds by State. (a) If the comptroller designates the financial institution as a state depository under Subchapter C, Chapter 404, Government Code, the comptroller may deposit public funds with a financial institution designated as a banking district depository under Section 279.151(a).

(b) If the comptroller designates the credit union as a state depository under Subchapter C, Chapter 404, Government Code, the comptroller may deposit public funds with a credit union designated as a credit union district depository under Section 279.151(b).

(c) For purposes of Subsections (a) and (b), a financial institution or credit union is subject to the collateral requirements of Section 404.031, Government Code.

(d) Subject to an agreement between the comptroller and the banking district or credit union district depository, public funds deposited in the district depository may earn a fixed interest rate that is at or below the financial institution's or credit union's posted two-year certificate of deposit rate, as appropriate.

(e) In calculating the yield under Section 2256.006, Government Code, of public funds deposited in a banking district or credit union district depository, the comptroller may consider the benefit to this state of stimulating economic development.

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TITLE 4. REGULATION OF INTEREST, LOANS, AND FINANCED TRANSACTIONS

SUBTITLE B. LOANS AND FINANCED TRANSACTIONS

CHAPTER 343. HOME LOANS

Subchapter A. General Provisions

Subchapter B. Provisions Relating to Home Loans in General

Subchapter C. High-Cost Home Loans

CHAPTER 343. HOME LOANS

Subchapter A. General Provisions

Sec. 343.001. Definitions. In this chapter:

(1) "Bridge loan" means temporary or short-term financing requiring payment of only interest until the entire unpaid balance is due.

(2) "Home loan" means a loan that is:

(A) made to one or more individuals for personal, family, or household purposes; and

(B) secured in whole or part by:

(i) a manufactured home, as defined by Section 347.002, used or to be used as the borrower's principal residence; or

(ii) real property improved by a dwelling designed for occupancy by four or fewer families and used or to be used as the borrower's principal residence.

(3) "Restructure" means a change in the payment schedule or other terms of a home loan as a result of the borrower's default.

Sec. 343.002. Applicability. This chapter does not apply to:

(1) a reverse mortgage; or

(2) an open-end account, as defined by Section 301.002.

Sec. 343.003. Conflict with Other Provisions of Title. If this chapter conflicts with another provision of this title, this chapter controls.

Subchapter B. Provisions Relating to Home Loans in General

Sec. 343.101. Refinancing. (a) For purposes of this section, a low-rate home loan is a home loan that at its inception carries an interest rate two percentage points or more below the yield on treasury securities having comparable periods of maturity to the loan maturity, except that if the loan's interest rate is a discounted introductory rate or a rate that automatically steps up over time, the fully indexed rate or the fully stepped-up rate, as appropriate, shall be used instead of the rate at the loan's inception to determine whether the loan is a low-rate loan.

(b) A lender may not replace or consolidate a low-rate home loan directly made by a government or nonprofit lender before the seventh anniversary of the date of the loan unless the new or consolidated loan has a lower interest rate and requires payment of a lesser amount of points and fees than the original loan or is a restructure to avoid foreclosure.

Sec. 343.103. Disclosure of Mortgage Information to Surviving Spouse. (a) In this section:

(1) "Estate" has the meaning assigned by Section 22.012, Estates Code.

(2) "Heir" has the meaning assigned by Section 22.015, Estates Code.

(3) "Mortgage servicer" and "mortgagor" have the meanings assigned by Section 51.0001, Property Code.

(b) Not later than the 30th day after a mortgage servicer of a home loan receives a request for the information from the surviving spouse of a mortgagor of the home loan, accompanied by the proof required under Subsection (c), the mortgage servicer shall provide the surviving spouse with information that the mortgagor would have received in a standard monthly statement, including:

(1) the current balance information, including the due dates and the amount of any installments;

(2) whether the loan is current and any amounts that are delinquent;

(3) any loan number; and

(4) the amount of any escrow deposit for taxes and insurance purposes.

(c) A surviving spouse must prove the person's status by providing:

(1) a death certificate of the mortgagor;

(2) an affidavit of disinterested witnesses that is in the form referenced in Section 203.002, Estates Code, including language stating that the surviving spouse was married to the mortgagor at the time of the mortgagor's death; and

(3) an affidavit signed by the surviving spouse stating that the surviving spouse is currently residing in the underlying mortgaged property as the primary residence.

(d) The request from the surviving spouse must also include a notice to the mortgage servicer that states in bold-faced, capital, or underlined letters: "THIS REQUEST IS MADE PURSUANT TO TEXAS FINANCE CODE SECTION 343.103. SUBSEQUENT DISCLOSURE OF INFORMATION IS NOT IN CONFLICT WITH THE GRAMM-LEACH-BLILEY ACT UNDER 15 U.S.C. SECTION 6802(e)(8)."

(e) A mortgage servicer that provides the information as required under this section is not liable to the estate of the mortgagor or any heir or beneficiary of the mortgagor as a result of providing this information to the surviving spouse.

Sec. 343.104. Restrictions on Single Premium Credit Insurance. A lender may not offer any individual or group credit life, disability, or unemployment insurance on a prepaid single premium basis in conjunction with a home loan unless the following notice is provided to each applicant for the loan by hand delivery or mail to the applicant not later than the third business day after the date the applicant's application for a home loan is received:

INSURANCE NOTICE TO APPLICANT

You may elect to purchase credit life, disability, or involuntary unemployment insurance in conjunction with this mortgage loan. If you elect to purchase this insurance coverage, you may pay for it either on a monthly premium basis or with a single premium payment at the time the lender closes this loan. If you choose the single premium payment, the cost of the premium will be financed at the interest rate provided for in the mortgage loan.
This insurance is NOT required as a condition of closing the mortgage loan and will be included with the loan only at your request.
You have the right to cancel this credit insurance once purchased. If you cancel it within 30 days of the date of

your loan, you will receive either a full refund or a credit against your loan account. If you cancel this insurance at any other time, you will receive either a refund or credit against your loan account of any unearned premium. YOU MUST CANCEL WITHIN 30 DAYS OF THE DATE OF THE LOAN TO RECEIVE A FULL REFUND OR CREDIT.

To assist you in making an informed choice, the following estimates of premiums are being provided along with an example of the cost of financing. The examples assume that the term of the insurance product is ____ years and that the interest rate is ______ percent (a rate that has recently been available for the type of loan you are seeking). PLEASE NOTE THAT THE ACTUAL LOAN TERMS YOU QUALIFY FOR MAY VARY FROM THIS EXAMPLE. "Total amount paid" is the amount that would be paid if you financed only the total insurance premium for a ___ year period and is equal to the amount you would have paid if you made all scheduled payments. This is NOT the total of payments on your loan.

CREDIT LIFE INSURANCE: Estimated premium of $_______
DISABILITY INSURANCE: Estimated premium of $_______
INVOLUNTARY UNEMPLOYMENT INSURANCE: Estimated premium of $________
TOTAL INSURANCE PREMIUMS: $_______
TOTAL AMOUNT PAID: $_______

Sec. 343.105. Notice of Penalties for Making False or Misleading Written Statement. (a) A lender, mortgage banker, or licensed mortgage broker shall provide to each applicant for a home loan a written notice at closing.

(b) The notice must:

(1) be provided on a separate document;

(2) be in at least 14-point type; and

(3) have the following or substantially similar language:

"Warning: Intentionally or knowingly making a materially false or misleading written statement to obtain property or credit, including a mortgage loan, is a violation of Section 32.32, Texas Penal Code, and, depending on the amount of the loan or value of the property, is punishable by imprisonment for a term of 2 years to 99 years and a fine not to exceed $10,000.

"I/we, the undersigned home loan applicant(s), represent that I/we have received, read, and understand this notice of penalties for making a materially false or misleading written statement to obtain a home loan.

"I/we represent that all statements and representations contained in my/our written home loan application, including statements or representations regarding my/our identity, employment, annual income, and intent to occupy the residential real property secured by the home loan, are true and correct as of the date of loan closing."

(c) On receipt of the notice, the loan applicant shall verify the information and execute the notice.

(d) The failure of a lender, mortgage banker, or licensed mortgage broker to provide a notice complying with this section to each applicant for a home loan does not affect the validity or enforceability of the home loan by any holder of the loan.

Sec. 343.106. Payoff Statements. (a) In this section, "mortgagee," "mortgage servicer," and "mortgagor" have the meanings assigned by Section 51.0001, Property Code.

(b) The finance commission shall adopt rules governing requests by title insurance companies for payoff information from mortgage servicers related to home loans and the provision of that information, including rules prescribing a standard payoff statement form that must be used by mortgage servicers to provide those payoff statements.

(c) In adopting rules under Subsection (b), the finance commission shall require a mortgage servicer who receives a request for a payoff statement with respect to a home loan from a title insurance company to deliver the requested payoff statement on the prescribed form within a time specified by finance commission rule, which must allow the mortgage servicer at least seven business days after the date the request is received to deliver the payoff statement.

(d) The standard payoff statement form prescribed by the finance commission under Subsection (b) must require that a completed form:

(1) state the proposed closing date for the sale and conveyance of the real property securing the home loan or for any other transaction that would involve the payoff of the home loan, as specified by the title insurance company's request; and

(2) provide a payoff amount that is valid through that date.

(e) Except as provided by Subsection (f) or (g), if the mortgage servicer provides a completed payoff statement form that meets the requirements of this section and rules adopted under this section in response to a request for a payoff statement, the mortgage servicer or mortgagee may not, on or before the proposed closing date, demand that a mortgagor pay an amount in excess of the payoff amount specified in the payoff statement.

(f) If a mortgage servicer or mortgagee discovers that a payoff statement is incorrect, the mortgage servicer or mortgagee may correct and deliver the statement on or before the second business day before the specified proposed closing date. The corrected payoff statement must be delivered to the requestor by:

(1) certified mail with return receipt requested; and

(2) electronic means, if the requestor provides the mortgage servicer with a means to deliver the corrected statement electronically.

(g) If a mortgage servicer submits an incorrect payoff statement to a title insurance company that results in the mortgage servicer requesting an amount that is less than the correct payoff amount, the mortgage servicer or mortgagee does not deliver a corrected payoff statement in accordance with Subsection (f), and the mortgage servicer receives payment in the amount specified in the payoff statement, the difference between the amount included in the payoff statement and the correct payoff amount:

(1) remains a liability of the former mortgagor owed to the mortgagee; and

(2) if the payoff statement is in connection with:

(A) the sale of the real property:

(i) the deed of trust or other contract lien securing an interest in the property is released;

(ii) within a reasonable time after receipt of payment by the mortgagee or mortgage servicer, the mortgagee or mortgage servicer, as applicable, shall deliver to the title company a release of the deed of trust or other contract lien securing an interest in the property; and

(iii) any proceeds disbursed at closing to or for the benefit of the mortgagor, excluding closing costs related to the transaction, are subject to a constructive trust for the benefit of the mortgagee to the extent of the underpayment; or

(B) a refinance by the mortgagor of the existing home loan:

(i) the lien securing the existing home loan becomes subordinate to the lien securing the new home loan; and

(ii) any proceeds disbursed at closing to or for the benefit of the mortgagor, excluding closing costs related to the transaction, are subject to a constructive trust for the benefit of the mortgagee to the extent of the underpayment.

Subchapter C. High-Cost Home Loans

Sec. 343.201. Definitions. In this subchapter:

(1) "High-cost home loan" means a loan that:

(A) is made to one or more individuals for personal, family, or household purposes;

(B) is secured in whole or part by:

(i) a manufactured home, as defined by Section 347.002, used or to be used as the borrower's principal residence; or

(ii) real property improved by a dwelling designed for occupancy by four or fewer families and used or to be used as the borrower's principal residence;

(C) has a principal amount equal to or less than one-half of the maximum conventional loan amount for first mortgages as established and adjusted by the Federal National Mortgage Association;

(D) is not:

(i) a reverse mortgage; or

(ii) an open-end account, as defined by Section 301.002; and

(E) is a credit transaction described by 12 C.F.R. Section 226.32, as amended, except that the term includes a residential mortgage transaction, as defined by 12 C.F.R. Section 226.2, as amended, if the total loan amount is $20,000 or more and:

(i) the annual percentage rate exceeds the rate indicated in 12 C.F.R. Section 226.32(a)(1)(i), as amended; or

(ii) the total points and fees payable by the consumer at or before loan closing will exceed the amount indicated in 12 C.F.R. Section 226.32(a)(1)(ii), as amended.

(2) "Points and fees" has the meaning assigned by 12 C.F.R. Section 226.32(b), as amended.

Sec. 343.202. Balloon Payment. A high-cost home loan may not contain a provision for a scheduled payment that is more than twice as large as the average of earlier scheduled monthly payments, unless the balloon payment becomes due not less than 60 months after the date of the loan. This prohibition does not apply if the payment schedule is adjusted to account for the seasonal or otherwise irregular income of the borrower or if the loan is a bridge loan in connection with the acquisition or construction of a dwelling intended to become the borrower's principal dwelling.

Sec. 343.203. Negative Amortization. A high-cost home loan may not provide for a payment schedule with regular periodic payments that cause the principal balance to increase, except that this section does not prohibit negative amortization as a consequence of a temporary forbearance, bridge loan, or restructure sought by the borrower.

Sec. 343.204. Consideration of Obligor's Payment Ability. (a) In this section, "obligor" means a person obligated to pay a loan, including a borrower, cosigner, or guarantor. If more than one person is obligated to pay a loan, the term refers to those persons collectively.

(b) A lender may not engage in a pattern or practice of extending credit to consumers under high-cost home loans based on the consumers' collateral without regard to the obligor's repayment ability, including the obligor's current and expected income, current obligations, employment status, and other financial resources, other than the obligor's equity in the dwelling that secures repayment of the loan.

Sec. 343.205. Prepayment Penalties Prohibited. A lender may not make a high-cost home loan containing a provision for a prepayment penalty.

Sec. 343.206. Charge Prohibited for Product or Service Not Received. A lender, in connection with a high-cost home loan, may not charge a borrower an amount for a service or product if the borrower does not receive the service or product.

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[The next chapter is Chapter 391]

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TITLE 5. PROTECTION OF CONSUMERS OF FINANCIAL SERVICES

CHAPTER 391. FURNISHING FALSE CREDIT INFORMATION

CHAPTER 391. FURNISHING FALSE CREDIT INFORMATION

Sec. 391.001. Definition. In this chapter, "credit reporting bureau" means a person who engages in the practice of assembling or reporting credit information about individuals for the purpose of furnishing the information to a third party.

Sec. 391.002. Furnishing False Information; Penalty. (a) A person commits an offense if the person knowingly furnishes false information about another person's creditworthiness, credit standing, or credit capacity to a credit reporting bureau.

(b) A credit reporting bureau commits an offense if the credit reporting bureau knowingly furnishes false information about a person's creditworthiness, credit standing, or credit capacity to a third party.

(c) An offense under this section is a misdemeanor punishable by a fine of not more than $200.

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CHAPTER 392. DEBT COLLECTION

Subchapter A. General Provisions

Subchapter B. Surety Bond

Subchapter C. Information in Files of Credit Bureau or Debt Collector

Subchapter D. Prohibited Debt Collection Methods

Subchapter E. Defense, Criminal Penalty, and Civil Remedies

CHAPTER 392. DEBT COLLECTION

Subchapter A. General Provisions

Sec. 392.001. Definitions. In this chapter:

(1) "Consumer" means an individual who has a consumer debt.

(2) "Consumer debt" means an obligation, or an alleged obligation, primarily for personal, family, or household purposes and arising from a transaction or alleged transaction.

(3) "Creditor" means a party, other than a consumer, to a transaction or alleged transaction involving one or more consumers.

(4) "Credit bureau" means a person who, for compensation, gathers, records, and disseminates information relating to the creditworthiness, financial responsibility, and paying habits of, and similar information regarding, a person for the purpose of furnishing that information to another person.

(5) "Debt collection" means an action, conduct, or practice in collecting, or in soliciting for collection, consumer debts that are due or alleged to be due a creditor.

(6) "Debt collector" means a person who directly or indirectly engages in debt collection and includes a person who sells or offers to sell forms represented to be a collection system, device, or scheme intended to be used to collect consumer debts.

(7) "Third-party debt collector" means a debt collector, as defined by 15 U.S.C. Section 1692a(6), but does not include an attorney collecting a debt as an attorney on behalf of and in the name of a client unless the attorney has nonattorney employees who:

(A) are regularly engaged to solicit debts for collection; or

(B) regularly make contact with debtors for the purpose of collection or adjustment of debts.

Subchapter B. Surety Bond

Sec. 392.101. Bond Requirement. (a) A third-party debt collector or credit bureau may not engage in debt collection unless the third-party debt collector or credit bureau has obtained a surety bond issued by a surety company authorized to do business in this state as prescribed by this section. A copy of the bond must be filed with the secretary of state.

(b) The bond must be in favor of:

(1) any person who is damaged by a violation of this chapter; and

(2) this state for the benefit of any person who is damaged by a violation of this chapter.

(c) The bond must be in the amount of $10,000.

Sec. 392.102. Claim Against Bond. A person who claims against a bond for a violation of this chapter may maintain an action against the third-party debt collector or credit bureau and against the surety. The aggregate liability of the surety to all persons damaged by a violation of this chapter may not exceed the amount of the bond.

Subchapter C. Information in Files of Credit Bureau or Debt Collector

Sec. 392.201. Report to Consumer. Not later than the 45th day after the date of the request, a credit bureau shall provide to a person in its registry a copy of all information contained in its files concerning that person.

Sec. 392.202. Correction of Third-party Debt Collector's or Credit Bureau's Files. (a) An individual who disputes the accuracy of an item that is in a third-party debt collector's or credit bureau's file on the individual and that relates to a debt being collected by the third-party debt collector may notify in writing the third-party debt collector of the inaccuracy. The third-party debt collector shall make a written record of the dispute. If the third-party debt collector does not report information related to the dispute to a credit bureau, the third-party debt collector shall cease collection efforts until an investigation of the dispute described by Subsections (b)-(e) determines the accurate amount of the debt, if any. If the third-party debt collector reports information related to the dispute to a credit bureau, the reporting third-party debt collector shall initiate an investigation of the dispute described by Subsections (b)-(e) and shall cease collection efforts until the investigation determines the accurate amount of the debt, if any. This section does not affect the application of Chapter 20, Business & Commerce Code, to a third-party debt collector subject to that chapter.

(b) Not later than the 30th day after the date a notice of inaccuracy is received, a third-party debt collector who initiates an investigation shall send a written statement to the individual:

(1) denying the inaccuracy;

(2) admitting the inaccuracy; or

(3) stating that the third-party debt collector has not had sufficient time to complete an investigation of the inaccuracy.

(c) If the third-party debt collector admits that the item is inaccurate under Subsection (b), the third-party debt collector shall:

(1) not later than the fifth business day after the date of the admission, correct the item in the relevant file; and

(2) immediately cease collection efforts related to the portion of the debt that was found to be inaccurate and on correction of the item send, to each person who has previously received a report from the third-party debt collector containing the inaccurate information, notice of the inaccuracy and a copy of an accurate report.

(d) If the third-party debt collector states that there has not been sufficient time to complete an investigation, the third-party debt collector shall immediately:

(1) change the item in the relevant file as requested by the individual;

(2) send to each person who previously received the report containing the information a notice that is equivalent to a notice under Subsection (c) and a copy of the changed report; and

(3) cease collection efforts.

(e) On completion by the third-party debt collector of the investigation, the third-party debt collector shall inform the individual of the determination of whether the item is accurate or inaccurate. If the third-party debt collector determines that the information was accurate, the third-party debt collector may again report that information and resume collection efforts.

Subchapter D. Prohibited Debt Collection Methods

Sec. 392.301. Threats or Coercion. (a) In debt collection, a debt collector may not use threats, coercion, or attempts to coerce that employ any of the following practices:

(1) using or threatening to use violence or other criminal means to cause harm to a person or property of a person;

(2) accusing falsely or threatening to accuse falsely a person of fraud or any other crime;

(3) representing or threatening to represent to any person other than the consumer that a consumer is wilfully refusing to pay a nondisputed consumer debt when the debt is in dispute and the consumer has notified in writing the debt collector of the dispute;

(4) threatening to sell or assign to another the obligation of the consumer and falsely representing that the result of the sale or assignment would be that the consumer would lose a defense to the consumer debt or would be subject to illegal collection attempts;

(5) threatening that the debtor will be arrested for nonpayment of a consumer debt without proper court proceedings;

(6) threatening to file a charge, complaint, or criminal action against a debtor when the debtor has not violated a criminal law;

(7) threatening that nonpayment of a consumer debt will result in the seizure, repossession, or sale of the person’s property without proper court proceedings; or

(8) threatening to take an action prohibited by law.

(b) Subsection (a) does not prevent a debt collector from:

(1) informing a debtor that the debtor may be arrested after proper court proceedings if the debtor has violated a criminal law of this state;

(2) threatening to institute civil lawsuits or other judicial proceedings to collect a consumer debt; or

(3) exercising or threatening to exercise a statutory or contractual right of seizure, repossession, or sale that does not require court proceedings.

Sec. 392.302. Harassment; Abuse. In debt collection, a debt collector may not oppress, harass, or abuse a person by:

(1) using profane or obscene language or language intended to abuse unreasonably the hearer or reader;

(2) placing telephone calls without disclosing the name of the individual making the call and with the intent to annoy, harass, or threaten a person at the called number;

(3) causing a person to incur a long distance telephone toll, telegram fee, or other charge by a medium of communication without first disclosing the name of the person making the communication; or

(4) causing a telephone to ring repeatedly or continuously, or making repeated or continuous telephone calls, with the intent to harass a person at the called number.

Sec. 392.303. Unfair or Unconscionable Means. (a) In debt collection, a debt collector may not use unfair or unconscionable means that employ the following practices:

(1) seeking or obtaining a written statement or acknowledgment in any form that specifies that a consumer's obligation is one incurred for necessaries of life if the obligation was not incurred for those necessaries;

(2) collecting or attempting to collect interest or a charge, fee, or expense incidental to the obligation unless the interest or incidental charge, fee, or expense is expressly authorized by the agreement creating the obligation or legally chargeable to the consumer; or

(3) collecting or attempting to collect an obligation under a check, draft, debit payment, or credit card payment, if:

(A) the check or draft was dishonored or the debit payment or credit card payment was refused because the check or draft was not drawn or the payment was not made by a person authorized to use the applicable account;

(B) the debt collector has received written notice from a person authorized to use the account that the check, draft, or payment was unauthorized; and

(C) the person authorized to use the account has filed a report concerning the unauthorized check, draft, or payment with a law enforcement agency, as defined by Article 59.01, Code of Criminal Procedure, and has provided the debt collector with a copy of the report.

(b) Notwithstanding Subsection (a)(2), a creditor may charge a reasonable reinstatement fee as consideration for renewal of a real property loan or contract of sale, after default, if the additional fee is included in a written contract executed at the time of renewal.

(c) Subsection (a)(3) does not prohibit a debt collector from collecting or attempting to collect an obligation under a check, draft, debit payment, or credit card payment if the debt collector has credible evidence, including a document, video recording, or witness statement, that the report filed with a law enforcement agency, as required by Subsection (a)(3)(C), is fraudulent and that the check, draft, or payment was authorized.

Sec. 392.304. Fraudulent, Deceptive, or Misleading Representations. (a) Except as otherwise provided by this section, in debt collection or obtaining information concerning a consumer, a debt collector may not use a fraudulent, deceptive, or misleading representation that employs the following practices:

(1) using a name other than the:

(A) true business or professional name or the true personal or legal name of the debt collector while engaged in debt collection; or

(B) name appearing on the face of the credit card while engaged in the collection of a credit card debt;

(2) failing to maintain a list of all business or professional names known to be used or formerly used by persons collecting consumer debts or attempting to collect consumer debts for the debt collector;

(3) representing falsely that the debt collector has information or something of value for the consumer in order to solicit or discover information about the consumer;

(4) failing to disclose clearly in any communication with the debtor the name of the person to whom the debt has been assigned or is owed when making a demand for money;

(5) in the case of a third-party debt collector, failing to disclose, except in a formal pleading made in connection with a legal action:

(A) that the communication is an attempt to collect a debt and that any information obtained will be used for that purpose, if the communication is the initial written or oral communication between the third-party debt collector and the debtor; or

(B) that the communication is from a debt collector, if the communication is a subsequent written or oral communication between the third-party debt collector and the debtor;

(6) using a written communication that fails to indicate clearly the name of the debt collector and the debt collector's street address or post office box and telephone number if the written notice refers to a delinquent consumer debt;

(7) using a written communication that demands a response to a place other than the debt collector's or creditor's street address or post office box;

(8) misrepresenting the character, extent, or amount of a consumer debt, or misrepresenting the consumer debt's status in a judicial or governmental proceeding;

(9) representing falsely that a debt collector is vouched for, bonded by, or affiliated with, or is an instrumentality, agent, or official of, this state or an agency of federal, state, or local government;

(10) using, distributing, or selling a written communication that simulates or is represented falsely to be a document authorized, issued, or approved by a court, an official, a governmental agency, or any other governmental authority or that creates a false impression about the communication's source, authorization, or approval;

(11) using a seal, insignia, or design that simulates that of a governmental agency;

(12) representing that a consumer debt may be increased by the addition of attorney's fees, investigation fees, service fees, or other charges if a written contract or statute does not authorize the additional fees or charges;

(13) representing that a consumer debt will definitely be increased by the addition of attorney's fees, investigation fees, service fees, or other charges if the award of the fees or charges is subject to judicial discretion;

(14) representing falsely the status or nature of the services rendered by the debt collector or the debt collector's business;

(15) using a written communication that violates the United States postal laws and regulations;

(16) using a communication that purports to be from an attorney or law firm if it is not;

(17) representing that a consumer debt is being collected by an attorney if it is not;

(18) representing that a consumer debt is being collected by an independent, bona fide organization engaged in the business of collecting past due accounts when the debt is being collected by a subterfuge organization under the control and direction of the person who is owed the debt; or

(19) using any other false representation or deceptive means to collect a debt or obtain information concerning a consumer.

(b) Subsection (a)(4) does not apply to a person servicing or collecting real property first lien mortgage loans or credit card debts.

(c) Subsection (a)(6) does not require a debt collector to disclose the names and addresses of employees of the debt collector.

(d) Subsection (a)(7) does not require a response to the address of an employee of a debt collector.

(e) Subsection (a)(18) does not prohibit a creditor from owning or operating a bona fide debt collection agency.

Sec. 392.305. Deceptive Use of Credit Bureau Name. A person may not use "credit bureau," "retail merchants," or "retail merchants association" in the person's business or trade name unless:

(1) the person is engaged in gathering, recording, and disseminating information, both favorable and unfavorable, relating to the creditworthiness, financial responsibility, and paying habits of, and similar information regarding, persons being considered for credit extension so that a prospective creditor can make a sound decision in the extension of credit; or

(2) the person is a nonprofit retail trade association that:

(A) consists of individual members;

(B) qualifies as a bona fide business league as defined by the United States Internal Revenue Service; and

(C) does not engage in the business of debt collection or credit reporting.

Sec. 392.306. Use of Independent Debt Collector. A creditor may not use an independent debt collector if the creditor has actual knowledge that the independent debt collector repeatedly or continuously engages in acts or practices that are prohibited by this chapter.

Subchapter E. Defense, Criminal Penalty, and Civil Remedies

Sec. 392.401. Bona Fide Error. A person does not violate this chapter if the action complained of resulted from a bona fide error that occurred notwithstanding the use of reasonable procedures adopted to avoid the error.

Sec. 392.402. Criminal Penalty. (a) A person commits an offense if the person violates this chapter.

(b) An offense under this section is a misdemeanor punishable by a fine of not less than $100 or more than $500 for each violation.

(c) A misdemeanor charge under this section must be filed not later than the first anniversary of the date of the alleged violation.

Sec. 392.403. Civil Remedies. (a) A person may sue for:

(1) injunctive relief to prevent or restrain a violation of this chapter; and

(2) actual damages sustained as a result of a violation of this chapter.

(b) A person who successfully maintains an action under Subsection (a) is entitled to attorney's fees reasonably related to the amount of work performed and costs.

(c) On a finding by a court that an action under this section was brought in bad faith or for purposes of harassment, the court shall award the defendant attorney's fees reasonably related to the work performed and costs.

(d) If the attorney general reasonably believes that a person is violating or is about to violate this chapter, the attorney general may bring an action in the name of this state against the person to restrain or enjoin the person from violating this chapter.

(e) A person who successfully maintains an action under this section for violation of Section 392.101, 392.202, or 392.301(a)(3) is entitled to not less than $100 for each violation of this chapter.

Sec. 392.404. Remedies Under Other Law. (a) A violation of this chapter is a deceptive trade practice under Subchapter E, Chapter 17, Business & Commerce Code, and is actionable under that subchapter.

(b) This chapter does not affect or alter a remedy at law or in equity otherwise available to a debtor, creditor, governmental entity, or other legal entity.

[The next chapter is Chapter 395]

CHAPTER 395. COMMUNITY REINVESTMENT WORK GROUP

Subchapter A. Composition and Operation

Subchapter B. Duties

CHAPTER 395. COMMUNITY REINVESTMENT WORK GROUP

Subchapter A. Composition and Operation

Sec. 395.001. Composition. The community reinvestment work group is composed of:

(1) a representative of the comptroller's office, appointed by the comptroller;

(2) a representative of the Texas Department of Housing and Community Affairs, appointed by the executive director of that department;

(3) a representative of the Texas Department of Economic Development, appointed by the executive director of that department;

(4) a representative of the Texas Department of Banking, appointed by the banking commissioner of Texas; and

(5) a representative of the Texas Department of Insurance, appointed by the commissioner of insurance.

Sec. 395.002. Officers. The representative of the comptroller's office serves as presiding officer of the work group. The members of the work group may elect other necessary officers.

Sec. 395.003. Meetings. The work group shall meet quarterly and may meet more often at the call of the presiding officer.

Sec. 395.004. Term of Office; Removal. A member of the work group serves a two-year term and may be removed for any reason by the appointing authority.

Sec. 395.005. Expenses; Compensation. The appointing authority is responsible for the expenses of a member's service on the work group. A member of the work group receives no additional compensation for serving on the work group.

Subchapter B. Duties

Sec. 395.101. General Duties. The work group shall work in conjunction with the banking community in this state to:

(1) develop statewide community reinvestment strategies using existing investment pools and other investment vehicles to leverage private capital from banks, insurance companies, and other entities for community development in the state;

(2) consult and coordinate with representatives from appropriate federal regulatory agencies, including the Office of the Comptroller of the Currency, the Federal Reserve Board of Governors, the Federal Deposit Insurance Corporation, and the Office of Thrift Supervision; and

(3) monitor and evaluate the strategies developed under this section.

Sec. 395.102. Developing Strategies. In developing the strategies required by Section 395.101, the work group shall:

(1) explore innovative qualified investment strategies;

(2) ensure to the extent possible that the strategies encourage financial institutions in this state to lend money to low-income and moderate-income families and individuals in the state;

(3) coordinate its efforts to attract private capital through investments that meet the requirements of the Community Reinvestment Act of 1977 (12 U.S.C. Section 2901 et seq.); and

(4) ensure to the extent possible that the strategies augment existing Community Reinvestment Act of 1977 programs in the state, including the operation of local community development corporations.

Sec. 395.103. [Repealed][1]

[The next page is: Page 2001]

[1] Repealed by Act 2003, 78th Leg., R.S., ch. 1310 (H.B. 2425), 121(3), eff Sept. 1, 2003.

TEXAS ADMINISTRATIVE CODE
TITLE 7. BANKING AND SECURITIES

[Cite as 7 TAC §_._]

PART 1. FINANCE COMMISSION OF TEXAS

PART 2. TEXAS DEPARTMENT OF BANKING

PART 8. JOINT FINANCIAL REGULATORY AGENCIES

TEXAS ADMINISTRATIVE CODE
TITLE 7. BANKING AND SECURITIES

PART 1. FINANCE COMMISSION OF TEXAS

CHAPTER 3. STATE BANK REGULATION

Subchapter A. Securities Activities and Subsidiaries

Subchapter B. General

Subchapter C. Foreign Bank Branches, Agencies and Representative Offices

Subchapter D. Pledge and Maintenance of Assets by Foreign Bank Licensed to Maintain Texas State Branch or Agency

Subchapter E. Banking House and Other Facilities

Subchapter F. Access to Information

CHAPTER 3. STATE BANK REGULATION

Subchapter A. Securities Activities and Subsidiaries

§3.1. Private Placement of Securities. (a) A state chartered bank may engage in private placement transactions by acting as broker and bringing together buyers and sellers of privately placed instruments. The term "private placement transactions" means:

(1) making recommendations regarding the terms and timing of the transaction;

(2) assisting in the preparation of the financing documents;

(3) contacting potential institutional investors;

(4) arranging meetings between the issuer and potential investors; and

(5) assisting in subsequent negotiations involving these parties.

(b) Except as otherwise permitted by Finance Code, Title 3, Subtitle A, a state chartered bank may not acquire for its own account any equity securities for which it has acted as agent or broker pursuant to this section.

Source: *The provisions of this §3.1 adopted to be effective August 19, 1985, 10 TexReg 2542; amended to be effective May 17, 1996, 21 TexReg 3929.*

§3.2. Investment and Financial Advisory Services. A state-chartered bank may provide investment and financial advisory services including professional asset management services and services as an adviser in connection with mergers, acquisitions, and divestitures. A state bank may also serve as a dealer-manager in connection with tender offers.

Source: *The provisions of this §3.2 adopted to be effective August 19, 1985, 10 TexReg 2542.*

§3.3. Securities Activities of Subsidiaries of State Banks. (a) Securities activities permitted. Pursuant to Finance Code, §34.103(c), and subject to the provisions of 12 Code of Federal Regulations (CFR), §337.4, a state bank may establish or acquire a subsidiary that engages in securities activities; provided, however, that said subsidiary shall comply with all rules and regulations of the Securities and Exchange Commission and the State Securities Board applicable to registered brokers-dealers and investment advisors. The term "securities activities" means issuing, underwriting, selling, or distributing, or acting as agent or advisor in the issuing, underwriting, selling, or distributing of stocks, bonds, debentures, notes, or other securities.

(b) Investment ceiling. Pursuant to Finance Code, §34.103(c), a state bank may invest not more than 10% of its capital and certified surplus in a subsidiary engaged in securities activities that the bank is prohibited from conducting directly.

(c) Capitalization. Any subsidiary engaged in securities activities pursuant to this regulation must comply with any applicable state and federal capital requirements including, but not limited to, those imposed by the Securities and Exchange Commission, the State Securities Board, or the National Association of Securities Dealers.

(d) Limitations.

(1) Unless otherwise permitted by Finance Code, Title 3, Subtitle A, a subsidiary of a state bank must dispose of any equity securities acquired for its own account within 90 days after the day of purchase.

(2) A state bank may not purchase, in its discretion as fiduciary or managing agent, any security underwritten, distributed, or issued by the bank's securities subsidiary or any security issued by an investment company advised by the subsidiary.

(e) Notice. A state bank must file with the banking commissioner copies of all notices required to be filed with the Federal Deposit Insurance Corporation under the provisions of 12 CFR, §337.4, or any successor regulation.

Source: *The provisions of this §3.3 adopted to be effective August 19, 1985, 10 TexReg 2542; amended to be effective May 17, 1996, 21 TexReg 3929.*

§3.4. Foreign Banking. (a) Any state-chartered bank that is well-capitalized as defined by Section 38, Federal Deposit Insurance Act, 12 United States Code (USC), §1831 may file an application with the banking commissioner for permission to exercise, upon such conditions as may be prescribed by the banking commissioner, the following powers:

(1) to establish branches in foreign countries of dependencies or insular possessions of the United States for the furtherance of foreign commerce and to act as fiscal agent for any governmental entity;

(2) to invest an amount not exceeding in the aggregate 10% of its paid-in capital stock and surplus in the stock of one or more banks or corporations chartered or incorporated under the laws of the United State or of any state thereof, and principally engaged in international or foreign banking, or banking in a dependency or insular possession of the United States either directly or indirectly; and

(3) to require and hold, directly or indirectly, stock or other evidences of ownership in one or more banks organized under the law of a foreign country or a dependency or insular possession of the United States and not engaged, directly or indirectly, in any activity in the United States except as, in the judgment of the banking commissioner, shall be incidental to the international or foreign business of such foreign bank; and to make loans or extensions of credit to or for the account of such bank in a manner and within limits prescribed by the banking commissioner.

(b) Such application shall specify the name and capital of the state bank filing it, the powers applied for, and the place or places where the banking or financial operations proposed are to be carried on. The banking commissioner shall have the power to approve or reject such application in whole or in part and shall also have the power from time to time to increase or decrease the number of places where such banking operations may be carried on.

(c) The investment limitation of Finance Code, §34.103(b), does not apply to an investment made pursuant to this section. The banking commissioner may approve any activity or investment authorized by this section subject to such restrictions as the banking commissioner deems advisable and consistent with safe and sound banking practices, and may require any investment pursuant to subsection (2) or (3) of this section to constitute a majority interest in the voting securities of the bank or corporation acquired.

Source: *The provisions of this §3.4 adopted to be effective August 19, 1985, 10 TexReg 2543; amended to be effective July 13, 1994, 19 TexReg 5035; amended to be effective May 17, 1996, 21 TexReg 3929; amended to be effective March 9, 2006, 31 TexReg 1643.*

§3.5. Financial Valuation and Advisory Services. A state-chartered bank may provide financial valuation and advisory services to its depositors or clients. The term "financial valuation and advisory services" means:

(1) the valuation of a company for purposes of acquisitions, mergers, and divestitures;

(2) fairness opinions in connection with tender offers, consolidations, or mergers;

(3) advice for management or for a bankruptcy court about the viability and capital adequacy of financially troubled companies and about the fairness of proposed bankruptcy reorganizations;

(4) valuation opinions for transactions in publicly held securities;

(5) valuations of the fair market value of employee stock ownership trusts;

(6) periodic valuation of stock of privately owned companies held in pension or profit-sharing plans, charitable trusts, or venture capital funds;

(7) valuation of a privately owned company, or of a large block of publicly owned securities;

(8) valuations, for estate tax and estate planning purposes, of a company's common stock

and other securities for recapitalization of a privately held company; and

(9) expert witness testimony in support of valuations.

Source: *The provisions of this §3.5 adopted to be effective August 19, 1985, 10 TexReg 2543.*

Subchapter B. General

§3.21. Bank Call Reports. (a) Definitions. The following words and terms, when used in this section, shall have the following meanings unless the context clearly indicates otherwise.

(1) Call report--A report of condition and income in FFIEC form as required by 12 United States Code (USC), §1817, or a report of financial condition and results of operations of a state bank as mandated by the banking commissioner pursuant to the Finance Code, §31.108.

(2) FDIA--The Federal Deposit Insurance Act, 12 United States Code (USC), §1811 *et seq.*

(3) FDIC--The Federal Deposit Insurance Corporation.

(4) FFIEC--The Federal Financial Institutions Examination Council.

(5) State bank--A bank as defined by the Finance Code, §31.002(a)(50).

(b) Reporting requirements of FDIA regulated state banks. Each state bank which is subject to regulation under FDIA will be considered to have filed a copy of its call report with the banking commissioner if the state bank has filed its call report pursuant to FDIA and FFIEC guidelines and requirements.

(c) Reporting requirements for non-FDIA regulated entities. Each state bank not subject to subsection (b) of this section shall file four call reports annually with the banking commissioner. Such call reports must be filed with the banking commissioner no later than April 30, July 31, and October 31 of each year and by January 31 of the subsequent year, and shall be for the periods ending on March 31, June 30, September 30, and December 31, respectively, of the annual reporting year. The call reports required under this subsection must be in substantially the same form and contain substantially the same information as call reports filed by FDIA-regulated state banks in accordance with FDIA and FFIEC requirements pursuant to subsection (b) of this section. The call report forms, the instructions for completing the reports and the accompanying materials will be furnished to all state banks subject to this subsection, or may be obtained upon request from the Bank and Trust Division, Texas Department of Banking, 2601 North Lamar Boulevard, Austin, Texas 78705-4294. The banking commissioner may make such modifications and additions to call report form and contents under this subsection as considered necessary in the discretionary discharge of the banking commissioner's duties, notwithstanding FDIA and FFIEC guidelines and requirements.

(d) Special call reports. In addition to the requirements of subsections (b) and (c) of this section, the banking commissioner may require a state bank to file and submit a special call report, in such form and manner and containing such information as may be requested, on dates fixed, whenever in the banking commissioner's discretion the special call report is necessary in the performance of the banking commissioner's supervisory duties related to the safety and soundness of the state bank. Special call reports must contain only such information as is specifically requested by the banking commissioner.

(e) Call report declarations and attestations. Each call report or special call report required to be filed under subsections (c) and (d) of this section must contain a declaration by the president, a vice president, the cashier, or by another officer designated by the board of directors of the state bank to make such declaration, that the report is true and correct to the best of such individual's knowledge and belief. The correctness of the call report or special call report must also be attested by the signatures of at least two of the directors of the state bank other than the officer making the declaration. The declaration of the directors must state that the call report or special call report has been examined by them and is true and correct to the best of their knowledge and belief.

(f) Lobby notice and publication. The latest call report filed with the banking commissioner pursuant to subsections (b) and (c) of this subsection must be posted in the lobby of the state bank at a point accessible to the public. A state bank is not required to publish its call report in a newspaper or other media unless specifically directed to do so by the banking commissioner. A state bank required to publish its call report by the banking commissioner shall publish the report in a newspaper or other medium of general circulation as directed by the banking commissioner.

(g) Confidentiality. Pursuant to the Finance Code, §31.301, call reports filed under subsections (b) or (c) of this section are public information to the extent that such reports are considered public records under the FDIA, implementing federal regulations, and FFIEC guidelines, and may be published or otherwise disclosed to the public. Special call reports filed pursuant to subsection (d) of this section and non-public portions of call reports filed pursuant to subsections (b) or (c) of this section are confidential, subject only to such disclosure as may be permitted by the Finance Code, §§31.302 - 31.308, or by §3.111 of this title (relating to Confidential Information).

(h) Penalties for failure to file or for filing a report with false or misleading information. A state bank which fails to make, file, or submit a call report or a special call report or fails to timely file a call report or special call report as required by this section is subject to a penalty not exceeding $500 a day to be collected by the attorney general on behalf of the banking commissioner. Any state bank which makes, files, submits or publishes a false or misleading call report or special call report is subject to an enforcement action pursuant to the Finance Code, Chapter 35.

Source: *The provisions of this §3.21 adopted to be effective May 17, 1996, 21 TexReg 3930; amended to be effective November 13, 1997, 22 TexReg 10949; amended to be effective March 9, 2006, 31 TexReg 1643.*

§3.22. Sale or Lease Agreements with an Officer, Director, or Principal Shareholder of the Bank or of an Affiliate of the Bank. (a) Agreement in writing. A sale or lease agreement between a state bank and an officer, director, or principal shareholder of the bank or of an affiliate of the bank must be in writing. Existing verbal agreements must be reduced to writing and approved by the board.

(b) Terms of agreement. A sale or lease agreement between a state bank and an officer, director, or principal shareholder of the bank or of an affiliate of the bank must comply with applicable laws and regulations, be consistent with prudent and sound banking principles, and have terms and rates that are substantially equivalent to or more favorable to the bank than those prevailing at the time for comparable transactions with or involving nonaffiliated parties.

(c) Board action. All transactions subject to the Finance Code, §33.109, must be considered and voted upon by the board. Under the Finance Code, §33.109(a), the prior approval of at least a majority of a quorum composed entirely of disinterested directors must be obtained or the transaction at issue must be submitted for prior approval of the banking commissioner. For purposes of this section, a quorum shall consist of a majority of the number of directors elected at the last meeting of shareholders. Even if the transaction is subject to the prior approval of the banking commissioner because a quorum composed entirely of disinterested directors cannot be obtained, as a matter of good corporate policy, a state bank proposing to enter into a transaction subject to the Finance Code, §33.109, should obtain the affirmative vote of a majority of the disinterested directors of the board.

(d) Application for approval. If a sale or lease agreement requires the written approval of the banking commissioner prior to consummating, renewing, or extending a sale or lease agreement, a written request for approval must be submitted to the banking commissioner at least 60 days prior to the proposed effective date of the sale or lease agreement and must include the following information:

(1) a copy of the proposed sale or lease agreement;

(2) a complete description of the personal or real property to be sold or leased;

(3) a full disclosure of all existing transactions and/or relationships, whether direct or indirect, between the state bank and the parties involved;

(4) in the case of a lease agreement involving real property, a copy of the minutes of the board meeting reflecting an analysis of the information contained in this subsection;

(5) a certified copy of a board resolution approving the transaction and indicating those directors voting or abstaining, as the case may be, and either:

(A) evidence that the transaction received the affirmative vote of at least a majority of disinterested directors on the board; or

(B) a statement explaining the reasons the affirmative vote of at least a majority of disinterested directors on the board could not be obtained;

(6) copies of appropriate supporting documentation, including analysis of comparable terms and rates for the real or personal property to be sold or leased;

(7) in the case of a lease agreement, evidence demonstrating that the state bank will account for the lease in accordance with FASB ASC Topic 840, Leases; and

(8) other information which the banking commissioner may request.

(e) Records. A state bank shall maintain the originals of all sale or lease agreements with an officer, director, or principal shareholder of the bank or of an affiliate of the bank, which documents must be made available at all times to the Texas Department of Banking for examination and review. For purposes of this subsection, required documentation need not be retained beyond three years after the expiration of the sale or lease agreement to which the documentation pertains.

(f) Exemption. Finance Code, §33.109, and this section do not apply to a transaction subject to and in compliance with the Federal Reserve Act, §23A and §23B (12 U.S.C. §371c and §371c-1), and implementing regulations, applicable to nonmember insured state banks by virtue of the Federal Deposit Insurance Act, §18(j)(1) (12 U.S.C. §1828(j)(1)).

Source: *The provisions of this §3.22 adopted to be effective November 22, 1996, 21 TexReg 11097; amended to be effective March 9, 2006, 31 TexReg 1643; amended to be effective May 10, 2007, 32 TexReg 2463; amended to be effective November 4, 2010, 35 TexReg 9694.*

§3.23. Exercise of Trust Powers. (a) As used in this section, "trust services" mean services provided to the public as a fiduciary for hire or compensation, to hold or administer accounts established through a customer relationship involving the transfer of title to funds or property to the bank, including a fiduciary relationship in which the bank acts as trustee, executor, administrator, guardian, custodian, conservator, receiver, registrar of stocks and bonds, mortgage or indenture trustee, escrow agent, transfer agent, or investment advisor, except that "trust services" do not include customer services in which:

(1) the bank's duties as trustee or custodian are essentially custodial or ministerial in nature; and

(2) the bank may only invest customer funds:

(A) in its own time or savings deposits; or

(B) in other assets at the explicit direction of the customer, provided the bank does not exercise any investment discretion or provide any investment advice with respect to such other assets.

(b) A state bank that does not currently provide trust services and has not provided trust services for a period in excess of one year may not begin offering or providing trust services except upon compliance with this section and with any requirements imposed by the bank's primary federal regulator.

(c) A state bank described in subsection (b) of this section that intends to offer and provide trust services shall submit a notice to the banking commissioner describing the proposed trust services and the anticipated date for initiation of such services. In addition, the bank must submit:

(1) the bank's proposed business plan for providing trust services, including the policies and procedures the bank will employ to manage its fiduciary risk;

(2) sufficient biographical information on proposed trust management personnel to enable the banking commissioner to assess their qualifications;

(3) a description of the locations where the bank proposes to offer trust services and the manner in which such services will be provided at each location, including the extent to which fiduciary authority is proposed to be delegated to personnel at such location;

(4) if the bank's certificate of formation does not authorize the bank to exercise the trust powers necessary to provide the proposed trust services, an application for amendment of its certificate of formation pursuant to Finance Code, §32.101, accompanied by the filing fee required by §15.2 of this title (relating to Filing Fees and Cost Deposits); and

(5) a copy of any filings made with the bank's primary federal regulator providing notice or seeking approval to offer trust services.

(d) Provided the bank's certificate of formation authorizes the bank to exercise trust powers sufficient to provide the proposed trust services, and subject to any conditions imposed by the banking commissioner and any required approval of the bank's primary federal regulator, the bank may begin offering and providing trust services on the 31st day after the date the banking commissioner receives the bank's notice under subsection (c) of this section unless the banking commissioner specifies an earlier or later date. The banking commissioner may extend the 30-day period on a determination that the bank's notice raises issues that require additional information or additional time for analysis. If the period is extended, or if the bank is amending its certificate of formation to authorize trust powers, the bank may not offer or provide trust services until it has received written approval of the banking commissioner.

Source*: The provisions of this §3.23 adopted to be effective May 7, 2015, 40 TexReg 2409*

§3.34. Posting of Notice in All Financial Institutions Regarding Requirements for Certain Loan Agreements To Be in Writing. (a) Pursuant to the Business and Commerce Code, §26.02, all financial institutions must conspicuously post notices informing borrowers of the requirements that certain loan agreements be in writing. Additionally, the finance commission is required to prescribe the language to be used in the notice. This section provides the language for the notice and clarifies the manner and location of the notice within the financial institutions so as to fully inform borrowers of the requirements.

(b) Each financial institution shall post in the public lobby of each of its offices other than off-premises electronic deposit facilities, the public notice set forth in this subsection.

NOTICE TO BORROWERS
CERTAIN LOAN AGREEMENTS
MUST BE IN WRITING

TEXAS LAW (Section 26.02, Business and Commerce Code) requires that all financial institutions conspicuously post notices summarizing requirements that loan agreements be in writing. You should know that:

- An agreement, promise, or commitment to loan more than $50,000 MUST BE IN WRITING AND SIGNED BY THE LENDER OR IT WILL BE UNENFORCEABLE.

- The written loan agreement will be the ONLY source of rights and obligations for agreements to lend more than $50,000.

- Oral agreements relating to loans over $50,000 are NOT EFFECTIVE either to establish a commitment to lend or to vary the terms of a written loan agreement.

As part of the documentation required for loans over $50,000, BORROWERS MUST BE PROVIDED AND MUST SIGN A NOTICE conspicuously stating that:

> THIS WRITTEN LOAN AGREEMENT REPRESENTS THE FINAL AGREEMENT BETWEEN THE PARTIES AND MAY NOT BE CONTRADICTED BY EVIDENCE OF PRIOR, CONTEMPORANEOUS, OR SUBSEQUENT ORAL AGREEMENTS OF THE PARTIES.
>
> THERE ARE NO UNWRITTEN ORAL AGREEMENTS BETWEEN THE PARTIES.

The notice set forth above, which must be signed by both the borrower and the financial institution, can be in a separate document or incorporated in one or more of the documents constituting the loan agreement. The notice must be in type that is boldfaced, capitalized, underlined or otherwise set out from surrounding written material so as to be conspicuous.

(c) The finance commission shall provide the preceding notice in dimensions and print which it determines is appropriate to fully inform borrowers of the requirements of the Business and Commerce Code, §26.02.

Source: *The provisions of this §3.34 adopted to be effective February 14, 1990, 15 TexReg 485; amended to be effective March 9, 2006, 31 TexReg 1643.*

§3.35. Safe Deposit Box Facilities. (a) Purpose. The Finance Code, §59.110, requires financial institutions to imprint keys issued to safe deposit boxes after September 1, 1992, with the financial institution's routing number. In addition, it requires a report to the Department of Public Safety if the routing number is altered or defaced so that the correct routing number is illegible. This section clarifies the requirements of this section.

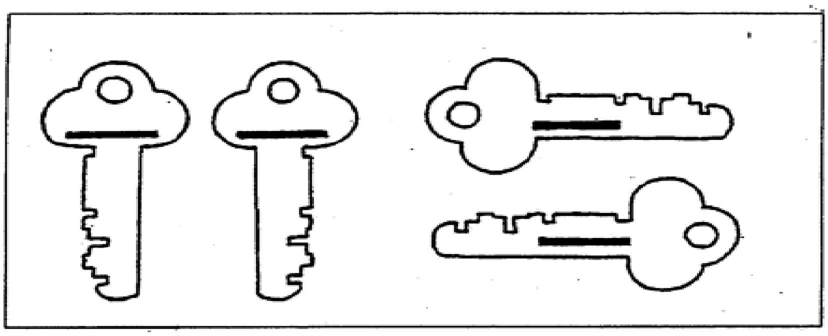
(b) Definitions. The following words and terms, when used in this section, shall have the following meanings, unless the context clearly indicates otherwise.

(1) Financial institution--A bank, savings and loan association, savings bank, or other financial institution that has been assigned a routing number unique to that institution.

(2) Routing number--The number printed on the face of a check in fractional form or in nine-digit form that identifies a paying financial institution.

(c) Imprinting requirements. A financial institution which has been issued a routing number shall imprint that routing number on safe deposit box keys on either the head of the key or the shank of the key if there is adequate room. The typical locations to be used are indicated in the following instructions and diagram. The imprint can be made anywhere on the key that has the required space available. It can be either on the head or on the shank of the key. When positioning the die on the key, be careful to place the die on the key where it will imprint on a flat surface and not in the area of the key cuts or on any of the shank ridges or grooves. Imprinting in these areas may interfere with the proper working of the key in the lock and may cause damage. In the event these standard areas for the location of the imprint are unavailable, either because of grooves on the key shank or the fact that the head of the key already has names and other numbers imprinted on it, then the financial institution may attach to the key a tag imprinted with the routing number. The tag used must be of such a nature as to be secure. Thus, a paper or cardboard tag or a tag affixed with string will not be acceptable. However, any other medium such as plastic or metal which can retain an imprint of a number shall be acceptable. The tag may be attached in any way to assure its affixation to the key. Typically, this will mean inserting the tag or a device to affix the tag through the hole in the head of the key normally used for placing keys on key chains. The tag method shall not be used if there is adequate room on the key itself for imprinting of the numbers.

There are four standard areas for the location of the imprinted routing number. These include: the head of the key, the shank of the key, and either place on the reverse side of the key. The standard imprint areas are shown below:



(d) Branch designation. A financial institution may, but is not required to, add a three-digit branch designation to its routing number. Thus, the main financial institution facility should receive the designation "001" and branch facilities should receive numbers consecutively beginning with "002" with successive numbers as needed. However, the financial institution may control the branch numbering system used provided that the financial institution must maintain a master list of branch designations used for this purpose. The master list should be maintained at the main office of the financial institution and shall include the following information: three-digit branch designation and address of facility. The financial institution then may imprint safe deposit box keys or tags with the routing number plus three-digit branch designation for full identification of the facility.

(e) Report of defaced or altered key. Within 10 days after an officer or employee of a financial institution observes that a key used to access a safe deposit box has had the routing number altered or defaced or the tag removed, a report shall be prepared of such incident. The report shall be on a form promulgated by the department in the form of the attached exhibit. The report should be submitted to the Department of Public Safety, Attention: Criminal Law Enforcement, Box 4087, Austin, Texas 78773-0001. The report should be mailed no later than 10 days after the incident. The financial institution should retain one copy of the incident report for a period of three years. Nothing in this section nor in the Finance Code, §59.110, shall require a financial institution to inspect routing numbers imprinted on a key or an attached tag to determine if the number has been altered or defaced.

EXHIBIT

REPORT OF DEFACED OR ALTERED ROUTING NUMBER ON SAFE DEPOSIT BOX KEY

Instructions: Complete the information below and submit the original report to Department of Public Safety, Attn: Criminal Law Enforcement, Box 4087, Austin, Texas 78773-0001, no later than 10 days after the defaced or altered key is used to access the box. Retain one copy for your files for a period of three years.

FINANCIAL INSTITUTION INFORMATION

Name of financial institution ________________________________
Address of safe deposit box facility ________________________________
____
Name and title of contact person at facility ________________________________
Area code and phone number of facility ________________________________
Routing number and branch designation (if any) ________________________________

INCIDENT INFORMATION

Customer name ________________________________
Date customer presented defaced or altered key ________________________________
Description of problem with key ________________________________
____
____
____

Date of report: ____________________

(f) Applicability to Existing Keys. A financial institution must imprint all safe deposit box keys issued on or after September 1, 1992. Additionally, the imprinting requirement applies to all keys issued prior to September 1, 1992. However, keys for boxes rented prior to September 1, 1992, need not be imprinted with the routing number unless and until a customer presents a safe deposit box key at a financial institution for access to a box. Nothing in this section or the Finance Code, §59.110, shall be construed to require a financial institution to provide notice to its safe deposit box customers or to otherwise require such customers to present their keys for imprinting. However, on the first date after September 1, 1992, that a customer presents a key which has not been imprinted, the financial institution shall imprint the key with the routing number as required by the Finance Code, §59.110.

(g) Effect of change in routing number. In the event a financial institution's routing number is changed as a result of a merger, acquisition, or other change, safe deposit box keys need not be replaced with a new routing number provided that the financial institution maintain a master list of the routing numbers used to imprint keys.

Source: *The provisions of this §3.35 adopted to be effective September 18, 1992, 17 TexReg 6097; amended to be effective May 17, 1996, 21 TexReg 3932; amended to be effective March 9, 2006, 31 TexReg 1643.*

§3.36. Annual Assessments and Specialty Examination Fees. (a) Authority. The assessment schedule contained in this section is made under the authority contained in the Finance Code, §31.003(a)(4) and §204.003(b).

(b) Definitions. The following words and terms, when used in this section, §3.37 of this title (relating to Calculation of Annual Assessment for Banks), or §3.38 of this title (relating to Calculation of Annual Assessment for Foreign Bank Branches and Agencies), shall have the following meanings, unless the context clearly indicates otherwise.

(1) Assessable assets--The sum of on-book assets and average off-book assets of a bank, foreign bank branch, or foreign bank agency.

(2) Average off-book assets--The average of the off-balance sheet items reported by a bank, foreign bank branch, or foreign bank agency in its most recent March 31st call report and the three immediately preceding call reports, as adjusted under subsection (c) of this section.

(3) Call report--The FFIEC quarterly, consolidated report of condition and income (including domestic and foreign subsidiaries) prepared and filed by a bank, foreign bank branch, or foreign bank agency under state and federal law.

(4) CAMELS composite rating--A bank's composite rating under the Uniform Financial Institutions Rating System (UFIRS), as described more fully in Supervisory Memorandum 1001, assigned by the department to a state bank in connection with its most recent examination by the department or by a federal bank regulatory agency.

(5) FFIEC--The Federal Financial Institutions Examination Council.

(6) On-book assets--The total assets reported by a bank, foreign bank branch, or foreign bank agency on the balance sheet contained in its most recent March 31st call report.

(c) Calculation of average off-book assets. As a component of assessable assets, a bank, foreign bank branch, or foreign bank agency must calculate a four-quarter average of off-book assets specifically as instructed in the assessment form applicable to the institution, using the most recent March 31st call report and the three preceding call reports. In general, the bank, foreign bank branch, or foreign bank agency must sum all line items for which values are included on "Schedule RC-L-Off-Balance Sheet Items," which could result in assets of the institution, with the exception of:

(1) Amount of financial standby letter of credit conveyed to others;

(2) Amount of performance standby letter of credit conveyed to others;

(3) Participations in acceptances conveyed to others by the reporting bank, foreign bank branch, or foreign bank agency; and

(4) All line items related to derivative products as identified by the department.

(d) Annual assessment. Effective September 1 of each year, the department will establish the annual assessment for each bank, foreign bank branch, and foreign bank agency under subsections (f) and (g) of this section.

(1) The assessment for a bank is based on its assessable assets and calculated in the manner described in §3.37 of this title. Upon receipt of written notice from the department, the bank must pay the assessment to the department in quarterly installments by electronic payment/ACH debited effective September 15, December 15, March 15, and June 15 of each year, or by another method if directed to do so by the department.

(2) The assessment for a foreign bank branch or a foreign bank agency is based on its assessable assets and calculated in the manner described in §3.38 of this title. Upon receipt of a written invoice from the department, the foreign bank branch or foreign bank agency must pay the assessment to the department in quarterly installments, due on or before September 15, December 15, March 15, and June 15 of each year, or by another method if directed to do so by the department.

(3) A foreign bank representative office shall pay an annual assessment fee of $2,500 to cover the cost of examinations and all associated expenses unless the foreign bank also maintains a foreign bank branch or foreign bank agency in this state subject to assessment under paragraph (2) of this subsection. Upon receipt of a written invoice from the department, each foreign bank representative office to which this paragraph applies must pay its annual assessment to the department in a single installment, due on or before September 15 of each year. The department may require each foreign bank representative office to pay the annual assessment fee through electronic funds transfer.

(4) Notwithstanding paragraph (1) of this subsection, the annual assessment established for the fiscal year beginning September 1, 2015, must be recalculated for each bank on March 1, 2016, using the revised table in §3.37(a). The two remaining quarterly installments due on or before March 15 and June 15, 2016, must be based on the recalculated assessment. In other words, subject to possible reduction under Subsection (g) of this section, the quarterly installments due on or before March 15 and June 15, 2016, will each be in an amount equal to 25 percent of the assessment as recalculated on March 1, 2016.

(e) Review of assessment factors. The department will review all appropriations, revenue sources, expenditure patterns, and other revenues and costs related to examination and supervision of banks, foreign bank branches, foreign bank agencies, and present to the finance commission no less frequently than once each biennium such information and a calculation chart that sets forth the annual assessment factors.

(f) Interim adjustments.

(1) If the size, condition, or other characteristics of a bank, foreign bank branch or foreign bank agency change sufficiently during a year to cause the institution to fall into a different assessable asset group or to be subject to a new or different surcharge based on a change in the institution's CAMELS composite rating, the department will adjust the annual assessment to the appropriate amount beginning with the first billed quarterly installment after the change.

(2) In the event of an acquisition or merger involving a surviving state bank, foreign bank branch, or foreign bank agency, the department will adjust the annual assessment to reflect the result of the acquisition or merger beginning with the first billed quarterly installment after the consummation of the transaction. The asset group will be calculated on the basis of the combined assessable assets of the surviving institution.

(3) A financial institution that becomes subject to this section during a fiscal year as a result of conversion, merger, branching, or other change during a fiscal year must pay to the department an assessment beginning in the quarter of the conversion, merger, or other change to reflect only the quarter or quarters of the year in which the institution is subject to this section.

(4) Each bank, foreign bank branch, and foreign bank agency must pay to the department the full quarterly installment of the assessment for the next three-month period on the due date of the installment without proration for any reason.

(g) Adjustment of an installment. The banking commissioner may, after review and consideration of actual and projected revenues and expenditures in the current fiscal year, lower the aggregate amount of an installment and bill each institution subject to assessment a proportionally lower amount, without the prior approval of the finance commission.

(h) Specialty examination fees.

(1) Examinations of fiduciary activities and other special examinations and investigations,

including but not limited to examinations of bank holding companies, interstate branches of state banks in Texas as host state, affiliates, and third-party contractors, are subject to a separate charge to cover the cost of time and expenses incurred in these examinations.

(2) The fee for an examination under this subsection will be calculated at a rate not to exceed $110 per examiner hour, to recoup the salary expense of examiners plus a proportionate share of department overhead allocable to the examination function. The banking commissioner in the exercise of discretion may lower the rate in connection with a specific examination or investigation for equitable reasons, without the prior approval of the finance commission.

(3) In connection with an examination under this subsection, the regulated entity or other legally responsible party shall pay to the department the examination fee set forth in paragraph (2) of this subsection, and shall also pay to the department an amount for actual travel expenses incurred by the examiners, including mileage, public transportation, food, and lodging.

(i) Special assessments. The finance commission may approve a special assessment to cover material expenditures, such as major facility repairs and improvements and other extraordinary expenses.

Source: *The provisions of this §3.36 adopted to be effective January 5, 1996, 20 TexReg 10994; amended to be effective March 21, 1997, 22 TexReg 2608; amended to be effective September 9, 1999, 24 TexReg 6969; amended to be effective September 4, 2003, 28 TexReg 7347; amended to be effective January 2, 2014, 38 TexReg 9481; amended to be effective November 5, 2015, 40 TexReg 7620.*

§3.37. Calculation of Annual Assessment for Banks. (a) Bank assessment calculation table. The annual assessment for a state bank is calculated as described in this section and paid as provided by §3.36 of this title (relating to Annual Assessments and Specialty Examination Fees), based on the values in the following table, as such values may be periodically adjusted in the manner provided by Subsection (b) of this section. The unadjusted values in the following table are effective until September 1, 2017:

First determine the bank's assessable asset group, then:

Steps	Assessment Calculation:		Assessable Asset Group:						
			1	2	3	4	5	6	7
1.	For assessable assets of at least (in thousands)		$0	$10,000	$25,000	$40,000	$70,000	$100,000	$250,000
	But not greater than (in thousands):		$10,000	$25,000	$40,000	$70,000	$100,000	$250,000	$1,000,000
2.	Take the total assessable assets over (in thousands):		$0	$10,000	$25,000	$40,000	$70,000	$100,000	$250,000
3.	And multiply by the **marginal assessment rate**:		0.789600	0.448000	0.212800	0.208320	0.201600	0.123200	0.082880
4.	Add this result to the **base assessment amount**:		$2,789	$10,685	$17,405	$20,597	$26,847	$32,895	$51,375
5.	Multiply the total by the factor corresponding to the bank's CAMELS composite rating (as defined in §3.36(b)):								
	a.	Rating of 3, 4 or 5:	2.0	2.0	2.0	2.0	2.0	2.0	2.0
	b.	Rating of 1 or 2:	1.0	1.0	1.0	1.0	1.0	1.0	1.0
6.	And multiply the total by 0.875 if bank has assessable assets of $500 million or less and a CAMELS composite rating of 1 or 2.								

Steps	Assessment Calculation:		Assessable Asset Group:						
			8	9	10	11	12	13	14
1.	For assessable assets of at least (in thousands):		$1,000,000	$5,000,000	$10,000,000	$20,000,000	$40,000,000	$60,000,000	$80,000,000
	But not greater than (in thousands):		$5,000,000	$10,000,000	$20,000,000	$40,000,000	$60,000,000	$80,000,000	-----
2.	Take the total assessable assets over (in thousands):		$1,000,000	$5,000,000	$10,000,000	$20,000,000	$40,000,000	$60,000,000	$80,000,000
3.	And multiply by the **marginal assessment rate**:		0.073920	0.067200	0.053933	0.032130	0.020655	0.013770	0.009180
4.	Add this result to the **base assessment amount** of:		$113,535	$409,215	$745,215	$1,284,545	$1,927,145	$2,340,245	$2,615,645
5.	And multiply the total by the factor corresponding to the bank's CAMELS composite rating:								
	a.	Composite rating of 3, 4, or 5:	2.0	2.0	2.0	2.0	2.0	2.0	2.0
	b.	Composite rating of 1 or 2:	1.0	1.0	1.0	1.0	1.0	1.0	1.0

(b) Required adjustments for inflation. In this section, "GDPIPD" means the Gross Domestic Product Implicit Price Deflator, published quarterly by the Bureau of Economic Analysis, United States Department of Commerce. The "annual GDPIPD factor" is equal to the percentage change in the GDPIPD index values published for the first quarter of the current year compared to the first quarter of the previous year (the March-to-March period immediately preceding the calculation date), rounded to a hundredth of a percent (two decimal places).

(1) Beginning September 1, 2017, and each September 1 thereafter, the table in subsection (a) of this section, as most recently revised before such date pursuant to this subsection, is revised as follows:

(A) Each marginal assessment factor listed in Step 3 of the table is increased (or decreased) by an amount proportionate to the measure of inflation (or deflation) reflected in the annual GDIPD factor, rounded to six decimal places;

(B) the base assessment amount listed in Step 4 for assessable asset group 1 is increased (or decreased) by an amount proportionate to the measure of inflation (or deflation) reflected in the annual GDIPD factor, rounded to whole dollars; and

(C) each base assessment amount listed in Step 4 for assessable asset groups 2 through 14 is adjusted to an amount equal to the maximum annual assessment possible for the next lower assessable asset group (without surcharge), rounded to whole dollars. For example, the base assessment amount for assessable asset group 2 is equal to the annual assessment (without surcharge) calculated under assessable asset group 1 for a bank with exactly $10 million in assessable assets.

(2) Not later than August 1 of each year, the department shall calculate and prepare a revised table reflecting the inflation-adjusted values to be applied effective the following September 1, and shall provide each state bank with notice of and access to the revised table. At least once every four years, the department shall propose amendments to this section for the purpose of substituting a current revised table in subsection (a) of this section, and for such other purposes as may be appropriate.

Source: *The provisions of this §3.37 adopted to be effective January 5, 1996, 20 TexReg 10994; amended to be effective September 9, 1999, 24 TexReg 6969; amended to be effective July 11, 2002, 27 TexReg 5961; amended to be effective September 4, 2003, 28 TexReg 7347; amended to be effective July 5, 2007, 32 TexReg 3977; amended to be effective January 3, 2008, 32 TexReg 9939; amended to be effective November 5, 2015, 40 TexReg 7620.*

§3.38. Calculation of Annual Assessment for Foreign Bank Branches or Agencies. The annual assessment for a foreign bank branch or agency is calculated as described in §3.36 of this title (relating to Annual Assessments and Specialty Examination Fees), based on the values in the following table:

First determine the bank's assessable asset group, then:

Steps	Assessment Calculation:	Assessable Asset Group		
1	For assessable assets of at least (in thousands)	$0	$70,000	$250,000
	But not greater than (in thousands)	$70,000	$250,000	—
2	Take the total assessable assets over (in thousands)	$0	$70,000	$250,000
3	And multiply by this factor:	0.00	0.05	0.01
4	For the assessment, add this result to the base assessment amount of:	$10,000	$10,000	$19,000

Source: *The provisions of this §3.38 adopted to be effective January 5, 1996, 20 TexReg 10994; amended to be effective September 9, 1999, 24 TexReg 6969.*

Subchapter C. Foreign Bank Branches, Agencies and Representative Offices

§3.40. Definitions. The following words and terms, when used in this subchapter, have the following meanings unless the context clearly indicates otherwise:

(1) Foreign bank branch or Texas branch--A Texas state branch proposed to be established or established and maintained by a foreign bank pursuant to the Finance Code, Chapter 204.

(2) Foreign bank agency or Texas agency--A Texas state agency proposed to be established or established and maintained by a foreign bank pursuant to the Finance Code, Chapter 204.

(3) Foreign bank representative office or Texas representative office--A Texas representative office proposed to be established or established and maintained by a foreign bank pursuant to the Finance Code, Chapter 204.

Source: *The provisions of this §3.40 adopted to be effective March 9, 2006, 31 TexReg 1643.*

§3.41. Applications, Notices and Reports Related to Foreign Bank Branches and Agencies.

(a) Application. To establish a Texas branch or agency, a foreign bank shall file with the banking commissioner an application for a license on the form prescribed by the commissioner. The application must:

(1) be in English and be signed, sworn to and acknowledged by an officer of the foreign bank;

(2) be fully completed and provide the information and include as attachments the documentation specified in the application form and the department's instructions, including the information and documentation required under the Finance Code, §204.101, and such other information and documentation as the banking commissioner reasonably requests; and

(3) be accompanied by the application fees and applicable deposits required by §15.2 of this title (relating to Filing Fees and Cost Deposits).

(b) If a foreign bank has established an initial Texas branch or agency, the banking commissioner may waive one or more of the informational requirements of the license application form with respect to any additional Texas branches or agencies the foreign bank seeks to establish. However, payment of the application fee provided for in §15.2 of this title may not be waived.

(c) Notices. A foreign bank that maintains a Texas branch or agency shall file with the banking commissioner:

(1) the notices and applications required under the Finance Code, Chapter 204, including §§204.005, 204.008, 204.107 - 204.109 and 204.115;

(2) if the foreign bank intends to establish a Texas representative office, a notice at least thirty days before the effective date of the opening of the office that states or includes:

(A) a copy of any filings with other state or federal agencies in connection with the establishment of the office;

(B) the street and mailing address and the telephone and fax numbers for the office;

(C) the name and qualifications of the manager or officer in charge of the office and contact information for that person;

(D) the Texas branch or agency or other office to which the Texas representative office will report and contact information for the responsible officer at that office;

(E) a list of the activities in which the office will engage; and

(F) a copy of the filed document evidencing compliance with the Finance Code, §201.102;

(G) a list of activities to be engaged in at the office; and

(H) date on which the foreign bank plans to commence business at the office; and

(3) if the foreign bank intends to establish, relocate or close a loan production office, the notice required under §3.91 of this title (relating to Loan Production Offices).

(d) Reports. A foreign bank that maintains a Texas branch or agency shall file with the banking commissioner the following reports:

(1) the reports required under the Finance Code, Chapter 204, including §204.002, and, to the extent applicable, §§3.51 - 3.62 of this title (relating to Pledge and Maintenance of Assets by Foreign Bank Licensed to Maintain Texas State Branch or Agency);

(2) an annual report, within 120 days after the close of the foreign bank's fiscal year, that is in English or accompanied by an English translation and is signed, sworn to and acknowledged by one of the authorized officers, managers, or agents transacting business in this state, and that includes:

(A) a copy of the most recent audited financial statement of the foreign bank, expressed in the currency of the country of its incorporation or organization and in United States currency;

(B) a letter from the certified public accountant, chartered accountant, or similar independent service provider of the foreign bank certifying that the statements have been prepared in accordance with generally accepted accounting principles of the home country of the foreign bank;

(C) a general description of the foreign bank's business activities;

(D) the location and a general description of the foreign bank's headquarters office if the office has been relocated since the last annual report filed under this paragraph;

(E) disclosure of all material legal proceedings in which the foreign bank or any of its subsidiaries has been named as a defendant that could result in a material adverse impact on the financial condition of the foreign bank, and a description of such potential impact, quantified to the extent feasible;

(F) a listing of the foreign bank's:

(i) board of directors;

(ii) executive officers; and

(iii) overseas operations by office; and

(G) a copy of the foreign bank's organizational chart by functional department.

Source: *The provisions of this §3.41 adopted to be effective March 9, 2006, 31 TexReg 1643.*

§3.42. Foreign Bank Branch and Agency Records. A foreign bank branch or agency shall maintain the following records in English, or accompanied by an English translation, at its authorized location and make the records available for examination by the department or as otherwise requested by the banking commissioner:

(1) the records required under the Finance Code, Chapter 204, including §204.002, and, to the extent applicable, §3.60 and §3.61 of this title (relating to Pledge and Maintenance of Assets by Foreign Bank Licensed to Maintain Texas State Branch or Agency);

(2) separate accounting records relating to its assets and liabilities and, if available, its income and expenses resulting from the branch's or agency's operations in this state;

(3) records relating to all filings or permits required by federal regulators;

(4) records of all credit balances, including:

(A) a list of each credit balance;

(B) the contractual terms applicable to each credit balance; and

(C) the contractual terms specifying the completion of the transactions to which the credit balance relates;

(5) records listing all representative offices, loan production offices, or other subsidiaries maintained in this state by the foreign bank branch or agency or by the foreign bank that controls the branch or agency; and

(6) such other records that the banking commissioner may require.

Source: *The provisions of this §3.42 adopted to be effective September 13, 1996, 21 TexReg 8451; amended to be effective March 9, 2006, 31 TexReg 1643.*

§3.43. Credit Balance of Funds. (a) A foreign bank branch or agency may not receive deposits except as specifically authorized under the Finance Code, §204.104(b). A foreign bank branch or agency may receive funds from a person and maintain a credit balance in accordance with the Finance Code, §204.104(b).

(b) A credit balance includes:

(1) proceeds of loans to customers where such proceeds are not immediately disbursed;

(2) loan payments from customers;

(3) funds delivered by customers to settle letters of credit accounts with the branch or agency prior to settlement date;

(4) proceeds of bills of exchange, drafts, notes, acceptances, and other obligations for the payment of money arising out of the purchase and sale (but not discount) of same;

(5) funds received from customers to cover currency transactions or as the result of currency transactions consummated by the branch or agency on behalf of customers;

(6) funds received for transmission to another place;

(7) fund arising out of repurchase agreements, federal funds transactions, and other types of purchase, sale, or borrowing transactions in interbank markets;

(8) proceeds of collections made for customers' accounts;

(9) accounts due to other offices or entities controlled by or under common control with the foreign bank that owns the foreign bank branch or agency; or

(10) funds received from customers as security for a loan.

(c) Credit balances may not remain in the foreign bank branch or agency after the completion of all transactions to which they relate.

Source: *The provisions of this §3.43 adopted to be effective September 13, 1996, 21 TexReg 8452; amended to be effective March 9, 2006, 31 TexReg 1643.*

§3.44. Statements of Registration, Notices and Filings Related to Foreign Bank Representative Offices. (a) General. A foreign bank may establish a representative office in this state whether or not the foreign bank is authorized to maintain a Texas branch or agency.

(b) Applicability. This section applies only to a foreign bank that does not maintain a Texas branch or agency. A foreign bank that maintains a Texas branch or agency is not subject to this section and may establish a representative office by providing the notice required under §3.41(b)(2) of this title (relating to Applications, Notices and Reports Related to Foreign Bank Branches and Agencies).

(c) Statement of registration. To establish a representative office in this state, a foreign bank shall file with the banking commissioner a statement of registration on the form prescribed by the department. The statement of registration must:

(1) be in English and be signed, sworn to and acknowledged by an officer of the foreign bank;

(2) be fully completed and provide the information and include as attachments the

documentation specified in the registration form and the department's instructions, including the information and documentation required under the Finance Code, §204.201, and such other information and documentation as the banking commissioner reasonably requests; and

(3) be accompanied by the registration fee established in §15.2(b) of this title (relating to Filing Fees and Cost Deposits).

(d) Commencement of operations. A foreign bank may establish its representative office upon receipt of written confirmation from the banking commissioner that the statement of registration is complete and all required fees have been paid.

(e) Separate statement of registration required. A statement of registration must be filed for each representative office a foreign bank establishes in this state. If a foreign bank has established an initial representative office in accordance with this section, the banking commissioner may waive one or more of the informational requirements of the statement of registration form with respect to any additional Texas representative office the foreign bank seeks to establish. However, payment of the registration fee provided for in §15.2(b) of this title (relating to Filing Fees and Cost Deposits) may not be waived.

(f) Notices. A foreign bank that maintains a representative office in this state shall file the following notices in English with the banking commissioner:

(1) the change of control notice required under the Finance Code, §204.005;

(2) notice of the closing of a representative office in this state at least 30 days before the effective date of the closing;

(3) notice of a change in location containing the street, post office and mailing address of the new location at least 30 days before the effective date of the relocation; and

(4) copies of other notices or applications filed with a federal regulator affecting the representative office in this state, at the time filed with the federal regulator.

Source: *The provisions of this §3.44 adopted to be effective March 9, 2006, 31 TexReg 1643.*

§3.45. Records of a Representative Office. (a) A representative office established in this state by a foreign bank shall maintain the following records in English or accompanied by an English translation and make the records available for examination by the department or as otherwise requested by the banking commissioner:

(1) copies of all reports sent to the foreign bank by the representative office;

(2) copies of all policies pertaining to the solicitation, origination, and accounting of loans between the representative office and other offices of the foreign bank;

(3) a description of all activities in which the representative office is engaged and its target market;

(4) assets, liabilities, and income and expense journals for the representative office;

(5) the organizational chart of the representative office, including officer titles, functions, and reporting lines;

(6) marketing, business plans, and budgets for the representative office;

(7) copies of all lease agreements on rented office space and fixed assets in this state, including details of the sharing arrangement covering the office space if the office space is shared with another unit of the foreign bank;

(8) a copy of the most recent audited annual report of the foreign bank, in English;

(9) copies of all insurance policies covering fraud and fixed assets that relate to the representative office;

(10) a list of other operations and affiliates of the foreign bank in the United States;

(11) for all extensions of credit solicited or handled by the representative office:

(A) copies of the credit approval from the domestic agency, branch facility, or foreign bank, which may authorize the representative office to sign and execute the loan contract and related documentation. The approval may be in the form of a facsimile transmission or telex from the applicable foreign bank office;

(B) complete copies of all loan agreements and all subsequent revisions and amendments; and

(C) complete copies of credit and collateral documentation, including borrowing base calculations and reports; and

(12) to the extent not identified in paragraphs (1) - (11) of this subsection, the records required under the Finance Code, §204.002; and

(13) such other records the banking commissioner may require.

(b) A representative office affiliated with a foreign bank branch or agency in this state may maintain records at the office of the foreign bank branch or agency.

Source: *The provisions of this §3.45 adopted to be effective September 13, 1996, 21 TexReg 8453; amended to be effective March 9, 2006, 31 TexReg 1643.*

Subchapter D. Pledge and Maintenance of Assets by Foreign Bank Licensed to Maintain Texas State Branch or Agency

§3.51. Authority, Purpose and Scope. (a) Authority. This subchapter is adopted under the authority of Finance Code, Title 3, Subtitle G, Chapter 204, Subchapter B, particularly Finance Code, §§204.113 and 204.114. Subchapter B authorizes a foreign bank to establish and maintain a Texas state branch or agency upon receiving a license from the Texas Banking Commissioner. Section 204.113 authorizes the banking commissioner to require a foreign bank so licensed to deposit and pledge to the banking commissioner assets in Texas in an amount and subject to such conditions as may be determined or authorized by rule. Section 204.114 authorizes the banking commissioner to require a foreign bank to satisfy the ratio of Texas state branch or agency assets to liabilities as may be determined or authorized by rule.

(b) Purpose. This subchapter implements Finance Code, §§204.113 and 204.114. It establishes the amount of assets that a foreign bank subject to its provisions must deposit and pledge and the conditions related to the pledge. The subchapter also authorizes the banking commissioner to require a foreign bank to maintain a specific ratio of assets to liabilities as the banking commissioner deems necessary or desirable to address supervisory concerns.

(c) Scope. This subchapter applies to a foreign bank that is licensed to establish and maintain one or more Texas state branches or Texas state agencies under Finance Code, Title 3, Subtitle G, Chapter 204, Subchapter B, and that carries nonrelated liabilities on the books, accounts and records of such branch, branches, agency or agencies.

Source: *The provisions of this §3.51 adopted to be effective November 12, 2003, 28 TexReg 9823.*

§3.52. General Definitions. Unless defined otherwise in this section, words and terms used in this subchapter that are defined in Finance Code, §31.002, have the same meanings as defined in the Finance Code. The following words and terms, when used in this subchapter, have the following meanings unless the context clearly indicates otherwise:

(1) Asset pledge--The total amount of assets a foreign bank must deposit and pledge to the banking commissioner and maintain on deposit at all times.

(2) Call Report--The FFEIC quarterly, consolidated report of assets and liabilities of United States branches and agencies of foreign banks, currently reported on FFIEC 002.

(3) Depository--An unaffiliated, FDIC-insured state or national bank in Texas, or a federal reserve bank.

(4) FFIEC--The Federal Financial Institutions Examination Council.

(5) Foreign bank--A foreign bank or foreign bank corporation, as defined in Section 1(b)(7), International Banking Act (12 USC Section 3107(7)), that is licensed under Finance Code, Chapter 204, to establish and maintain a Texas state branch or Texas state agency.

(6) ROCA--The rating system used by the Federal Reserve Board, the Office of the Comptroller of the Currency, and state banking regulatory authorities that measures risk management, operation controls, compliance and asset quality and thereby determines the condition of a foreign bank's branch or agency or commercial lending subsidiary in the United States.

(7) Texas state branch--One or more branches established and maintained in Texas by a foreign bank under a license issued pursuant to Finance Code, Chapter 204. The term also includes a foreign bank branch as referred to in subchapters B and C of this title (relating to General state bank regulations and Foreign Bank Agencies, respectively).

(8) Texas state agency--One or more agencies established and maintained in Texas by a foreign bank under a license issued pursuant to Finance Code, Chapter 204. The term also includes a foreign bank agency as referred to in subchapters B and C of this title (relating to General state bank regulations and Foreign Bank Agencies, respectively).

(9) Nonrelated deposit liabilities--The liabilities to nonrelated parties consisting of deposits and credit balances reported in the Call Report in accordance with Call Report instructions, currently reported on line 4.a. of Schedule RAL-Assets and Liabilities.

(10) Nonrelated other liabilities--The liabilities to nonrelated parties, exclusive of nonrelated deposit liabilities, reported in the Call Report in accordance with Call Report instructions, currently reported on lines 4.b-4.g. of Schedule RAL-Assets and Liabilities. Nonrelated other liabilities include federal funds purchased and sold under agreements to repurchase, other borrowed money, branch or agency liability on acceptances executed and outstanding, trading liabilities and other liabilities to nonrelated parties.

Source: *The provisions of this §3.52 adopted to be effective November 12, 2003, 28 TexReg 9823.*

§3.53. Asset Deposit and Pledge Requirement Applicable to Branch or Agency with Nonrelated Deposit Liabilities. (a) Asset pledge required. A foreign bank that maintains and operates a Texas state branch or agency, and carries nonrelated deposit liabilities on the books and records of its Texas state branch or agency as liabilities of such branch or agency, must pledge and keep assets on deposit with a depository in accordance with this subchapter.

(b) Amount of deposit. Subject to a minimum deposit of $100,000, the amount of assets required to be deposited under subsection (a), based upon the lower of principal amount or market value, is equal to the lesser of:

(1) one percent of the average total nonrelated liabilities, consisting of nonrelated deposit liabilities and nonrelated other liabilities, for the previous calendar quarter of such branch or agency appearing on the books, accounts and records of such branch or agency; or

(2) $100 million.

(c) Pledge of assets to banking commissioner. The assets required to be deposited under this section are deemed to be pledged to the banking commissioner for the benefit of the creditors and depositors of the Texas state branch's or agency's business in this State. Notwithstanding any provision of the Uniform Commercial Code to the contrary, the banking commissioner is deemed to have a security interest in such assets.

(d) Projection of liabilities. Upon opening its first Texas state branch or agency that will carry nonrelated deposit liabilities on the books and records of such branch or agency, a foreign bank must deposit assets based upon such branch's or agency's projection of total nonrelated liabilities, consisting of nonrelated deposit liabilities and nonrelated other liabilities, at the end of its first year of operation.

(e) Increase in amount of required deposit. The banking commissioner may increase the amount required to be deposited by a foreign bank under this section if necessary or desirable to:

(1) maintain the Texas state branch or agency in sound financial condition;

(2) protect the depositors, creditors and the public interest in Texas; or

(3) support public confidence in the business of the Texas state branch or agency.

Source: *The provisions of this §3.53 adopted to be effective November 12, 2003, 28 TexReg 9823.*

§3.54. Asset Deposit and Pledge Requirement Applicable to Branch or Agency with Only Nonrelated Other Liabilities. (a) Asset pledge not generally required. Subject to subsection (b) of this section, a foreign bank that carries only nonrelated other liabilities on the books and records of its Texas state branch or agency, and does not carry nonrelated deposit liabilities, is not required to pledge assets under this subchapter.

(b) Authority of banking commissioner to require asset pledge. The banking commissioner, in his sole discretion based upon the factors identified in §3.53(e) of this title (relating to Asset Deposit and Pledge Requirement Applicable to Branch or Agency with Nonrelated Deposit Liabilities), may require a foreign bank that carries only nonrelated other liabilities on the books and records of its Texas state branch or agency to pledge assets in accordance with §3.53 of this title (relating to Asset Deposit and Pledge Requirement Applicable to Branch or Agency with Nonrelated Deposit Liabilities). In such event, the bank must comply with all provisions of this subchapter relating to the deposit and pledge of assets.

Source: *The provisions of this §3.54 adopted to be effective November 12, 2003, 28 TexReg 9823.*

§3.55. Calculation of Liabilities. (a) Calculation of liabilities in accordance with Call Report. For purposes of §3.53(b), and except as otherwise provided in this subchapter, a foreign bank must:

(1) calculate the nonrelated deposit liabilities and nonrelated other liabilities of its Texas state branch or agency in accordance with the instructions in the FFEIC Call Report; and

(2) calculate the asset pledge on the same basis on which it calculates quarterly averages for Call Report purposes (currently, the average of liabilities subject to asset pledge either as of the close of business for each day of the calendar quarter or as of the close of business on each Wednesday during the calendar quarter).

(b) Aggregation. A foreign bank that maintains more than one Texas state branch or agency must calculate the amount of the required asset pledge on an aggregate basis.

Source: *The provisions of this §3.55 adopted to be effective November 12, 2003, 28 TexReg 9823.*

§3.56. Asset Pledge Report and Additional Deposits. (a) Report of liabilities and pledged assets. Each foreign bank that maintains a Texas state branch or agency that carries nonrelated liabilities, consisting of nonrelated deposit liabilities and nonrelated other liabilities, on the books and records of its Texas state branch or agency as liabilities of such branch or agency, must prepare and submit to the banking commissioner, on a form prescribed by the banking commissioner, a report showing:

(1) the average total nonrelated liabilities, consisting of nonrelated deposit liabilities and nonrelated other liabilities, of its Texas state branch or agency for the previous calendar quarter, calculated in accordance with §3.55 of this title (relating to Calculation of Liabilities); and

(2) if assets are deposited and pledged for the account of the banking commissioner under §3.53 of this title (relating to Asset Deposit and Pledge Requirement Applicable to Branch or Agency with Nonrelated Deposit Liabilities), the assets deposited and pledged and the total value of such assets as of the end of the quarter for which liabilities are reported under subsection (a)(1) of this section.

(b) Authentication and submission of report. A duly authorized officer of the foreign bank must sign the report required under subsection (a) of this section and certify that the report is true and correct. The report must be submitted to the banking commissioner no later than the date the foreign bank must submit the Call Report for the end of the quarter for which the calculation is made to the appropriate Federal Reserve Bank according to Call Report instructions.

(c) Additional deposits to satisfy the pledge requirement. A foreign bank must deposit into the pledge account such additional assets as may be required, based upon the quarterly calculation, to satisfy the pledge requirement established in §3.53 of this title (relating to Asset Deposit and Pledge Requirement Applicable to Branch or Agency with Nonrelated Deposit Liabilities). The foreign bank must deposit the additional assets no later than the date on which the bank must submit the Call Report for the end of the quarter for which the calculation is made.

Source: *The provisions of this §3.56 adopted to be effective November 12, 2003, 28 TexReg 9823.*

§3.57. Excluded Liabilities. The following liabilities of a foreign bank's Texas state branch or agency are not included for purposes of calculating the amount of assets required to be pledged under §3.53 of this title (relating to Asset Deposit and Pledge Requirement Applicable to Branch or Agency with Nonrelated Deposit Liabilities):

(1) amounts due and other liabilities to other offices, agencies, branches and affiliates of the foreign bank;

(2) liabilities arising from repurchase agreements and other similar instruments to the extent secured by collateral;

(3) reserves for possible loan losses and other contingencies; and

(4) such other liabilities as the banking commissioner may determine.

Source: *The provisions of this §3.57 adopted to be effective November 12, 2003, 28 TexReg 9823.*

§3.58. Eligible Assets and Conditions. (a) Eligible assets. In addition to the assets consisting of dollar deposits and investment securities described in Finance Code, §204.113(a), a foreign bank may deposit the following assets to satisfy the pledge requirement established in §3.53 of this title (relating to Asset Deposit and Pledge Requirement Applicable to Branch or Agency with Nonrelated Deposit Liabilities):

(1) reserves maintained with a federal reserve bank in or outside this state;

(2) United States and non-United States debt obligations that are rated investment grade by a recognized United States rating service; and

(3) assets specifically approved by the banking commissioner upon prior written application.

(b) Asset pledge conditions and limitations. Unless the banking commissioner specifically permits otherwise, the following conditions and limitations apply to the asset pledge:

(1) Assets must be payable in the United States and payable in United States dollars; and

(2) Assets must be capable of being promptly sold under ordinary market conditions at a fair market value determined by reliable and continuously available price quotations, based upon actual transactions on an auction or similarly available daily bid and ask price market.

(c) Authority of banking commissioner to impose additional conditions. With respect to any asset, the commissioner may determine that, for purposes of this subchapter, a foreign bank must hold such asset in such form or subject to such conditions as the banking commissioner may prescribe. The banking commissioner may expressly disallow one or more otherwise eligible assets, either for all foreign banks or a specific foreign bank. All assets are subject to any additional conditions or limitations deemed by the banking commissioner to be necessary or desirable.

Source: *The provisions of this §3.58 adopted to be effective November 12, 2003, 28 TexReg 9823.*

§3.59. Deposit Agreement and Conditions. (a) Approved deposit agreement. A foreign bank and a depository must execute a deposit agreement approved by the banking commissioner before the foreign bank may deposit assets for purposes of Finance Code, §204.113, and this subchapter. In addition to any other terms and conditions that are not inconsistent with those listed in this section or imposed by the banking commissioner, the deposit agreement must include the terms and conditions set forth in subsections (b) through (m) of this section.

(b) Limitation on assets that may be deposited. Only assets eligible to be pledged under §3.58 of this title (relating to Eligible Assets and Conditions) may be deposited into the pledge account.

(c) Assets pledged to banking commissioner. The assets must be pledged to the banking commissioner for the benefit of the creditors and depositors of the Texas state branch's or agency's business in this State. The banking commissioner is deemed to have a security interest in the pledged assets.

(d) Assets held as special deposit. The depository must hold the assets deposited under the agreement as a special deposit free of any lien, charge, right of set-off, credit, or preference in connection with any claim of the depository against the foreign bank or the Texas state branch or agency. The depository may not accept any asset under the agreement that is not accompanied by documentation necessary to facilitate transfer of title.

(e) Depository to furnish receipt. The depository must furnish the foreign bank, upon the deposit of assets under the depository agreement, a receipt or statement as evidence of the deposit. The receipt or statement must identify the deposit as having been made pursuant to Finance Code, §204.113, and under the deposit agreement, and must state the amount of the deposit and, with respect to the deposit of securities, a description of each security deposited.

(f) Release of securities by depository. The depository must release deposited assets to the foreign bank upon written request:

(1) when accompanied by a certificate, as described in subsection (g) of this section, signed by a duly authorized officer of the foreign bank; or

(2) upon receipt of the banking commissioner's written order to release such part of the deposited assets under such conditions and terms as the order may specify.

(g) Model certificate. A duly authorized officer of the foreign bank must execute the following or a similar certificate before making a withdrawal under subsection (f)(1) of this section: It is hereby certified that the aggregate value of securities and/or funds remaining on deposit pursuant to the Deposit Agreement after this withdrawal or substitution amounts to $_________, valued at the lower of principal amount or market value, and that such amount is at least equal to the amount required to be deposited under Finance Code, §204.113, and 7 TAC §3.51 et seq. The amount required to be maintained on deposit, calculated in accordance with this subchapter, is $_____ as of this date.

(h) Depository to furnish monthly statement of all transactions. The depository must furnish to the foreign bank, at least once in each calendar month, a statement of all transactions in the pledge account since the closing date of the previous statement. The statement must include a listing of the securities and/or the amount of funds on deposit as of the closing date of the statement. The depository must simultaneously send a copy of the statement to the banking commissioner.

(i) Depository may pay interest. So long as the Texas state branch or agency continues business in the ordinary course, the depository may pay interest earned on the assets in the pledge account in accordance with such arrangements as may be made between the depository and the foreign bank.

(j) Responsibility of depository with respect to deposited securities. Except as provided in this subsection, a depository must hold securities deposited under the deposit agreement separate and apart from all other securities and must permit duly authorized representatives of the foreign bank or of the banking commissioner to examine and compare such securities. A depository may utilize a central depository, clearing corporation or book entry system to hold securities deposited under the deposit agreement, provided that the records of the central depository, clearing corporation or book entry system show that the depository holds the securities as principal or as agent or as custodian of its customers. The depository must maintain adequate records to demonstrate the disposition of any book entry deposits.

(k) Safeguarding of deposited securities. The depository must give the same degree of care to the safekeeping, handling and shipping of deposited securities that the depository would give to its own securities.

(l) Banking commissioner not to pay for services rendered. The banking commissioner is not required to pay for any of the services rendered or any expenses incurred by the depository or the foreign bank under or in connection with 7 TAC §§3.51-3.61 or the deposit agreement.

(m) Termination of deposit agreement by foreign bank or depository. The foreign bank or the depository may terminate the deposit agreement by giving the other party at least sixty days written notice of the termination, or such shorter notice as the banking commissioner may approve, provided that no termination by the foreign bank or the depository is effective until:

(1) the foreign bank has designated another depository;

(2) the foreign bank has provided the banking commissioner with the name and address of the successor depository;

(3) the foreign bank and the successor depository have executed a deposit agreement that conforms to this section and has been approved by the banking commissioner; and

(4) the depository has released to foreign bank all the deposited assets in accordance with written instructions from the foreign bank approved by the banking commissioner.

(n) Additional terms and conditions. The banking commissioner may at any time impose different or additional terms and conditions upon the deposit agreement as deemed necessary or desirable.

(o) Termination of the right to substitute or withdraw assets. Upon notice to the foreign bank and the depository, the banking commissioner may terminate or suspend the authority of the foreign bank under subsection (f)(1) of this section to substitute or withdraw deposited assets.

(p) Termination of deposit agreement by banking commissioner. Upon notice to the foreign bank and the depository, the banking commissioner may terminate the deposit agreement and order the depository to release the pledged assets on such terms as are specified in the order if the foreign bank or the depository fails to comply with any term of the deposit agreement required by this section or with any other terms and conditions imposed by the banking commissioner under subsection (n) of this section.

Source: *The provisions of this §3.59 adopted to be effective November 12, 2003, 28 TexReg 9823.*

§3.60. Record of Deposited and Withdrawn Assets. (a) Retention of receipts of statements. A foreign bank must retain for three years from the date of receipt the originals of all receipts or statements obtained from a depository under §3.59 of this title (relating to Deposit Agreement and Conditions). The foreign bank must make such originals available to the department at the time of the examination of such branch or agency.

(b) Withdrawal request and certificate. Coincidentally with any withdrawal request authorized pursuant to §3.59 of this title (relating to Deposit Agreement and Conditions), a foreign bank must furnish the banking commissioner a copy of the withdrawal request and the certificate required under §3.59(g) of this title (relating to Deposit Agreement and Conditions).

Source: *The provisions of this §3.60 adopted to be effective November 12, 2003, 28 TexReg 9823.*

§3.61. Record of Assets and Liabilities. (a) Maintenance of record of liabilities. A foreign bank must maintain a record of the liabilities of the foreign bank appearing on the books, accounts and records of its Texas state branch or agency as liabilities of such branch or agency as determined in accordance with §3.55 of this title (relating to Calculation of Liabilities) and §3.56 of this title (relating to Asset Pledge Report and Additional Deposits). The record must be maintained in permanent ledger form. A foreign bank authorized to maintain more than one branch or agency in this State must maintain the record on a consolidated basis. No specific format for the record is prescribed. It must, however, contain such information in sufficient detail as will permit ready verification of its accuracy.

(b) Maintenance of record of assets. In addition to the record of liabilities required to be maintained by subsection (a) of this section, a foreign bank must maintain an itemized record of assets deposited for the account of the banking commissioner under §3.53 of this title (relating to Asset Deposit and Pledge Requirement Applicable to Branch or Agency with Nonrelated Deposit Liabilities). The record must describe each deposited asset and include the value of such asset, at principal or market value, whichever is lower.

(c) General requirements applicable to records. The records required to be maintained under subsections (a) and (b) must:

(1) support the calculations and asset lists and valuations contained in the quarterly asset pledge report required under §3.56 of this title (relating to Asset Pledge Report and Additional Deposits);

(2) be authenticated by the signature of a duly authorized officer of the foreign bank; and

(3) be retained for three years from the date the records are received or generated.

(d) Additional records and reports. The banking commissioner may require a foreign bank subject to this subchapter to maintain records and submit reports in addition to those required by this section and §3.60 of this title (relating to Record of Deposited and Withdrawn Assets) as deemed necessary or desirable.

Source: *The provisions of this §3.61 adopted to be effective November 12, 2003, 28 TexReg 9823.*

§3.62. Asset Maintenance. (a) Maintenance of specific ratio not generally required. Subject to subsection (b) of this section, a foreign bank is not required to maintain a specific ratio of assets to liabilities appearing on the books, accounts and records of its Texas state branch or agency.

(b) Authority of banking commissioner to require maintenance of specific ratio. The banking commissioner may require a foreign bank to maintain a specific ratio of assets to liabilities as deemed necessary or desirable. In addition to the factors identified in Finance Code, §204.114(d), the banking commissioner may take into account the following in determining the ratio:

(1) the existence any formal supervisory, regulatory or enforcement actions outstanding against the foreign bank in any jurisdiction or its Texas state branch or Texas state agency;

(2) the composite ROCA rating for the Texas state branch or agency; and

(3) the comprehensive composite ROCA rating of the foreign bank's operations in the United States; and

(4) the financial strength or condition of the foreign bank.

(c) Determination of Assets and Liabilities. The banking commissioner will determine the assets and liabilities that may or must be included for purposes satisfying the requirements of this section consistent with Finance Code, §204.114.

Source: *The provisions of this §3.62 adopted to be effective November 12, 2003, 28 TexReg 9823.*

Subchapter E. Banking House and Other Facilities

§3.91. Loan Production Offices. (a) Loan production activities. A Texas state bank may, to the extent authorized by its board of directors, engage in loan production activities at a site other than the home office or a branch of the bank, and may use the services of, and compensate, persons not employed by the bank in its loan production activities. Subject to the requirements of subsection (b) of this section, the bank or its operating subsidiary may establish a loan production office (LPO) at which an employee or agent of the bank or of its operating subsidiary accepts loan applications, provided that the loan is made at the home office or a branch of the bank or at an office of the operating subsidiary located on the premises of, or contiguous to, the home office or branch of the bank. A LPO is not a branch within the meaning of Finance Code, §31.002(a)(8), so long as it does not engage the public in the business of banking as defined by Finance Code, §31.002(a)(4), including making loans, receiving deposits, and paying withdrawals, drafts, or checks. All such deposit or withdrawal activity must be performed by the state bank customer in person at the home office or a branch, or by mail, electronic transfer, or similar transfer method.

(b) Required information. Pursuant to Finance Code, §32.204(b), a Texas state bank shall notify the banking commissioner of its intent to establish a new LPO. The banking commissioner must be notified in writing before the 31st day preceding the date of establishment of the LPO, except that the banking commissioner in the exercise of discretion may waive or shorten the period. The written notification must include the physical address of the planned LPO, a list of the specific activities to be performed at the planned LPO, the anticipated date for the establishment of the LPO, and other information which the banking commissioner may reasonably request.

(c) Relocation or closure of a LPO. A Texas state bank which seeks to relocate or close an established LPO, shall notify the banking commissioner in writing before the fifth day preceding the date of the planned relocation or closure of the LPO. The written notification must include the physical address of the relocated or closed LPO, the anticipated date for the closure or relocation of the LPO, and other information which the banking commissioner may reasonably request.

(d) Exemption: temporary LPO. Subsections (b) and (c) of this section do not apply to a LPO which operates for less than a total of 21 days in any one 12-month period. Instead, state banks shall register the location of a temporary LPO with the banking commissioner no later than the tenth day after such office is opened. As a part of such notice, the bank may indicate the anticipated repeated use of such office through the year. For example, a temporary LPO in a convention or exposition hall used in connection with trade shows may be registered once each year with an estimate of usage throughout the year.

(e) Transactions with management and affiliates. A state bank establishing a LPO involving the purchase or lease of personal or real property from an officer, director, manager, managing participant, or principal shareholder or participant of the bank or an affiliate of the bank, must comply with the provisions of the Finance Code, §33.109, and §3.22 of this title (relating to Sale or Lease Agreements With an Officer, Director, or Principal Shareholder of the Bank or of an Affiliate of the Bank).

(f) Out-of-state banks. A bank not domiciled or primarily located in this state must comply with the provisions of the Finance Code, Chapter 201, Subchapter B (§§201.101 *et seq.*), to establish a LPO in this state.

(g) Foreign bank LPOs. A banking corporation or association incorporated or organized under the laws of a jurisdiction other than the United States or a state, territory, commonwealth, or other political subdivision of the United States, must comply with the provisions of the Finance Code, Chapter 201, Subchapter B (§§201.101 *et seq*.), and Finance Code, Chapter 204, to establish an LPO, unless the LPO will be an office of a Federal branch regulated by the Office of the Comptroller of the Currency (OCC). In the latter case, the Federal branch must comply with subsection (h) of this section.

(h) Federal branch LPO. A Federal branch may establish an LPO in this state by complying with the provisions of Finance Code, Chapter 201, Subchapter B (§§201.101 *et seq*.), and by notifying the banking commissioner of its intent to establish the LPO.

(1) The Federal branch shall notify the banking commissioner in writing on or before the 31st day preceding the date of establishment of the LPO, except that the banking commissioner may waive or shorten the period if the banking commissioner does not have a significant supervisory or regulatory concern regarding the Federal branch or its planned LPO. The written notification must include the physical address of the planned LPO, a list of the specific activities to be performed at the planned LPO, the anticipated date for the establishment of the LPO, documentation evidencing the approval of the OCC, and such other information as the banking commissioner may reasonably request.

(2) To relocate or close an existing LPO in this state, a Federal branch shall notify the banking commissioner in writing on or before the tenth day following the date of the relocation or closure of the LPO. The written notification must include the physical address of the LPO, the date for its closure or relocation, documentation evidencing the approval or acquiescence of the OCC, and such other information as the banking commissioner may reasonably request.

(3) An LPO of a Federal branch established in compliance with this section is not subject to examination by the banking commissioner under, or subject to any fee imposed by, Finance Code, Chapter 204.

Source: *The provisions of this §3.91 adopted to be effective November 22, 1996, 21 TexReg 11098; amended to be effective March 9, 2006, 31 TexReg 1643; amended to be effective November 7, 2013, 38 TexReg 7683; amended to be effective May 7, 2015, 40 TexReg 2410.*

§3.92. User Safety at Unmanned Teller Machines. (a) Definitions. Words and terms used in this subchapter that are defined in the Finance Code, §59.301, have the same meanings as defined in the Finance Code.

(b) Measurement of candle foot power. For purposes of measuring compliance with the Finance Code, §59.307, candle foot power should be determined under normal, dry weather conditions, without complicating factors such as fog, rain, snow, sand or dust storm, or other similar condition.

(c) Leased premises.

(1) Noncompliance by landlord. Pursuant to the Finance Code, §59.306, the landlord or owner of property is required to comply with the safety procedures of the Finance Code, Chapter 59, Subchapter D, if an access area or defined parking area for an unmanned teller machine is not controlled by the owner or operator of the unmanned teller machine. If an owner or operator of an unmanned teller machine on leased premises is unable to obtain compliance with safety procedures from the landlord or owner of the property, the owner or operator shall notify the landlord in writing of the requirements of the Finance Code, Chapter 59, Subchapter D, and of those provisions for which the landlord is in noncompliance.

(2) Enforcement. Noncompliance with safety procedures required by the Finance Code, Chapter 59, Subchapter D, by a landlord or owner of property after receipt of written notification from the owner or operator constitutes a violation of the Finance Code, Chapter 59, Subchapter D, which may be enforced by the Texas Attorney General.

(d) Safety evaluations.

(1) The owner or operator of an unmanned teller machine shall evaluate the safety of each machine on a basis no less frequently than annually.

(2) The safety evaluation shall consider at the least the factors identified in the Finance Code, §59.308.

(3) The owner or operator of the unmanned teller machine may provide the landlord or owner of the property with a copy of the safety evaluation if an access area or defined parking area for an unmanned teller machine is not controlled by the owner or operator of the machine.

(e) Notice. An issuer of access devices shall furnish its customers with a notice of basic safety precautions that each customer should employ while using an unmanned teller machine. The notice must be personally delivered or sent to each customer whose mailing address is in this state, according to records for the account to which the access device relates, and may be included with other disclosures related to the access device, including an initial or periodic disclosure statement furnished under the Electronic Fund Transfer Act (15 U.S.C. §1693 et seq.). The notice may be delivered electronically if permissible under Business & Commerce Code, §322.008.

(1) When notice is required. The issuer must furnish the notice to its customer whenever an access device is issued or renewed. If the issuer furnishes an access device to more than one customer on the same account, the issuer is not required to furnish the notice to more than one of the customers.

(2) Content of notice. The notice of basic safety precautions required by this subsection may include recommendations or advice regarding:

(A) security at walk-up and drive-up unmanned teller machines, such as recommendations that the customer should:

(i) remain aware of surroundings and exercise caution when withdrawing funds;

(ii) inspect an unmanned teller machine before use for possible tampering, or for the presence of an unauthorized attachment that could capture information from the access device or the customer's personal identification number;

(iii) refrain from displaying cash and put it away as soon as the transaction is completed; and

(iv) wait to count cash until the customer is in the safety of a locked enclosure, such as a car or home;

(B) protection of customer's code or personal identification number, such as a recommendation that the customer ensure no one can observe entry of the customer's code or personal identification number;

(C) safeguarding and protection of the customer's access device, such as a recommendation that the customer treat the access device as if it were cash, and if the access device has an embedded chip, that the customer keep the access device in a safety envelope to avoid undetected and unauthorized scanning;

(D) procedures for reporting a lost or stolen access device and for reporting a crime;

(E) reaction to suspicious circumstances, such as a recommendation that a customer who observes suspicious persons or circumstances, while approaching or using an unmanned teller machine, should not use the unmanned teller machine at that time or, if the customer is in the middle of a transaction, should cancel the transaction, take the access device, leave the area, and come back at another time, or use an unmanned teller machine at another location;

(F) safekeeping and secure disposition of unmanned teller machine receipts;

(G) the inadvisability of surrendering information about the customer's access device over the telephone or over the Internet, unless to a trusted merchant in a call or transaction initiated by the customer;

(H) protection against unmanned teller machine fraud, such as a recommendation that the customer promptly review the customer's monthly statement and compare unmanned teller machine receipts against the statement;

(I) protection against Internet fraud, such as a recommendation that the customer, if purchasing online with the access device, should end transactions by logging out of websites instead of just closing the web browser; and

(J) other recommendations that the issuer reasonably believes are appropriate to facilitate the security of its unmanned teller machine customers.

(f) Video surveillance equipment. Video surveillance equipment is not required to be installed at all unmanned teller machines. The owner or operator must determine whether video surveillance or unconnected video surveillance equipment should be installed at a particular unmanned teller machine site, based on the safety evaluation required under the Finance Code, §59.308. If an owner or operator determines that video surveillance equipment should be installed, the owner or operator must provide for selecting, testing, operating, and maintaining appropriate equipment.

(g) Unmanned teller machines located in a bank vestibule. The provisions of the Finance Code, Chapter 59, Subchapter D, and this section are applicable to an unmanned teller machine located in a bank vestibule if there is 24 hour access to the vestibule from outside the building.

(h) Certification of Compliance. The security officer of each depository shall certify compliance with the Finance Code, Chapter 59, Subchapter D, and this section on a basis no less frequently than annually.

Source: *The provisions of this §3.92 adopted to be effective January 5, 1996, 20 TexReg 10997; amended to be effective November 22, 1996, 21 TexReg 11099; amended to be effective November 13, 1997, 22 TexReg 10949; amended to be effective March 9, 2006, 31 TexReg 1643; amended to be effective March 12, 2015, 40 TexReg 1062.*

§3.93. Deposit Production Offices. (a) Engaging in deposit production activities. A Texas state bank may, to the extent authorized by its board of directors, engage in deposit production activities at a site other than the home office or a branch of the bank, including establishing a deposit production office (DPO) of the bank. A DPO may only solicit deposits, provide information about deposit products, and assist persons in completing application forms and related documents to open a deposit account. A DPO is not a branch within the meaning of Finance Code, §31.002(a)(8), so long as it does not engage the public in the business of banking as defined by Finance Code, §31.002(a)(4), including making loans, receiving deposits, and paying withdrawals, drafts, or checks. All such deposit or withdrawal activity must be performed by the state bank customer in person at the home office or a branch, or by mail, electronic transfer, or similar transfer method.

(b) Notification to the banking commissioner. Pursuant to Finance Code, §32.204(b), a Texas state bank shall notify the banking commissioner in writing before the 31st day preceding the date of establishment of a DPO, except the banking commissioner in the exercise of discretion may waive or shorten the period. The written notification must include the physical address of the DPO, a list of the specific activities to be performed at the planned DPO, and other information which the banking commissioner may reasonably request.

(c) Relocation or closure of a DPO. A Texas state bank which seeks to relocate or close an established DPO shall notify the banking commissioner in writing before the fifth day preceding the date of the planned relocation or closure of the DPO. The written notification must include the physical address of the relocated or closed DPO, the anticipated date for the closure or relocation of the DPO, and other information which the banking commissioner may reasonably request.

(d) Transactions with management and affiliates. A state bank establishing a DPO involving the purchase or lease of personal or real property from an officer, director, manager, managing participant, or principal shareholder or participant of the bank or an affiliate of the bank, must comply with the provisions of the Finance Code, §33.109, and §3.22 of this title (relating to Sale or Lease Agreements with an Officer, Director, or Principal Shareholder of the Bank or of an Affiliate of the Bank).

(e) Out-of-state banks. A bank not domiciled or primarily located in this state must comply with the provisions of the Finance Code, Chapter 201, Subchapter B (§§201.101 et seq.), to establish a DPO in this state.

Source: *The provisions of this §3.93 adopted to be effective March 8, 2012, 37 TexReg 1496; amended to be effective November 7, 2013, 38 TexReg 7683.*

Subchapter F. Access to Information

§3.111. Confidential Information. (a) Policy. The Texas Department of Banking (the department) is committed to the concept of open state government. As a regulator of financial institutions, however, the department recognizes the mandate of the legislature to balance the competing interests of the need of financial institutions for confidentiality regarding their financial condition and business affairs with the general public's need for information. The legislature has determined that confidential information, with limited exceptions, should not be disclosed. See Finance Code, Chapter 31, Subchapter D, Chapter 181, and §§201.007, 204.102(c), 204.117(d) and 204.205(d). Inappropriate disclosures can result in substantial harm to financial institutions and to those persons and entities (including other financial institutions) that have relationships with them. In accordance with the historical availability of records of financial institutions and the sound public policy that generally protects them, non-disclosure under this section protects the stability of such institutions by preventing disclosures that could adversely impact financial institutions. For example, the department may criticize a bank in an examination report for a financial weakness that does not currently threaten the solvency of the bank. If improperly disclosed, the criticism can lead to adverse impacts such as the possibility of bank “runs,” short-term liquidity problems, and volatility in costs of funds, which in turn can exacerbate the problem and cause the failure of the bank. Bank failures lead to reduced access to credit and greater risk to depositors. Further, specific loans may be criticized in an examination report, and confidentiality of the information protects the financial privacy of customers. Finally, protecting confidential information from disclosure facilitates the free exchange of information between the financial institution and the regulator, encourages candor, and promotes regulatory responsiveness and effectiveness. Information that does not fall within the meaning of confidential information as defined in this section may be confidential under other definitions and controlled by other laws, and is not subject to this section.

(b) Definitions. The following words and terms, when used in this section, shall have the following meanings, unless the context clearly indicates otherwise.

(1) Affiliate--A company that directly or indirectly controls, is controlled by, or is under common control with a bank or other company.

(2) Confidential information--Written and oral information obtained directly or indirectly by the department relative to the financial condition or business affairs of a financial institution, or a present, former, or prospective shareholder, participant, officer, director, manager, affiliate, or service provider of a financial institution, whether obtained through application, examination, or otherwise, and all related files and records of the department, regardless of the form of the information when obtained or as held by the department or when the department first obtained it, and whether or not the information is part of the department’s official files or records. The term does not include:

(A) the public portions of call reports of state banks and public trust companies;

(B) the names of proposed directors of a de novo financial institution or an entity converting to a state financial institution;

(C) information contained in an official document required to be filed with the department in order to have legal effect (Examples of such documents include, without limitation, Certificate of Amendment, Certificate of Merger, or Certificate of Conversion);

(D) information contained in the portion of an application submitted to the department that has been designated as public by the applicant, department or a federal agency; or

(E) information previously disclosed to the public by the person or entity to which the information relates.

(3) Financial institution--As defined in the Finance Code, §31.002(a)(25). For purposes of this section only, the term includes a trust company incorporated under the Texas Trust Company Act, Finance Code, Chapters 181 *et seq*, or a predecessor statute, and a foreign bank branch, agency or representative office licensed under the Finance Code, Chapter 204 *et seq*.

(4) Governmental agency--Another department of this state, another state, the United States, a foreign sovereign state, or any related agency or instrumentality.

(5) Court--A court of law or equity or other adjudicatory tribunal with jurisdiction to issue a subpoena or other legal process for the production of documents, including a government agency exercising adjudicatory functions and an alternative dispute resolution mechanism, voluntary or required, under which a party may compel the production of documents.

(c) Authority to receive, hold or disclose confidential information. Authority to disclose confidential information to an individual, business, or governmental agency under this section constitutes authority to disclose it to the appropriate person officially connected to such individual, business, or governmental agency that has a need to know the information in connection with the discharge of official responsibilities and authority for the person who is officially connected to such individual, business, or governmental agency to receive such information. A person officially connected to a financial institution includes its holding company, officer, director, manager, attorney, auditor, independent auditor, employee, and a person reasonably designated as officially connected with the financial institution by resolution duly adopted by the board of directors of the financial institution. A financial institution or its service provider, or affiliate may disclose confidential information, other than as specifically mentioned, to a non-employee, such as its agent, bonding company, or a prospective acquirer, only pursuant to board resolution designating the person or entity as officially connected with the financial institution, affiliate, or service provider. The financial institution, affiliate, or service provider may not disclose confidential information to a shareholder or participant that is specifically denied to such person under the Finance Code, §31.308. Only a person to whom confidential information has been released pursuant to lawful authority may disclose that information to another, and all such further disclosures must be in accordance with the Finance Code and this section.

(d) Disclosure prohibited.

(1) Pursuant to the Finance Code, §31.301, and *Stewart v. McCain*, 575 S.W.2d 509 (Tex. 1978), the department possesses an absolute privilege against disclosure of confidential information held by the department. Except as provided by the Finance Code, Title 3, Subtitle A, and rules adopted under the Finance Code, the finance commission, a member of the finance commission, the banking commissioner, or an employee or agent of the department may not directly or indirectly disclose confidential information, whether voluntarily or pursuant to subpoena or other legal process. Confidential information is discoverable from the department under this section only pursuant to a protective order under subsection (f) of this section in a case in which the department is a party other than as intervenor under this section. Pursuant to the Finance Code, §31.306, and notwithstanding any other provision of this section authorizing the release of confidential information, the banking commissioner may refuse to release information or records in the custody of the department if, in the opinion of the banking commissioner, release of the information or records might jeopardize an ongoing investigation by the department or other governmental agency of potentially unlawful activities.

(2) Except as provided by the Finance Code, Title 3, Subtitle A, and this section, a financial institution, its service provider, or its affiliate may not disclose confidential information received from the department. Confidential information includes an examination report of, correspondence with, and formal and informal actions of the department taken against the financial institution, service provider, or affiliate.

(e) Exceptions to non-disclosure.

(1) Disclosures by the department. Confidential information disclosed by the department pursuant to an exception to disclosure remains the confidential property of the department. The department may:

(A) disclose confidential information to the finance commission and other governmental agencies as provided by the Finance Code, §31.302 and §31.303;

(B) publish final removal, prohibition, and cease-and-desist orders and information regarding the existence of a cease-and-desist order as provided by the Finance Code, §35.012;

(C) release employment information as provided by the Finance Code, §31.307;

(D) provide a copy of the regular report of examination and an order, opinion, or other confidential information to the financial institution, its service provider, or affiliate for which it was prepared and to which it relates and correspond with that financial institution, service provider, or affiliate regarding such information;

(E) provide a copy of the regular report of examination of a service provider and an order, opinion, or other confidential information relating to the service provider to the financial institution or institutions it services;

(F) forward to a court of proper jurisdiction, subject to any existing administrative protective order, the record of an administrative hearing under appeal that contains confidential information. In the event an administrative protective order does not exist, the department or another party shall file a motion with the court for a protective order consistent with the terms of subsection (f)(4) of this section prior to filing the administrative record. Discretion of the banking commissioner or finance commission to vacate an administrative protective order entered under §9.22 of this title (relating to Protective Orders; Motions to Compel) ceases at the time the appeal is filed;

(G) provide complete copies of documents previously submitted to the department by a financial institution to the same financial institution or the successor financial institution upon request; and

(H) provide certificates and certified copies upon request. The cost for a formal certificate issued by the department shall be $20.00 plus $1.00 per page for certified copies of pages attached to the certificate.

(2) Further disclosure by a governmental agency, financial institution, service provider or affiliate. Except for disclosures pursuant to subsection (f) of this section, confidential information released to a financial institution, its service provider, or affiliate may be disclosed by the recipient only to a person officially connected to the recipient as provided by subsection (c) of this section and, if authorized under the terms of a confidentiality agreement between the department and another governmental agency, to that governmental agency in the discharge of its official duties. Disclosures to a person designated by board resolution as officially connected to the financial institution, service provider, or affiliate must be made pursuant to a confidentiality agreement between the financial institution, service provider, or affiliate and the recipient. Confidential information released to a governmental agency may be disclosed by the agency only to a person officially connected to the agency as provided by subsection (c) of this section or to another governmental agency to the extent authorized by this section or other law, and must be in accordance with the terms of this section and a confidentiality agreement with or letter of instructions from the department.

(3) Disclosures of certain information.

(A) Statistical data. Confidential information consisting solely of statistical data may be disclosed, providing its release does not directly or indirectly disclose the identity of an individual or financial institution related to the data.

(B) Records of a failed financial institution. Subject to an appropriate finding of the banking commissioner under this subparagraph, the department may release confidential information in or related to the records of a failed financial institution. Release may not occur under this subparagraph earlier than three years after the date such financial institution failed. Information subject to release must pertain only to the condition of the financial institution and cannot include confidential customer information, absent customer consent, or information made confidential by laws other than the Finance Code, Title 3, Subtitle A, or this section. Confidential information, as limited herein, may be released if the banking commissioner, in the exercise of discretion, finds that:

(i) production of records is neither overly burdensome nor contrary to the public interest;

(ii) the need for the information clearly outweighs the need to maintain the confidentiality of the information; or

(iii) a compelling need exists for release of the records.

(C) Records of another governmental agency. Information the department has obtained from a federal or state governmental agency that is confidential under federal or state law or by agreement with the other agency is not considered part of the department's records. The department may not release such information unless the request for release is submitted with a certification from the appropriate state or federal authority that the information is subject to release under the laws of that jurisdiction.

(f) Discovery of confidential information from a governmental agency, financial institution, service provider, or affiliate.

(1) General rule. A governmental agency, financial institution, service provider, or affiliate that receives a subpoena or other legal process in any proceeding for the release of confidential information shall promptly notify the department of the request, provide the department with a copy of the process and of the requested documents or information, and object by written motion or other means available under applicable rules of procedure. Notice and documents should be sent to the Texas Department of Banking at 2601 North Lamar Boulevard, Austin, Texas, 78705-4294, to the attention of the General Counsel, and should be labeled "Request for Release of Confidential Information under 7 TAC §3.111." Prior to the release of confidential information, such government agency, financial institution, service provider, or affiliate also must file and obtain a ruling on a motion for a protective order and in camera inspection in accordance with this subsection. Confidential information may be released only pursuant to a protective order in a form consistent with that set out in this section and only if a court with jurisdiction has found that:

(A) the party seeking the information has a substantial need for the information;

(B) the information is directly relevant to the legal dispute in issue; and

(C) the party seeking the information is unable without undue hardship to obtain its substantial equivalent by other means.

(2) Discretionary filings by department. On receipt of notice under subsection (f)(1) of this section, the department may take action as may be appropriate to protect confidential information. The department has standing to intervene in a suit or administrative hearing for the purpose of filing a motion for protective order and in camera inspection in accordance with this subsection.

(3) Motion for protective order and in camera inspection. The movant shall ask the court to enter a protective order in accordance with this subsection regarding the release of confidential information. If necessary to resolve a dispute regarding the confidential status or direct relevance of any information sought to be released, the party seeking the protective order shall move for in camera inspection of the pertinent information. Until subject to a protective order, confidential information may not be released, and the party seeking a protective order shall request the court officer to deny discovery of such confidential information. The party seeking the protective order must comply with the court's applicable rules of procedure.

(4) Protective order. A protective order obtained pursuant to the terms of this subsection must:

(A) specifically bind each party to the litigation, including one who becomes a party to the suit after the protective order is entered, each attorney of record, and each person who becomes privy to the confidential information as a result of its disclosure under the terms of the protective order;

(B) describe in general terms the confidential information to be produced;

(C) state substantially the following in the body of the protective order:

(i) absent court order to the contrary, only the court reporter and attorneys of record in the cause may copy confidential information produced under the protective order in whole or part;

(ii) the attorneys of record are custodians responsible for all originals and copies of confidential information produced under the protective order and must insure that disclosure is limited to those persons specified in the protective order;

(iii) confidential information subject to the protective order and all information derived therefrom may be used only for the purpose of the trial, appeal, or other proceedings in the case in which it is produced;

(iv) confidential information to be filed or included in a filing in the case must be filed with the clerk separately in a sealed envelope bearing suitable identification, and is available only to the court and to those persons authorized by the order to receive confidential information, and all originals and copies made of such documents and records must be kept under seal and disclosed only in accordance with the terms of the protective order;

(v) confidential information produced under to the protective order may be disclosed only to the following persons and only after counsel has explained the terms of the order to the person who will receive the information and provided that person with a copy of the order:

(I) to a party and to an officer, employee, or representative of a party, to a party's attorneys (including other members and associates of the respective law firms and contract attorneys in connection with work on the case) and, to the extent an attorney of record in good faith determines disclosure is necessary or appropriate for the conduct of the litigation, legal assistants, office clerks and secretaries working under that attorney's supervision;

(II) to a witness or potential witness in the case;

(III) to an outside expert retained for consultation or for testimony, provided the expert agrees to be bound by the terms of the protective order and the party employing the expert agrees to be responsible for the compliance of its expert with this confidentiality obligation; and

(IV) to the court or to an appellate officer or body with jurisdiction of an appeal in the case;

(vi) at the request of the department or a party, only the court, the parties and their attorneys, and other persons the court reasonably determines should be present may attend the live testimony of a witness or discussions or oral arguments before the court that may include confidential information or relate to such confidential information. The parties shall request the court to instruct all persons present at such testimony, discussions, or arguments that release of confidential information is strictly forbidden;

(vii) a transcript, including a deposition transcript, that may include confidential information subject to non-disclosure is subject to the protective order. The party requesting the testimony of a current or former department officer, employee, or agent shall, at its expense, furnish the department a copy of the transcript of the testimony once it has been transcribed.

(viii) upon ultimate conclusion of the case by final judgment and the expiration of time to appeal, or by settlement or otherwise, counsel for each party shall return to the party that produced the confidential information all copies of every document subject to the protective order and for which the counsel is custodian; and

(ix) production of documents subject to the protective order does not waive a claim of privilege or right to withhold the documents from a person not subject to the protective order.

(D) Clauses (i), (ii), and (v)-(vii) of subparagraph (C) of this paragraph are subject to modification by the court for good cause before the conclusion of the proceeding, upon notice and opportunity to appear to the department.

Source: *The provisions of this §3.111 adopted to be effective March 1, 1996, 21 TexReg 1380; amended to be effective November 13, 1997, 22 TexReg 10949; amended to be effective March 9, 2006, 31 TexReg 1643; amended to be effective August 31, 2006, 31 TexReg 6641; amended to be effective November 7, 2013, 38 TexReg 7684.*

§3.112. What will the Department Charge for Providing Public Information? (a) If you request the department to provide copies or allow inspection of public information in the possession of the department, you may be required to pay the charges and meet other requirements specified by the Texas Attorney General.

(b) The department may reduce or waive an applicable charge under subsection (a) of this section, in the discretion of the commissioner, if the cost of collecting the charge will exceed the amount of the charge or a public benefit will result from the reduction or waiver.

Source: *The provisions of this §3.112 adopted to be effective May 21, 2002, 27 TexReg 4324; amended to be effective March 9, 2006, 31 TexReg 1643.*

[The next page is 2041]

CHAPTER 5. ADMINISTRATION OF FINANCE AGENCIES

CHAPTER 5. ADMINISTRATION OF FINANCE AGENCIES

§5.101. Employee Training and Education Assistance Programs. (a) For purposes of this rule, "finance agencies" means the Texas Department of Banking, the Texas Department of Savings and Mortgage Lending, and the Office of Consumer Credit Commissioner. Pursuant to the State Employees Training Act, Chapter 656, Subchapter C of the Texas Government Code, it is the policy and practice of the finance agencies to encourage employees' professional development through training and education programs sponsored or supported by the finance agencies.

(b) The finance agencies may provide assistance for education and training that will enhance an employee's ability to perform current or prospective job duties and will benefit both the respective finance agency and the employee.

(c) Approval to participate in a training or education program is not automatic and is subject to eligibility of individual employees as established in the respective finance agency's policy, and the availability of funds within the respective finance agency's budget.

(d) The employee training and education program for the finance agencies may include one or more of the following:

(1) agency-sponsored training provided in-house or by contract;

(2) seminars and conferences;

(3) technical or professional certifications and licenses; or

(4) reimbursement for tuition, fees and required course materials.

(e) The finance agencies will develop and maintain policies for administering the employee training and education program of each respective finance agency. These policies will include:

(1) eligibility requirements for participation;

(2) designation of appropriate level of approval for participation; and

(3) obligations of program participants.

(f) Approval to participate in any portion of a finance agency's training and education program will not in any way affect an employee's at-will status.

(g) In order to receive tuition reimbursement for a course offered by an institution of higher education, the employee must successfully complete the course, and the executive head of the finance agency must personally authorize the tuition reimbursement payment.

Source: *The provisions of this §5.101 adopted to be effective November 6, 2014, 39 TexReg 8571, amended to be effective March 10, 2016, 41 TexReg 1672.*

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CHAPTER 6. BANKING DEVELOPMENT DISTRICTS

CHAPTER 6. BANKING DEVELOPMENT DISTRICTS

§6.1. Purpose; Scope. (a) This chapter implements Finance Code, Chapter 279, by providing application requirements for a municipality or county that seeks to establish a banking development district in conjunction with a financial institution.

(b) This chapter does not affect or circumvent:

(1) requirements under the Tax Increment Financing Act or the Property Redevelopment and Tax Abatement Act (Government Code, Chapters 311 and 312, respectively), including requirements for designation of an area as a municipal or county reinvestment zone or for authorization to enter into a tax abatement agreement; or

(2) any required regulatory approval for a financial institution that seeks to establish a branch in a banking development district.

Source: *The provisions of this §6.1 adopted to be effective November 5, 2015, 40 TexReg 7621.*

§6.2. Definitions. The following words and terms, when used in this chapter, shall have the following meanings, unless the context clearly indicates otherwise:

(1) "Alternative providers" means check cashers, licensed money transmitters, licensed lenders, and licensed residential mortgage lenders.

(2) "Banking services" include deposit taking, check-cashing, and origination of residential mortgages, commercial mortgages, or other secured or unsecured consumer or commercial loans.

(3) "Branch" means a full-service main office or branch office of a financial institution or credit union.

(4) "Commission" means the Finance Commission of Texas.

(5) "Credit union" means a state or federal credit union.

(6) "Department" means the Texas Department of Banking.

(7) "District" means a banking development district under this chapter.

(8) "Financial institution" means a state or national bank, a state or federal savings bank, or a state or federal savings and loan association.

(9) "Local government" means a municipality or county.

Source: *The provisions of this §6.2 adopted to be effective November 5, 2015, 40 TexReg 7621.*

§6.3. Application Requirements. (a) Basic application. A local government, in conjunction with a financial institution, may submit an application to the commission for the designation of a proposed banking development district, as provided by §6.4 of this title (relating to Submission and Processing of Application). The application must include the following information to the extent available:

(1) identification of the local government applicant and evidence of the approval of the application by its governing body;

(2) identification of the participating financial institution by type and name, and identification of its primary state and/or federal regulator;

(3) a description of the geographic area comprising the proposed district, including a map that identifies the borders of the proposed district;

(4) a compilation and explanation of the population demographics included within the proposed district, including the number of residents

and the percentage of the population that can be described as comprised of, for example, elderly (age 64 and over), disabled, non-English speaking, and identifiable racial, ethnic or other minorities;

(5) a compilation and explanation of economic indicators pertinent to the proposed district, to the extent available, including per capita annual income, median household annual income, unemployment data, percentage of the population at or below the poverty level, and percentage of the population receiving public assistance within the proposed district;

(6) a description of the type and nature of commercial businesses located in the proposed district, including the number and percentage of which constitute small business, as that term is defined by Government Code §2006.001(2);

(7) a compilation and summary of significant business developments within the past three years, including corporate restructurings, plant closings, other business closings, and recent or proposed business openings or expansions;

(8) the location, number, and proximity of sites where banking services are available in or near the proposed district, including branches of financial institutions and credit unions, and deposit-taking ATMs other than those located at branches;

(9) a compilation and description of alternate providers in the proposed district;

(10) a description of the anticipated impact that additional banking services would have on potential economic development within the proposed district.

(b) Optional information. An application for designation of a banking development district may also include:

(1) a description of other local government and community initiatives proposed to be undertaken and coordinated with establishment of the proposed district;

(2) indications of community support or opposition for the application, as evidenced by letters from entities such as local chambers of commerce, local businesses, community-based organizations, non-profit organizations, government officials, or community residents; and

(3) such other information that the applicant believes will demonstrate that the proposed district meets the standards set forth in §6.5 of this title (relating to Criteria for Approval).

Source: *The provisions of this §6.3 adopted to be effective November 5, 2015, 40 TexReg 7621.*

§6.4. Submission and Processing of Application. (a) The application must be submitted to the commission in care of the Texas Department of Banking, 2601 North Lamar Boulevard, Austin, Texas 78705. No filing fee is required.

(b) On or before the 15th day after initial submission of an application, the department shall issue a written notice informing the applicant either that the application is complete and accepted for filing, or that the application is deficient and specific additional information is required. The applicant must supply any additional information requested by the department on or before the 61st day after the date of initial submission of the filing. Upon a finding of good and sufficient cause, the department shall grant an applicant additional time to complete the application. Extensions will be communicated to the applicant before the expiration of the filing period.

(c) After the issuance of written notice informing the applicant that the application is complete and accepted for filing, the department shall evaluate the application to the extent necessary to make a written recommendation to the commission under the criteria set forth in §6.5 of this title. The department shall submit the completed application and the department's recommendation to the commission for decision at the next regularly scheduled meeting of the commission, which must be on or before the 120th day after the date the completed application is accepted for filing.

(d) If the finance commission approves the application, the department shall notify the interested parties as required by Finance Code, §279.055(b).

Source: *The provisions of this §6.4 adopted to be effective November 5, 2015, 40 TexReg 7621.*

§6.5. Criteria for Approval. In determining whether to approve an application for the designation of a banking development district, the commission shall take into consideration the following criteria:

(1) the location, number, and proximity of sites where banking services are available in the proposed district;

(2) consumer needs for banking services in the proposed district;

(3) the economic viability and local credit needs of the community in the proposed district;

(4) the existing commercial development in the proposed district;

(5) the impact additional banking services would have on potential economic development in the proposed district;

(6) the physical size and cohesiveness of the proposed district; and

(7) the history of the availability of banking services in the proposed district.

Source: *The provisions of this §6.5 adopted to be effective November 5, 2015, 40 TexReg 7621.*

§6.6. Monitoring. (a) A local government that receives approval for a district under this chapter shall notify the department in writing on or before the 21st day after the date:

(1) the financial institution opens a branch in the district and the address of the branch; and

(2) the financial institution closes a branch in the district.

(b) On behalf of the commission, the department may request periodic status reports from the local government in order to ensure that the needs of the community located in the district are being met in an appropriate manner.

Source: *The provisions of this §6.6 adopted to be effective November 5, 2015, 40 TexReg 7621.*

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CHAPTER 9. RULES OF PROCEDURE FOR CONTESTED CASE HEARINGS, APPEALS, AND RULEMAKINGS

Subchapter A. General

Subchapter B. Contested Case Hearings

Subchapter C. Appeals to Finance Commission

Subchapter D. Court Appeals

Subchapter E. Rulemaking

CHAPTER 9. RULES OF PROCEDURE FOR CONTESTED CASE HEARINGS, APPEALS, AND RULEMAKINGS

Subchapter A. General

§9.1.Definitions and Interpretation;Severability. (a) The same rules of construction that apply to interpretation of Texas statutes and codes, the definitions in Government Code, §2001.003, and the definitions in subsection (b) of this section govern the interpretation of this chapter. If any section of this chapter is found to conflict with an applicable and controlling provision of other state or federal law, the section involved shall be void to the extent of the conflict without affecting the validity of the rest of this chapter.

(b) The following words and terms, when used in this chapter, have the following meanings, unless the context clearly indicates otherwise:

(1) Administrative law judge--The hearings officer employed by or contracted by an agency to conduct administrative hearings for the finance commission, the department of banking, the department of savings and mortgage lending, and the office of consumer credit commissioner.

(2) Agency--The finance commission, the department of banking, the department of savings and mortgage lending, or the office of consumer credit commissioner.

(3) Agency head(s)--Finance commission members, the banking commissioner, the savings and mortgage lending commissioner, or the consumer credit commissioner, or a designee if authorized by law.

(4) Applicant--A party seeking a license, registration, charter, or permit, or to amend its authority under an existing license, registration, charter or permit, or other action from an agency.

(5) Protestant--A party opposing an application for a license, registration, charter, permit, or other action filed with an agency who has paid any filing fees required by an applicable law.

(6) Respondent--A permittee, licensee, registrant, charter holder, or other party against whom a disciplinary proceeding is directed by an agency.

Source: *The provisions of this §9.1 adopted to be effective November 13, 1997, 22 TexReg 10951; amended to be effective August 28, 2008, 33 TexReg 6808; amended to be effective January 9, 2011, 35 TexReg 11849.*

§9.2. Procedure. (a) Insofar as practicable and except as otherwise provided in this chapter, procedure in contested case hearings will be in accordance with the Texas Rules of Civil Procedure. References in the Texas Rules of Civil Procedure to the "court" or the "judge" will be construed as references to the administrative law judge as the context may require. All documents required by the Texas Rules of Civil Procedure to be filed with the clerk must be filed with the administrative law judge or with a person designated by the administrative law judge.

(b) The agency with jurisdiction over a particular case is a party to that case through its attorney of record. The agency attorney must be served with copies of all notices, orders, pleadings, motions, and correspondence, notified of all hearings and conferences, and has full rights to participate at all stages of the case.

Source: *The provisions of this §9.2 adopted to be effective November 13, 1997, 22 TexReg 10951.*

§9.3. Ex Parte Communications. A person may not conduct oral or written communications with the administrative law judge regarding an issue of law or fact in a contested case other than on notice to all parties with an opportunity to participate or as otherwise authorized by law. Letters to the administrative law judge must show that copies have been sent to all parties (through counsel if a party is represented by counsel).

Source: *The provisions of this §9.3 adopted to be effective November 13, 1997, 22 TexReg 10951.*

Subchapter B. Contested Case Hearings

§9.11. Notice and Initiation of Proceedings. (a) An action subject to this chapter is initiated by the publication or service of such documents or notices as are required to be published or served under the substantive law governing the particular proceeding. Unless other law authorizing a different notice period is applicable to the particular proceeding, all hearings in contested cases must be preceded by at least 10 days notice, as required by Government Code, §2001.051. Applicants and holders of licenses, registrations, charters, and permits shall keep the agency informed as to their correct current mailing addresses and may be served with initial process by registered or certified mail, return receipt requested, to the address furnished the agency. Service of initial process on parties other than licensees, registrants, charter holders, permittees, or applicants (unless applicable law provides otherwise), must be made in the manner provided in the Texas Rules of Civil Procedure for initiating a civil suit.

(b) Notice of a disciplinary proceeding that is required to be preceded by a hearing must be signed by the agency head or administrative law judge and must contain:

(1) an order to appear at a specified time, date, and place;

(2) a statement of the nature of the administrative action to be commenced and the authority under which the administrative action is conducted;

(3) a description in plain language of the specific act(s) or omission(s) asserted as grounds for the contemplated administrative action;

(4) a description of the remedies sought, including the penalties or consequences sought to be imposed;

(5) a disclosure that the respondent is entitled to:

(A) be represented by an attorney of respondent's choice;

(B) directly or through an attorney contest the admissibility of evidence and cross-examine the witnesses against the respondent; and

(C) respond and present evidence and argument in respondent's behalf pursuant to Government Code, §2001.051(2) and §2001.087;

(6) a disclosure that the failure of respondent to appear at the hearing will be considered a waiver of respondent's rights under paragraph (5) of this subsection;

(7) a copy of this chapter included as an attachment;

(8) the name, title, address, and phone number of the person handling the administrative action for the agency and to whom the respondent or the respondent's attorney should direct inquiries regarding additional information, detail, or further discussion or negotiation in connection with the administrative action; and

(9) such other information as may be required under the substantive law governing the particular proceeding.

(c) Notice of an action that is not required to be preceded by a hearing, but that requires a party to be advised of a right to hearing before the action becomes final, must contain a notice that a written request for a hearing under the Administrative Procedure Act must be delivered to the agency by a specific date certain or the administrative action will become final. The notice must explain fully how a hearing may be requested and contain such other information as may be required under the substantive law governing the particular proceeding.

(d) In a case in which restitution is sought, the notice of hearing (or an amended or supplemental notice or pleading served a sufficient time before the hearing to provide respondent with fair notice of the claim and a reasonable opportunity to defend) shall contain, in plain language, pertinent information regarding why the agency seeks restitution, for whom it is sought, the aggregate amount of restitution anticipated, and a citation to the specific statutory provision under which the restitution claim is made. A claim for restitution, like any other notice or pleading under these rules, is subject to a motion for more definite statement.

Source: *The provisions of this §9.11 adopted to be effective November 13, 1997, 22 TexReg 10951; amended to be effective January 9, 2011, 35 TexReg 11849.*

§9.12. Default. If, after served with notice in compliance with §9.11 of this title (relating to Notice and Initiation of Proceedings), a party fails to attend a hearing, the administrative law judge may proceed in that party's absence and, where appropriate, may issue a proposal for decision against that party. The proposal for decision shall be served upon the defaulting party and the party will be afforded the opportunity to contest the law as stated in the proposal for decision, but shall be deemed to have waived the right to contest the evidence, cross-examine the witnesses, and present an affirmative case or defense.

Source: *The provisions of this §9.12 adopted to be effective November 13, 1997, 22 TexReg 10951.*

§9.13. Appearances and Representation. (a) Because contested case procedures are closely modeled upon those used in a court of law, the agency strongly urges but does not require parties to employ attorneys for representation. Only licensed attorneys may file pleadings, make written or oral arguments or objections to evidence, or examine witnesses in agency hearings, except that:

(1) a natural person may appear "pro se" (without an attorney) in his or her own behalf;

(2) a company or an employee of the company may appear through a bona fide officer or employee of the company even if the representative is not a lawyer; and

(3) a party may appear through an out-of-state attorney, qualified law student, or an unlicensed law school graduate under the same conditions as would govern an appearance by the representative in state court.

(b) In making an appearance at an agency hearing, each party and each representative shall obey the same rules of ethics and professional conduct that govern a licensed attorney in this state.

Source: *The provisions of this §9.13 adopted to be effective November 28, 1995, 20 TexReg 9407; amended to be effective March 11, 2004, 29 TexReg 2301.*

§9.14. Protests. Protests shall be allowed to the extent authorized by law applicable to each agency and type of proceeding. A protestant must include a certificate of service on any protest showing that a copy has been served on the applicant. Every protest must be accompanied by any filing fees required by law.

Source: *The provisions of this §9.14 adopted to be effective November 13, 1997, 22 TexReg 10951.*

§9.15. Party Status; Participation by General Public. (a) Every person or entity named or admitted as a party to a contested case has an equal right to participate fully in all stages of the proceeding.

(b) Party status is limited to persons or entities with a legal right, duty, privilege, power, or economic interest that may be directly affected by the outcome of the proceeding or who are entitled to be parties pursuant to a statute or regulation governing the particular proceeding.

(c) Party status will not be conferred on persons or entities that:

(1) only have an interest in the outcome of the proceeding that is common to members of the general public;

(2) seek to litigate issues that are not by statute or regulation made part of the administrative proceeding in which party status is sought; or

(3) are not among the persons or entities described by statute or regulation as eligible to participate in the particular type of administrative proceeding in which party status is sought.

(d) The administrative law judge has discretion to allow a member of the general public who has not been admitted as a party to testify under oath or affirmation in a contested case. The administrative law judge may set fair and reasonable conditions on such an appearance, and the testimony shall be subject to cross-examination, challenge and rebuttal. After affording all parties a reasonable opportunity to be heard on this issue, the administrative law judge shall determine the extent, if any, to which a member of the general public who is not a party will be allowed to participate in a contested case.

Source: *The provisions of this §9.15 adopted to be effective November 13, 1997, 22 TexReg 10951.*

§9.16. Pleadings. (a) Required pleadings in agency hearings consist of such applications, protests, notices, or requests for hearing as are required under the substantive law governing each particular type of proceeding.

(b) When an application for an original license or renewal license has been denied based on the applicant's criminal history, the applicant shall have the burden of pleading and proving affirmative defenses to establish that the applicant is entitled to the license under Chapter 53 of the Occupations Code (related to the collateral consequences of a criminal conviction) or any mitigating facts related to the applicant's convictions or deferred adjudications.

(c) In addition, a party may file such other pleadings as the party considers appropriate to fully explain and present the party's side of the case. A party who wishes to raise an "affirmative defense" as defined in Texas Rules of Civil Procedure, Rule 94, must notify the agency in writing at least seven days before the hearing unless the administrative law judge allows a shorter notification period pursuant to Texas Rules of Civil Procedure, Rule 63.

(d) If a pleading is so vague or ambiguous that a party is unable to fully understand what is intended to be placed in issue, the party may move for a more definite statement and the administrative law judge shall grant the motion if it is well taken and direct that a more definite statement be made.

Source: *The provisions of this §9.16 adopted to be effective November 13, 1997, 22 TexReg 10951; amended to be effective March 11, 1999, 24 TexReg 1611; amended to be effective August 28, 2008, 33 TexReg 6808.*

§9.17. Motions, Pleas and Other Written Requests for an Order or Ruling. (a) A party applying to the administrative law judge for an order or ruling shall do so by written motion, plea, or other form of written request unless an oral motion, plea, or request is made during a hearing, conference, or telephone conference call of which all parties had advance notice with a reasonable opportunity to participate. The parties shall send copies of all pleadings and responses subject to this section to one another (through their attorneys if represented by counsel), and shall include a certificate of service on such documents attesting they have done so. Each pleading subject to this section shall specify the grounds on which the relief or order is sought and the legal basis for the relief or order.

(b) The administrative law judge shall allow all parties a reasonable amount of time to be heard before ruling on a pleading subject to this section unless the pleading is for:

(1) a continuance or an extension of time due to an emergency and reasonable attempts to reach opposing counsel have been unsuccessful;

(2) an order to which all parties have agreed; or

(3) a temporary emergency order until a hearing can be held.

(c) The administrative law judge has discretion to order oral or written argument or an evidentiary hearing on a pleading subject to this section as needed to clarify the issues and decide them properly.

(d) An application for a subpoena may be requested and issued ex parte and is not subject to this section.

Source: *The provisions of this §9.17 adopted to be effective November 13, 1997, 22 TexReg 10951.*

§9.18. Issuance of Subpoenas. On the administrative law judge's own motion or on the written request of a party to a contested case pending before one of the finance commission agencies, the administrative law judge may issue a subpoena addressed to the sheriff or to a constable to require the attendance of a witness or the production of books, records, papers, or other objects that may be necessary and proper for the purposes of a proceeding if:

(1) good cause is shown; and

(2) for a subpoena requested by a party to a contested case, an amount is deposited that will reasonably ensure payment of the amounts estimated to be due under Government Code, §2001.103.

Source: *The provisions of this §9.18 adopted to be effective August 28, 2008, 33 TexReg 6809.*

§9.19. Continuances. Motions for continuance must be in writing and filed not less than five calendar days prior to the hearing, except for good cause shown. Motions must set forth the specific grounds upon which the moving party seeks continuance, make reference to all similar motions filed in the case, and state whether all parties agree with the continuance. The administrative law judge may not grant a continuance without consultation with all parties except in the event of an emergency after a bona fide effort to reach other parties to the case has been unsuccessful.

Source: *The provisions of this §9.19 adopted to be effective November 13, 1997, 22 TexReg 10951.*

§9.20. Prehearing Conferences. (a) Sua sponte or on the motion of any party, the administrative law judge may direct that the parties or their authorized representatives appear at a prehearing conference to consider any of the matters specified in Rule 166, Texas Rules of Civil Procedure (other than those matters having to do with trial by jury).

(b) In the administrative law judge's discretion, the prehearing conference may be formal or informal, may be conducted in person or by telephone, and may be conducted with or without a court reporter. In the event that no court reporter is used, the administrative law judge shall prepare or may direct the parties to prepare a memorandum encompassing any agreements reached and decisions made.

Source: *The provisions of this §9.20 adopted to be effective November 13, 1997, 22 TexReg 10951.*

§9.21. Discovery. (a) Parties may use all permissible forms of discovery authorized in the Texas Rules of Civil Procedure in accordance with and subject to the limitations provided therein. A party may apply to the administrative law judge for issuance of a commission to take a deposition only if the parties disagree on its scheduling or scope. Procedures for obtaining a ruling on objections or on a motion to compel compliance with discovery must comply with the Rule of Civil Procedure that relates to the particular form of discovery on which a ruling is sought.

(b) A motion regarding discovery must contain a certificate that efforts to resolve the discovery dispute without intervention by the administrative law judge have been attempted and failed.

(c) Due to space limitations, parties should not file a discovery document with the administrative law judge unless the document contains information material to an issue upon which a ruling is requested or is to be introduced into evidence.

(d) In the interest of justice and for good cause shown, the administrative law judge may enter a discovery order superceding a rule of discovery that might otherwise be applicable.

Source: *The provisions of this §9.21 adopted to be effective November 13, 1997, 22 TexReg 10951; amended to be effective March 11, 2004, 29 TexReg 2301.*

§9.22. Protective Orders; Motions To Compel. All exemptions and privileges recognized under Texas law are recognized in agency hearings to the same extent as they are recognized in civil cases in the courts of this state. If a party or witness is asked to reveal privileged material or conversations, the party may make a motion with the administrative law judge for such protective orders as are reasonable and necessary or may refuse to provide the information and assert the privilege in response to a motion to compel. The administrative law judge shall hold such hearings and issue such orders on motions to compel or requests for protective orders as are required by the law applicable to the facts and circumstances of the case.

Source: *The provisions of this §9.22 adopted to be effective November 13, 1997, 22 TexReg 10951.*

§9.23. Summary Judgment. (a) At any time after a notice of hearing is issued, a party may move for a summary judgment on all or any part of a claim or defense.

(b) Except as set out in this section, the finance commission agencies adopt, by reference, the summary judgment procedure in Rule 166a, Texas Rules of Civil Procedure. In addition, the following requirements shall also apply:

(1) The administrative law judge shall hear oral argument on all motions for summary judgment unless the judge expressly waives this requirement.

(2) Before filing the motion, the party moving for summary judgment, in consultation with the administrative law judge's clerk, must schedule the motion for submission on oral argument at least 21 days after the date on which it is filed. If there is an applicable statutory deadline by which the agency must hold a hearing, the submission date must be within the deadline unless it has been waived by both parties.

(3) The party moving for summary judgment must serve on all opposing parties, with a copy of the motion for summary judgment, a notice containing the following information:

(A) the time, date, and place when the administrative law judge will hear oral argument on the motion;

(B) disclosure that any party opposing the motion must file affidavits, other written material, and any cross-claims or counterclaims, with the administrative law judge by the close of business seven days before the date of submission on oral argument;

(C) disclosure that the administrative law judge may take the allegations in the motion as true unless contested by opposing parties through affidavits or other written material; and

(D) disclosure that the administrative law judge will not hear any oral testimony related to the motion.

(4) If one of the agencies files the motion for summary judgment, the agency head or the administrative law judge must sign the notice.

(5) In the administrative law judge's discretion, the judge may set the motion for summary judgment on

the same date as an evidentiary hearing scheduled in the cause which is the subject of the motion for summary judgment.

(6) The administrative law judge's proposal for decision recommending summary judgment shall be circulated for exceptions, replies to exceptions, and the filing of briefs before it is sent to the agency heads in compliance with §9.34 of this title (relating to Post-hearing Proceedings).

Source: *The provisions of this §9.23 adopted to be effective August 28, 2008, 33 TexReg 6809.*

§9.25. The Hearing. (a) The administrative law judge has authority analogous to that of a district judge sitting without a jury in a civil case and may make such rulings and issue such orders as may be required to provide a fair, just, expeditious, orderly, and proper hearing. Hearings are open to the public, except that matters made confidential by law must be considered in executive session if requested. If an executive session is not requested before confidential evidence is introduced, the confidentiality of such evidence is considered to have been waived.

(b) At the time and place set for hearing, the administrative law judge shall proceed with the hearing as nearly as may be according to the rules of procedure governing the trial of civil cases in the courts of this state. The party with the burden of proof shall present such party's case, followed by other parties in the sequence assigned by the administrative law judge. Each party shall have the opportunity to present such party's case, by calling and examining witnesses, offering documentary evidence, and making legal arguments. Each party shall have the opportunity to contest the admissibility of evidence and cross-examine opposing witnesses on any matter relevant to the issues even if the matter was not covered in direct examination. A party must make an objection to testimony or an evidentiary offer in a timely manner, stating the basis for the objection, or the objection is waived.

(c) In a case involving an original application for a license, the burden of proof is on the applicant. In cases involving an order to cease and desist, the imposition of penalties, the collection of restitution for violations of law, or an agency's failure to renew an existing license, the burden of proof is on the agency.

(d) A party pleading an "affirmative defense" as defined in Texas Rules of Civil Procedure, Rule 94, has the burden to prove that defense.

(e) The assertion that an applicant for an original or renewal license qualifies for the license under Chapter 53 of the Occupations Code (related to the collateral consequences of a criminal conviction) is an affirmative defense. The applicant for the original or renewal license has the burden to prove the satisfaction of the conditions on which the applicant would be entitled to the license under the Occupations Code. The existence of mitigating circumstances related to a criminal conviction is an affirmative defense. The applicant for an original or renewal license has the burden to prove the existence of such mitigating circumstances.

(f) Unless otherwise provided by statute, the burden of proof shall be by a preponderance of the evidence.

(g) If an applicant for an original license application fails to appear at a scheduled hearing and the agency can prove proper service of notice of the hearing, the administrative law judge may deny the application based on the applicant's failure to carry its burden of proof. If the respondent fails to appear at a hearing in which the agency has the burden of proof, the agency attorney must prove actual or constructive service of a notice of hearing and must present evidence sufficient to prove the agency's case. Failure of the respondent to answer or to appear and contest the agency's case may be considered as some evidence supporting an adverse inference that respondent could not defend or rebut the agency's case.

Source: *The provisions of this §9.25 adopted to be effective August 28, 2008, 33 TexReg 6809.*

§9.26. Applicability of Texas Rules of Evidence. (a) The Texas Rules of Evidence, as applied in non-jury cases in the courts of Texas, apply in contested cases under this subchapter. The administrative law judge shall exclude irrelevant, immaterial, or unduly repetitious evidence. When necessary to ascertain facts not reasonably susceptible of proof under those rules, the administrative law judge may admit evidence not admissible under those rules, except where precluded by law, if of a type commonly relied upon by reasonably prudent persons in the conduct of their affairs. Letters and affidavits are not admissible into evidence in contested case hearings unless they satisfy an exception to the hearsay rule or come into evidence without objection.

(b) In cases arising under Occupations Code, Chapter 53 (related to consequences of criminal conviction), letters of recommendation will be considered by a finance agency if submitted during the investigative stage of the licensing proceeding but will not be admitted into evidence at the hearing unless the letter satisfies an exception to the hearsay rule or comes into evidence without objection. A party must arrange to have all character witnesses give testimony in person or, with advance notice to opposing counsel, by phone pursuant to and in accordance with §9.32 of this title (relating to Telephone Hearings).

Source: *The provisions of this §9.26 adopted to be effective November 13, 1997, 22 TexReg 10951; amended to be effective November 8, 2007, 32 TexReg 7895; amended to be effective August 28, 2008, 33 TexReg 6808.*

§9.27. Facts Not Reasonably Susceptible of Proof under Rules of Evidence. The administrative law judge will treat the Texas Administrative Procedure Act exception under Government Code, §2001.081 (providing for the admission of evidence "not admissible under the Texas Rules of Evidence if of a type commonly relied upon by reasonably prudent persons in the conduct of their affairs"), as identical to Federal Rule of Evidence 807, i.e., the administrative law judge will admit evidence pursuant to this exception only if the administrative law judge finds that:

(1) although not covered by any of the exceptions listed in Rule 803, Texas Rules of Evidence, the statement has equivalent circumstantial guarantees of trustworthiness to the exceptions listed in the rule;

(2) the fact the statement is offered to prove is material;

(3) the statement is more probative on the point for which it is offered than any other evidence that the proponent can procure through reasonable efforts;

(4) the interests of justice will be served by the statement's admission into evidence; and

(5) a reasonable time before the hearing, the statement's proponent furnished opposing parties with a copy of the statement and the name and address of the declarant (or information regarding where the statement was published) and of the intent of the statement's proponent to introduce the statement into evidence at the hearing so that opposing parties had a fair opportunity to anticipate the statement and rebut, explain, or contest it.

Source: *The provisions of this §9.27 adopted to be effective November 13, 1997, 22 TexReg 10951; amended to be effective March 15, 2007, 32 TexReg 1231.*

§9.28. Prefiled Testimony. On the judge's own motion, or the motion of any party, the administrative law judge may omit oral presentation of the direct testimony of any witness and may allow prefiled written testimony to be presented in its place. The written testimony carries the same force and effect as though stated orally by the witness; provided that the witness must be present at the hearing at which such testimony is offered and adopt such testimony under oath, and must be made available for cross-examination. Written reports of agency investigations on fact issues, if offered into evidence in a hearing in which the facts covered by the report are directly at issue, will be treated as prefiled testimony and the investigator must be made available for cross-examination unless the investigator is unavailable to the agency as a witness or unless the report comes into evidence without objection. If the investigator is unavailable to the agency as a witness, the report shall be admissible under Rule 803, Texas Rules of Evidence if it meets the requirements for admission into evidence under that rule. For purposes of this section "unavailability as a witness" has the same meaning as in Rule 804(a), Texas Rules of Evidence.

Source: *The provisions of this §9.28 adopted to be effective November 13, 1997, 22 TexReg 10951; amended to be effective January 8, 2009, 34 TexReg 42.*

§9.29. Stipulations. Parties may by written stipulation, or by oral stipulation on the record, agree upon the facts and their stipulation may be regarded and used as evidence at the hearing. The administrative law judge in such cases may require any additional evidence necessary to establish the facts to the administrative law judge's satisfaction.

Source: *The provisions of this §9.29 adopted to be effective November 13, 1997, 22 TexReg 10951; amended to be effective August 28, 2008, 33 TexReg 6808.*

§9.30. Official Notice. The administrative law judge may take official notice of judicially cognizable facts, and of generally recognized facts within the area of the agency's specialized knowledge. A party that desires the administrative law judge to take official notice of particular facts must make a motion that the administrative law judge do so, stating with specificity the facts, material, records, or documents encompassed in the motion. A party who opposes the motion will have the opportunity to contest the requested action. The administrative law judge may also sua sponte take official notice of facts, material, records, or documents on giving the parties an opportunity to contest the facts, material, records, or documents to be officially noticed.

Source: *The provisions of this §9.30 adopted to be effective November 13, 1997, 22 TexReg 10951.*

§9.31. Reporters and Transcripts. In all proceedings when requested by the administrative law judge, the agency, or by any party, a court reporter shall make a stenographic record of the hearing.

Source: *The provisions of this §9.31 adopted to be effective November 13, 1997, 22 TexReg 10951.*

§9.32. Telephone Hearings. (a) Sua sponte or on motion of any party and a showing of good cause, after reasonable notice to all parties to allow them to object and argue against the procedure, the administrative law judge may conduct all or part of a hearing by telephone or other electronic means. In determining whether to allow testimony by telephone or other electronic means, the administrative law judge shall consider all relevant factors including whether the motion is opposed, the cost and feasibility of the witness being present at the hearing instead of appearing by telephone or other electronic means, the nature and duration of the expected testimony, the nature of any exhibits expected to be introduced through the witness, whether there is a good reason that the witness is unavailable to testify in person, and the extent to which the demeanor and credibility of the witness are likely to be significant factors in weighing the witness' testimony. In deciding a motion under this section, the administrative law judge shall ensure that substantive and procedural rights of all parties are respected.

(b) Documentary evidence to be offered during a telephone hearing must be delivered by the proponent to all parties and to the administrative law judge prior to hearing.

(c) In a telephone hearing, the administrative law judge may consider the following as a failure to appear if the conditions exist for more than 20 minutes after the scheduled time for hearing:

(1) failure to answer the telephone;

(2) failure to free the telephone for a hearing; or

(3) failure to be ready to proceed with the hearing as scheduled.

Source: *The provisions of this §9.32 adopted to be effective November 13, 1997, 22 TexReg 10951; amended to be effective January 9, 2011, 35 TexReg 11849.*

§9.33. Mediation. The administrative law judge may arrange for the services of a qualified mediator to work with the parties and attempt to bring about a settlement. The administrative law judge may assess costs of the mediator's services against the parties in the same manner as other costs or may require advance payment. The mediation ends when successful or when a party decides that such party no longer wishes to participate in the mediation. The parties shall immediately inform the administrative law judge when the mediation ends. An offer to compromise or a statement made during mediation may not be admitted into evidence or considered for any purpose in the hearing of a case in which mediation was attempted.

Source: *The provisions of this §9.33 adopted to be effective November 13, 1997, 22 TexReg 10951.*

§9.34. Post-hearing Proceedings. (a) Following the hearing the administrative law judge upon request shall give the parties an opportunity to file written briefs and proposed findings of fact and conclusions of law. Pursuant to Government Code, §2001.062, the administrative law judge shall review these materials and all evidence and testimony, and prepare a proposal for decision containing a statement of the reasons for the proposed decision and of each finding of fact and conclusion of law necessary to the proposed decision. The administrative law judge shall also prepare a proposed final order for the agency head to sign adopting the proposed decision. Upon completion, the administrative law judge shall serve copies of the proposal for decision and proposed final order on all parties and give each adversely affected party an opportunity to file exceptions and present briefs. If a party files exceptions or presents briefs, the administrative law judge shall give an opportunity to other parties to file replies to the exceptions or briefs. Exceptions, replies to exceptions, and related briefs must be filed within deadlines established by the administrative law judge. The administrative law judge may amend the proposal for decision and proposed final order in response to the exceptions, replies, or briefs submitted. If the administrative law judge makes substantive revisions, the administrative law judge shall circulate the amended proposal for decision and proposed final order to the parties for additional exceptions and briefs before submitting the proposal for decision and the proposed final order based thereon to the agency head(s) for approval.

(b) After the administrative law judge has circulated the proposal for decision and proposed order to the parties and the parties have had an opportunity to file exceptions and briefs in the manner provided in subsection (a) of this section, the administrative law judge shall submit the proposal for decision and proposed order together with all materials listed in Government Code, §2001.060, to the agency head(s) for review. No additional briefs may be submitted after the case is under submission to the agency head(s) for decision unless requested by the agency head(s). The agency head(s) may:

(1) adopt the proposal for decision and proposed final order, in whole or in part;

(2) modify and adopt the proposal for decision and proposed final order, in whole or in part;

(3) decline to adopt the proposal for decision and proposed final order, in whole or in part;

(4) remand the proceeding for further examination by the administrative law judge, including for the limited purpose of receiving additional briefing or evidence from the parties on specific issues; or

(5) take another lawful and appropriate action with regard to the case.

(c) If a court renders a decision that may be pertinent to the outcome of the case after it is under submission to the agency head, a party may direct the agency's attention to such decision by a cover letter transmitting a copy of the decision to the administrative law judge and agency head(s) (at the same time furnishing a copy to opposing parties). The cover letter may reference the case to which the decision pertains but may not contain arguments.

(d) If remand pursuant to subsection (b) of this section results in a substantially revised proposal for decision and order, the administrative law judge shall circulate the revised proposal for decision and order to the parties for additional exceptions and replies in the manner provided by subsection (a) of this section. After the parties have had an opportunity to file additional exceptions and replies, the administrative law judge shall submit the revised proposal for decision and order, together with the supplemental record, to the agency head(s) for consideration in the manner provided by subsection (b) of this section.

Source: *The provisions of this §9.34 adopted to be effective November 13, 1997, 22 TexReg 10951; amended to be effective July 2, 1998, 23 TexReg 6714.*

§9.35. Dismissal. Following notice to all affected parties and the opportunity for hearing, the administrative law judge with the consent of the agency head may dismiss any contested case, with or without prejudice, under such conditions and for such reasons as are found just and reasonable, including the following:

(1) failure to prosecute;

(2) unnecessary duplication of proceedings or res judicata;

(3) withdrawal;

(4) moot questions or obsolete petitions;

(5) lack of jurisdiction;

(6) abuse of discovery;

(7) refusal to observe proper decorum or obey orders of the administrative law judge made within the scope of authority; or

(8) if necessary in the interest of justice.

Source: *The provisions of this §9.35 adopted to be effective November 13, 1997, 22 TexReg 10951.*

§9.36. Disruption of Hearing. To preserve decorum and ensure the orderly administration of hearings conducted on behalf of the finance commission agencies, the administrative law judge may expel a person from a contested case hearing and impose appropriate sanctions if that person engages in conduct that disrupts the hearing.

Source: *The provisions of this §9.36 adopted to be effective November 13, 1997, 22 TexReg 10951.*

§9.37. Sanctions. (a) Sua sponte or on motion of a party and after notice and an opportunity for a hearing and subject to approval by the agency head on behalf of which the hearing is being conducted, the administrative law judge may impose appropriate sanctions as provided by subsection (b) of this section against a party or its representative for:

(1) filing a motion or pleading that is groundless and brought:

(A) in bad faith;

(B) for the purpose of harassment; or

(C) for any other improper purpose, such as to cause unnecessary delay or needless increase in the cost of the proceeding;

(2) abuse of the discovery process in seeking, making, or resisting discovery; or

(3) failure to obey an order of the administrative law judge.

(b) A sanction imposed under subsection (a) of this section may include, as appropriate and justified, issuance of an order:

(1) disallowing further discovery of any kind or of a particular kind by the offending party;

(2) charging all or any part of the expenses of discovery against the offending party or its representatives;

(3) holding that designated facts be considered admitted for purposes of the proceeding;

(4) refusing to allow the offending party to support or oppose a designated claim or defense or prohibiting the party from introducing designated matters in evidence;

(5) disallowing in whole or in part requests for relief by the offending party and excluding evidence in support of those requests;

(6) striking pleadings or testimony, or both, in whole or in part; or

(7) imposing any other sanction that the agency head with jurisdiction in the case could have imposed if the agency head had personally presided in hearing the case.

Source: *The provisions of this §9.37 adopted to be effective November 13, 1997, 22 TexReg 10951.*

§9.38. Recovery of Agency Costs. The administrative law judge may allocate costs incurred by the agency among the parties in accordance with applicable law. Notwithstanding any other provision of agency rules, the administrative law judge may impose costs that are solely or primarily attributable to a particular party against that party.

Source: *The provisions of this §9.38 adopted to be effective November 13, 1997, 22 TexReg 10951.*

§9.39. Disposition of Exhibits. The agency may dispose of exhibits after a case is final in the manner provided in Texas Rules of Civil Procedure, Rule 14b, and the order of the Texas Supreme Court adopted pursuant to Rule 14b effective January 1, 1988.

Source: *The provisions of this §9.39 adopted to be effective March 11, 1999, 24 TexReg 1611.*

Subchapter C. Appeals to Finance Commission

§9.51. Time Deadlines for Appeal to the Finance Commission Mandatory. The administrative law judge does not have authority to grant an extension of the time periods provided for perfecting an appeal to the finance commission.

Source: *The provisions of this §9.51 adopted to be effective November 28, 1995, 20 TexReg 9407.*

§9.52. Motion for Rehearing. A motion for rehearing in the manner and within the time required in Government Code, §2001.145, is a prerequisite to an appeal to the finance commission in a contested case, except that a motion for rehearing is not a prerequisite to an appeal of a decision or order that is final and effective on the date rendered. A motion for rehearing must state the claimed error with specificity. Responses to the motion must be filed and the motion must be ruled upon by the agency within the time periods specified in Government Code, §2001.146.

Source: *The provisions of this §9.52 adopted to be effective November 28, 1995, 20 TexReg 9407.*

§9.54. Application for Review. (a) The application for review must be filed within 30 days of notification that the motion for rehearing has been overruled, or within 30 days of the date that it is overruled by operation of law, or within 30 days of a decision or order that is final and effective on the date rendered.

(b) The application must state the identities of the parties, the action complained of, the interests of the parties, specific objections, the action sought from the finance commission, and also contain any other information and be accompanied by any fees required by statute or administrative regulation.

Source: *The provisions of this §9.54 adopted to be effective November 28, 1995, 20 TexReg 9407.*

§9.55. Scope of Review. The finance commission shall consider the questions raised by the application for review and may also consider such additional matters pertinent to the appeal as it may determine, whether or not included in the application. Decisions by the finance commission must be based on testimony and other evidence in the record. The finance commission may adopt or decline to adopt the agency head's decision and the underlying findings of fact and conclusions of law in whole or in part. The finance commission may remand the proceeding for further consideration by the agency head with or without reopening the hearing. The finance commission may take any other action it considers to be just and reasonable, as permitted by law.

Source: *The provisions of this §9.55 adopted to be effective November 28, 1995, 20 TexReg 9407.*

§9.56. Oral Argument before the Finance Commission. A party may request oral argument to the finance commission by separate pleading or include a request for oral argument in its review application. The finance commission, in its discretion, may grant or deny the request. If granted, the amount of time allotted and the issues on which oral argument is allowed are within the finance commission's discretion. The finance commission may deny the request for oral argument but request that the parties be present at the meeting at which the case is to be considered to address any questions that finance commission members may have.

Source: *The provisions of this §9.56 adopted to be effective November 28, 1995, 20 TexReg 9407.*

§9.57. Interim Appeals. A party may not make an interim appeal to the finance commission except as specifically provided for by statute or by rule adopted by the finance commission.

Source: *The provisions of this §9.57 adopted to be effective November 28, 1995, 20 TexReg 9407.*

Subchapter D. Court Appeals

§9.71. Appeals to the Courts. Appeals to the courts shall be as provided by statute and applicable case law.

Source: *The provisions of this §9.71 adopted to be effective November 28, 1995, 20 TexReg 9407.*

§9.72. Administrative Record. The party appealing an agency order to the courts must pay the agency the cost of preparing the copy of the record that is to be transmitted to the reviewing court at rates approved by the Office of the Attorney General. If more than one party appeals the agency's order, the cost of the preparation of the record may be divided equally among the appealing parties or as agreed by the parties.

Source: *The provisions of this §9.72 adopted to be effective November 28, 1995, 20 TexReg 9407; amended to be effective January 9, 2011, 35 TexReg 11849.*

Subchapter E. Rulemaking

§9.81. Rulemaking. Rulemaking proceedings must comply with Government Code, Chapter 2001, Subchapter B (§§2001.021 et seq.).

Source: *The provisions of this §9.81 adopted to be effective November 28, 1995, 20 TexReg 9407; amended to be effective March 12, 1998, 23 TexReg 2285.*

§9.82. Petitions To Initiate Rulemaking Proceedings. Petitions to initiate rulemaking proceedings pursuant to Government Code, §2001.021, must be submitted to the agency in writing. A petition must include:

(1) a brief explanation of the proposed rule;

(2) the full text of the proposed rule, and, if the petition is to modify an existing rule, the text of the proposed rule prepared in the same manner as an amendment to legislation that clearly identifies any words to be added or deleted from the existing text by underlining new language and striking through language to be deleted;

(3) a concise explanation of the legal authority to adopt the proposed rule, including a specific reference to the particular statute or other authority that authorizes it;

(4) an explanation of how the public would be benefitted by the adoption of the proposed rule;

(5) all available data or information showing a need for the proposed rule; and

(6) such other or additional information as the agency may request.

Source: *The provisions of this §9.82 adopted to be effective November 28, 1995, 20 TexReg 9407.*

§9.83. Agency Action on Petitions To Initiate Rulemaking Proceedings. (a) When the agency receives a rulemaking petition, the agency shall review it for compliance with the requirements of §9.82 of this title (relating to Petitions To Initiate Rulemaking). If the petition is determined to comply, the agency shall notify the applicant that it has been accepted for filing and the petition will be processed in accord with Government Code, §2001.021(c). If the petition is determined not to comply, the agency shall notify the applicant in writing of all deficiencies found and give the petitioner an opportunity to cure them by filing an amended petition. If no amended petition curing the deficiencies is filed with the agency by 5:00 p.m. on the 15th day following the date that the agency mailed a notice of deficiencies to the applicant, the petition shall be deemed denied for the reasons stated in the deficiency notice without the necessity of further action.

(b) If a petition is accepted for filing, within 60 days of the date that the petition was accepted for filing, the agency must either deny the petition for reasons stated in writing or initiate a rulemaking proceeding.

Source: *The provisions of this §9.83 adopted to be effective November 28, 1995, 20 TexReg 9407.*

§9.84. Hearings on Proposed Rules. (a) The agency shall grant an opportunity for a public hearing before adoption of any proposed rule as required by Government Code, §2001.029(b), or other applicable statute.

(b) The hearing may be held by the agency head(s) or by the administrative law judge or by any other person designated by the agency head(s). In the exercise of discretion, the agency head(s) may impose reasonable time limits on presentation of evidence and argument, determine the order of the presentations, and conduct the hearing in a manner suitable to the particular proceeding. Public hearings on proposed rules are neither contested cases nor full legal adversary proceedings. Ex parte prohibitions do not apply.

Source: *The provisions of this §9.84 adopted to be effective November 28, 1995, 20 TexReg 9407; amended to be effective March 12, 1998, 23 TexReg 2285.*

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CHAPTER 10. CONTRACT PROCEDURES

Subchapter A. Negotiation and Mediation

Subchapter B. Contract Protests

CHAPTER 10. CONTRACT PROCEDURES

Subchapter A. Negotiation and Mediation

§10.1. Purpose and Application. This subchapter governs the negotiation and mediation of a claim of breach of contract asserted by a contractor against a Finance Unit of state government, under Government Code, Chapter 2260.

Source: *The provisions of this §10.1 adopted to be effective November 7, 2010, 35 TexReg 9694.*

§10.2. Definitions. The following words and terms, when used in this chapter, shall have the following meaning, unless the context clearly indicates otherwise:

(1) Chief administrative officer--The commissioner, executive director, president or other executive officer responsible for the day to day operations of a unit of state government, or that person's designee.

(2) Commission--The Finance Commission of Texas.

(3) Contract Protest Officer--The person or persons assigned by a Finance Unit to resolve disputes over the solicitation, evaluation, or award of a contract.

(4) Contractor--Independent contractor who has entered into a contract directly with a Finance Unit of state government. The term does not include:

(A) A contractor's subcontractor, officer, employee, agent, or other person furnishing goods or services to a contractor;

(B) An employee of a Finance Unit of state government; or

(C) A student at an institution of higher education.

(5) Day--A calendar day. If an act is required to occur on a day falling on a Saturday, Sunday, or holiday, the first working day which is not one of these days should be counted as the required day for purpose of this chapter.

(6) Finance Agency--The Texas Department of Banking, the Department of Savings and Mortgage Lending, or the Office of Consumer Credit Commissioner.

(7) Finance Unit of state government or Finance Unit--The Commission or any of the Finance Agencies.

(8) Interested parties--All vendors who have submitted bids, proposals or other expressions of interest for the provision of goods or services pursuant to a contract with a Finance Unit of state government.

(9) Parties--The contractor and Finance Unit of state government that have entered into a contract in connection with which a claim of breach of contract has been filed under this subchapter.

(10) Unit of state government--The state or an agency, department, commission, bureau, board, office, council, court, or other entity that is in any branch of state government and that is created by the constitution or a statute of this state, including a university system or institution of higher education. The term does not include a county, municipality, court of a county or municipality, special purpose district, or other political subdivision of this state.

Source: *The provisions of this §10.2 adopted to be effective November 7, 2010, 35 TexReg 9694.*

§10.3. Prerequisites to Suit. The procedures contained in this subchapter are exclusive and required prerequisites to suit under the Civil Practice and Remedies Code, Chapter 107, and the Government Code, Chapter 2260.

Source: *The provisions of this §10.3 adopted to be effective November 7, 2010, 35 TexReg 9694.*

§10.4. Sovereign Immunity. This subchapter does not waive a Finance Unit of state government's sovereign immunity to suit or liability.

Source: *The provisions of this §10.4 adopted to be effective November 7, 2010, 35 TexReg 9694.*

§10.5. Notice of Claim of Breach of Contract. (a) A contractor asserting a claim of breach of contract under the Government Code, Chapter 2260, shall file notice of the claim as provided by this section.

(b) The notice of claim shall:

(1) be in writing and signed by the contractor or the contractor's authorized representative;

(2) be delivered by hand, certified mail return receipt requested, or other verifiable delivery service, to the officer of the Finance Unit of state government designated in the contract to receive a notice of claim of breach of contract under the Government Code, Chapter 2260; if no person is designated in the contract, the notice shall be delivered to the Finance Unit's chief administrative officer; and

(3) state in detail:

(A) the nature of the alleged breach of contract, including the date of the event that the contractor asserts as the basis of the claim and each contractual provision allegedly breached;

(B) a description of damages that resulted from the alleged breach, including the amount and method used to calculate those damages; and

(C) the legal theory of recovery, i.e., breach of contract, including the relationship between the alleged breach and the damages claimed.

(c) The notice of claim shall be delivered no later than 180 calendar days after the date of the event that the contractor asserts as the basis of the claim.

Source: *The provisions of this §10.5 adopted to be effective November 7, 2010, 35 TexReg 9694.*

§10.6. Agency Counterclaim. *(*a) A Finance Unit of state government asserting a counterclaim under the Government Code, Chapter 2260, shall file notice of the counterclaim as provided by this section.

(b) The notice of counterclaim shall:

(1) be in writing;

(2) be delivered by hand, certified mail return receipt requested or other verifiable delivery service to the contractor or representative of the contractor who signed the notice of claim of breach of contract; and

(3) state in detail:

(A) the nature of the counterclaim;

(B) a description of damages or offsets sought, including the amount and method used to calculate those damages or offsets; and

(C) the legal theory supporting the counterclaim.

(c) The notice of counterclaim shall be delivered to the contractor no later than 60 calendar days after the Finance Unit of state government's receipt of the contractor's notice of claim.

(d) Nothing in this subchapter precludes the Finance Unit of state government from initiating a lawsuit for damages against the contractor in a court of competent jurisdiction.

Source: *The provisions of this §10.6 adopted to be effective November 7, 2010, 35 TexReg 9694.*

§10.7. Duty to Negotiate. The parties shall negotiate in accordance with the timetable set forth in §10.8 of this subchapter (relating to Timetable) to attempt to resolve all claims and counterclaims filed under this subchapter. No party is obligated to settle with the other party as a result of the negotiation.

Source: *The provisions of this §10.7 adopted to be effective November 7, 2010, 35 TexReg 9694.*

§10.8. Timetable. (a) Following receipt of a contractor's notice of claim, the chief administrative officer of the Finance Unit of state government or other designated representative shall review the contractor's claim and the Finance Unit's counterclaim, if any, and initiate negotiations with the contractor to attempt to resolve the claim and counterclaim.

(b) Subject to subsection (c) of this section, the parties shall begin negotiations no later than 120 calendar days following the date the Finance Unit of state government receives the contractor's notice of claim.

(c) The Finance Unit of state government may delay negotiations until after the 180th day after the date of the event giving rise to the claim of breach of contract by:

(1) delivering written notice to the contractor that the commencement of negotiations will be delayed; and

(2) delivering written notice to the contractor when the Finance Unit of state government is ready to begin negotiations.

(d) The parties may conduct negotiations according to an agreed schedule as long as they begin negotiations no later than the applicable deadlines set forth in subsections (b) or (c) of this section, whichever is applicable.

(e) Subject to subsection (f) of this section, the parties shall complete the negotiations that are required by this subchapter as a prerequisite to a contractor's request for contested case hearing no later than 270 days after the Finance Unit of state government receives the contractor's notice of claim.

(f) The parties may agree in writing to extend the time for negotiations on or before the 270th day after the Finance Unit of state government receives the contractor's notice of claim. The agreement shall be signed by representatives of the parties with authority to bind each respective party.

(g) The contractor may request a contested case hearing before the State Office of Administrative Hearings (SOAH) pursuant to §10.13 of this title (relating to Request for Contested Case Hearing) after the 270th day after the Finance Unit of state government receives the contractor's notice of claim, or the expiration of any extension agreed to under subsection (f) of this section.

(h) The parties may agree to mediate the dispute at any time before the 120th day after the Finance Unit of state government receives the contractor's notice of claim and before the expiration of any extension agreed to by the parties pursuant to subsection (f) of this section. The mediation shall be governed by §§10.14 - 10.21 of this subchapter.

(i) Nothing in this section is intended to prevent the parties from commencing negotiations earlier than the deadlines established in subsections (b) and (c) of this section, or from continuing or resuming negotiations after the contractor requests a contested case hearing before SOAH.

Source: *The provisions of this §10.8 adopted to be effective November 7, 2010, 35 TexReg 9694.*

§10.9. Conduct of Negotiation. (a) Negotiation is a consensual bargaining process in which the parties attempt to resolve a claim and counterclaim. A negotiation under this subchapter may be conducted by any method, technique, or procedure authorized under the contract or agreed upon by the parties. The parties may conduct negotiations with the assistance of one or more neutral third parties. The parties may choose to mediate their dispute in accordance with §§10.14 - 10.21 of this subchapter.

(b) To facilitate meaningful evaluation and negotiation of the claims and any counterclaims, the parties may exchange relevant documents that support their respective claims, defenses, counterclaims or positions.

Source: *The provisions of this §10.9 adopted to be effective November 7, 2010, 35 TexReg 9694.*

§10.10. Settlement Approval Procedures. The parties' settlement approval procedures shall be disclosed prior to, or at the beginning of negotiations. To the extent possible, the parties shall select negotiators who are knowledgeable about the subject matter of the dispute, who are in a position to reach agreement and who can credibly recommend approval of an agreement.

Source: *The provisions of this §10.10 adopted to be effective November 7, 2010, 35 TexReg 9694.*

§10.11. Settlement Agreement. (a) A settlement agreement may resolve an entire claim or any designated and severable portion of a claim.

(b) To be enforceable, a settlement agreement must be in writing and signed by representatives of the contractor and the Finance Unit of state government who have authority to bind each respective party.

(c) A partial settlement does not waive a contractor's rights under the Government Code, Chapter 2260, as to the parts of the claim that are not resolved.

Source: *The provisions of this §10.11 adopted to be effective November 7, 2010, 35 TexReg 9694.*

§10.12. Costs of Negotiation. Unless the parties agree otherwise, each party shall be responsible for its own costs incurred in connection with a negotiation, including, without limitation, the costs or fees for attorneys, consultants and experts.

Source: *The provisions of this §10.12 adopted to be effective November 7, 2010, 35 TexReg 9694.*

§10.13. Request for Contested Case Hearing. (a) If a claim of breach of contract is not resolved in its entirety through negotiation or mediation in accordance with this subchapter on or before the 270th day after the Finance Unit of state government receives the notice of claim, or after the expiration of any extension agreed to by the parties pursuant to §10.8(f) of this subchapter (relating to Timetable), the contractor may file a request with the Finance Unit of state government for a contested case hearing before SOAH.

(b) A request for a contested case hearing shall state the legal and factual basis for the claim, and shall be delivered to the chief administrative officer of the Finance Unit of state government within a reasonable time after the 270th day or the expiration of any written extension agreed to pursuant to §10.8(f) of this subchapter.

(c) The Finance Unit of state government shall forward the contractor's request for a contested case hearing to SOAH within a reasonable period of time, not to exceed thirty days, after receipt of the request.

(d) The parties may agree to submit the case to SOAH before the 270th day after the notice of claim is received by the Finance Unit of state government if they have achieved a partial resolution of the claim or if an impasse has been reached in the negotiations and proceeding to a contested case hearing would serve the interests of justice.

Source: *The provisions of this §10.13 adopted to be effective November 7, 2010, 35 TexReg 9694.*

§10.14. Agreement to Mediate. The parties may agree to mediate a claim through an impartial third party. For purposes of this subchapter, "mediation" is assigned the meaning set forth in the Civil Practice and Remedies Code, §154.023. The mediation is subject to the provisions of the Governmental Dispute Resolution Act, Government Code, Chapter 2009. The parties may be assisted in the mediation by legal counsel or another individual.

Source: *The provisions of this §10.14 adopted to be effective November 7, 2010, 35 TexReg 9694.*

§10.15. Qualifications and Immunity of the Mediator. The mediator shall possess the qualifications required under the Civil Practice and Remedies Code, §154.052, be subject to the standards and duties prescribed by the Civil Practice and Remedies Code, §154.053 and have the qualified immunity prescribed by the Civil Practice and Remedies Code §154.055, if applicable.

Source: *The provisions of this §10.15 adopted to be effective November 7, 2010, 35 TexReg 9694.*

§10.16. Confidentiality of Mediation and Final Settlement Agreement. (a) A mediation conducted under this subchapter is confidential in accordance with the Government Code, §2009.054.

(b) The confidentiality of a final settlement agreement to which a Finance Unit of state government is a signatory that is reached as a result of the mediation is governed by the Public Information Act, Government Code, Chapter 552.

Source: *The provisions of this §10.16 adopted to be effective November 7, 2010, 35 TexReg 9694.*

§10.17. Costs of Mediation. Unless the parties agree otherwise in writing, each party shall be responsible for its own costs incurred in connection with a mediation, including without limitation, costs of document reproduction, fees for attorneys, consultants and experts, and the cost of the mediator shall be divided equally between the parties.

Source: *The provisions of this §10.17 adopted to be effective November 7, 2010, 35 TexReg 9694.*

§10.18. Settlement Approval Procedures. The parties' settlement approval procedures shall be disclosed by the parties prior to the mediation. To the extent possible, the parties shall select representatives who are knowledgeable about the subject matter of the dispute, who are in a position to reach agreement, and who can credibly recommend approval of an agreement.

Source: *The provisions of this §10.18 adopted to be effective November 7, 2010, 35 TexReg 9694.*

§10.19. Initial Settlement Agreement. Any settlement agreement reached during a mediation shall be signed by representatives of the contractor and the Finance Unit of state government, and shall describe any procedures that the parties must follow to obtain final and binding approval of the agreement.

Source: *The provisions of this §10.19 adopted to be effective November 7, 2010, 35 TexReg 9694.*

§10.20. Final Settlement Agreement. A final settlement agreement reached during or as a result of a mediation that resolves an entire claim or counterclaim, or any designated and severable portion of a claim or counterclaim, shall comply with §10.11 of this subchapter (relating to Settlement Agreement).

Source: *The provisions of this §10.20 adopted to be effective November 7, 2010, 35 TexReg 9694.*

§10.21. Referral to State Office of Administrative Hearings. If mediation does not resolve the claim to the satisfaction of the contractor, the contractor may request that the claim be referred to SOAH in accordance with §10.13 of this subchapter (relating to Request for Contested Case Hearing.)

Source: *The provisions of this §10.21 adopted to be effective November 7, 2010, 35 TexReg 9694.*

Subchapter B. Contract Protests

§10.30. Protests. (a) Any actual or prospective bidder, offeror, or contractor who is aggrieved in connection with the solicitation, evaluation, or award of a contract by any Finance Unit of state government may formally protest to the Finance Unit. Such protests must be made in writing and received by the Chief Administrative Officer of the Finance Unit within 10 working days after the protesting party knows, or should have known, of the occurrence of the action that is protested. Formal protests must conform to the requirements of this section. The protesting party must mail or deliver copies of the protest to all other interested parties.

(b) In the event of a timely protest under this section, the Finance Unit of state government shall not proceed further with the solicitation or award of the contract unless the Chief Administrative Officer of such Finance Unit makes a written determination that the contract must be awarded without delay, to protect the best interests of the state.

(c) A formal protest must be sworn and contain:

(1) a specific identification of the statutory or regulatory provision that the protesting party alleges has been violated;

(2) a specific description of each action by the Finance Unit of state government that the protesting party alleges to be a violation of the statutory or regulatory provision that the protesting party has identified pursuant to paragraph (1) of this subsection;

(3) a precise statement of the relevant facts;

(4) a statement of any issues of law or fact that the protesting party contends must be resolved;

(5) a statement of the argument and authorities that the protesting party offers in support of the protest; and

(6) a statement that copies of the protest have been mailed or delivered to all other identifiable interested parties.

(d) The Contract Protest Officer of the Finance Unit of state government may settle and resolve the dispute over the solicitation or award of a contract at any time before the matter is submitted on appeal to the Chief Administrative Officer of the Finance Unit. The Contract Protest Officer of the Finance Unit of state government may solicit written responses to the protest from other interested parties.

(e) If the protest is not resolved by mutual agreement, the Contract Protest Officer of the Finance Unit of state government shall issue a written determination that resolves the protest.

(1) If the Contract Protest Officer of the Finance Unit of state government determines that no violation of statutory or regulatory provisions has occurred, then the Contract Protest Officer shall inform the protesting party and other interested parties by letter that sets forth the reasons for the determination.

(2) If the Contract Protest Officer of the Finance Unit of state government determines that a violation of any statutory or regulatory provisions has occurred in a situation in which a contract has not been awarded, then the Contract Protest Officer of the Finance Unit shall inform the protesting party and other interested parties of that determination by letter that details the reasons for the determination and the appropriate remedy.

(3) If the Contract Protest Officer of the Finance Unit of state government determines that a violation of any statutory or regulatory provisions has occurred in a situation in which a contract has been awarded, then the Contract Protest Officer of the Finance Unit shall inform the protesting party and other interested parties of that determination by letter that details the reasons for the determination. This letter may include termination of the contract.

(f) The protesting party may appeal a determination of a protest by the Contract Protest Officer of the Finance Unit of state government to the Chief Administrative Officer of the Finance Unit. An appeal of the Contract Protest Officer's determination must be in writing and received in the office of the Chief Administrative Officer of the Finance Unit by not later than 10 working days after the date on which written notice of determination was sent. The scope of the appeal shall be limited to review of the Contract Protest Officer's determination. The protesting party must mail or deliver to all other interested parties a copy of the appeal, which must contain a certified statement that such copies have been provided.

(g) A written decision that the Chief Administrative Officer has issued shall be the final administrative action of the Finance Unit of state government.

(h) The Finance Unit of state government shall maintain all documentation on the purchasing process that is the subject of a protest or appeal in accordance with the retention schedule of the Finance Unit.

Source: *The provisions of this §10.30 adopted to be effective November 7, 2010, 35 TexReg 9694.*

CHAPTER 11. MISCELLANEOUS

CHAPTER 11. MISCELLANEOUS

Subchapter A. General

§11.27. [Repealed effective June 6, 2002.]

§11.37. How Do I Provide Information to Consumers on How to File a Complaint?

(a) Definitions

(1) "Consumer" means an individual who obtains or has obtained a product or service from you that is to be used primarily for personal, family, or household purposes.

(2) "Privacy notice" means any notice which you give regarding a consumer's right to privacy as required by a specific state or federal law.

(3) "Required notice" means a notice in a form set forth or provided for in subsection (b)(1) of this section.

(4) "You" means a bank, foreign bank, bank holding company, or trust company that is chartered, licensed, or registered by the Texas Department of Banking under the Finance Code.

(b) How do I provide notice of how to file complaints?

(1) You must use a notice that substantially conforms to the language and form of the following notice in order to let your consumers know how to file complaints: The (your name) is (chartered, licensed, or registered) under the laws of the State of Texas and by state law is subject to regulatory oversight by the Texas Department of Banking. Any consumer wishing to file a complaint against the (your name) should contact the Texas Department of Banking through one of the means indicated below: In Person or U.S. Mail: 2601 North Lamar Boulevard, Suite 300, Austin, Texas 78705-4294, Telephone No.: (877) 276-5554, Fax No.: (512) 475-1313, email: consumer.complaints@dob.texas.gov, Website: www.dob.texas.gov.

(2) You must provide the required notice in the language in which a transaction is conducted.

(3) You must include the required notice with each privacy notice that you send out.

(4) Regardless of whether you are required by any state or federal law to give privacy notices, you must take appropriate steps to let your consumers know how to file complaints by giving them the required notice in compliance with paragraph (1) of this subsection.

(5) You must use the following measures to give the required notice:

(A) In each area where you conduct business on a face-to-face basis, you must conspicuously post the required notice. A notice is deemed to be conspicuously posted if a consumer with 20/20 vision can read it from the place where he or she would typically conduct business or if it is included on a bulletin board, in plain view, on which all required notices to the general public (such as equal housing posters, licenses, Community Reinvestment Act notices, etc.) are posted.

(B) For consumers who are not given privacy notices, you must give the required notice when the consumer first obtains a product or service from you.

(C) Those portions of your website that offer consumer goods and services must contain access to the required notice.

Source: *The provisions of this §11.37 adopted to be effective January 3, 2002, 26 TexReg 10850; amended to be effective November 4, 2010, 35 TexReg 9695; amended to be effective September 8, 2016, 41 TexReg 6676.*

§11.81. [Repealed effective September 5, 2002.]

§11.83. [Repealed effective September 5, 2002.]

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CHAPTER 12. LOANS AND INVESTMENTS

Subchapter A. Lending Limits

Subchapter B. Loans

Subchapter C. Investment Limits

Subchapter D. Investments

CHAPTER 12. LOANS AND INVESTMENTS

Subchapter A. Lending Limits

§12.1. Purpose and Scope. (a) Purpose. The purpose of this subchapter is to administer and carry out the objectives of the Finance Code, Title 3, Subtitle A, particularly the Finance Code, §34.201, to protect the safety and soundness of state-chartered banks by preventing excessive loans to one person or a relatively small group of persons who are financially interdependent, and to promote diversification of loans to reduce portfolio and credit risk. Notwithstanding the provisions of the Finance Code, §34.201, and this subchapter, loans and extensions of credit by state banks and their operating subsidiaries remain subject to the exercise of prudent lending standards and safe and sound banking practices.

(b) Scope.

(1) This subchapter applies to all loans and extensions of credit made by a state bank and its operating subsidiaries. This subchapter does not apply to loans made by an insured state bank and its domestic operating subsidiaries to the bank's "affiliates," as that term is defined in 12 U.S.C. §371c(b)(1), pursuant to the Finance Code, §34.201(a)(13), or to loans made by a state bank to the bank's operating subsidiaries, pursuant to the Finance Code, §34.201(a)(14). Except as otherwise provided, this subchapter does not apply to other loans specifically exempted from the lending limit pursuant to the Finance Code, §34.201.

(2) Loans and extensions of credit to affiliates, executive officers, directors, and principal shareholders of state banks, and their related interests,

are subject to the limits prescribed by 12 U.S.C. §§371c, 371c-1, 375a, and 375b, Regulation O (12 C.F.R. §215.1 et seq.), and 12 C.F.R. §337.3, in addition to the lending limits established by the Finance Code, §34.201, and this subchapter, where applicable.

(3) The lending limits in this subchapter are separate and apart from the investment limits set forth in the Finance Code, §34.101, and regulations adopted to govern investment limits. A state bank may make loans or extensions of credit to one borrower up to the full amount permitted by this subchapter and also purchase and hold eligible investment securities issued by the same obligor up to the full amount permitted under the Finance Code, §34.101.

Source: *The provisions of this §12.1 adopted to be effective March 1, 1996, 21 TexReg 1383; amended to be effective September 6, 2007, 32 TexReg 5655.*

12.2. Definitions. Definitions in the Finance Code, Title 3, Subtitles A and G, are incorporated herein by reference. As used in this subchapter and in Finance Code, Chapter 34, concerning investments and loans, the following words and terms shall have the following meanings, unless the context clearly indicates otherwise.

(1) Borrower--A person who is named as a borrower, obligor, or debtor in a loan or extension of credit; a person to whom a state bank has credit exposure arising from a derivative transaction or a securities financing transaction, entered by the bank; or any other person, including but not limited to a drawer, endorser, or guarantor who is considered to be a borrower under the direct benefit, source of repayment, or common enterprise tests set forth in §12.9 of this title (relating to Aggregation and Attribution).

(2) Call report--The federal Consolidated Report of Condition and Income required by and filed under 12 U.S.C. §1817 (or under 12 U.S.C. §324 in the case of a bank that is a member of the Federal Reserve System), or a report of financial condition and results of operations of a state bank required by the banking commissioner under Finance Code, §31.108.

(3) Control--Control is presumed to exist when a person directly or indirectly, or acting through or together with one or more persons:

(A) owns, controls, or has the power to vote 25 percent or more of any class of voting securities of another person;

(B) controls, in any manner, the election of a majority of the directors, trustees, or other persons exercising similar functions of another person; or

(C) has the power to exercise a controlling influence over the management or policies of another person.

(4) Credit derivative--As defined in §2 of the federal capital adequacy guidelines.

(5) Derivative transaction--Includes any transaction that is a contract, agreement, swap, warrant, note, or option that is based, in whole or in part, on the value of, any interest in, or any quantitative measure or the occurrence of any event relating to, one or more commodities, securities, currencies, interest or other rates, indices, or other assets.

(6) Effective margining arrangement--A master legal agreement governing derivative transactions between a bank and a counterparty that requires the counterparty to post, on a daily basis, variation margin to fully collateralize that amount of the bank's net credit exposure to the counterparty that exceeds $25 million created by the derivative transactions covered by the agreement.

(7) Eligible credit derivative--A single-name credit derivative or a standard, non-tranched index credit derivative provided that:

(A) the derivative contract meets the requirements of an eligible guarantee, as defined in §2 of the federal capital adequacy guidelines, and has been confirmed by the protection purchaser and the protection provider;

(B) any assignment of the derivative contract has been confirmed by all relevant parties;

(C) if the credit derivative is a credit default swap, the derivative contract includes the following credit events:

(i) failure to pay any amount due under the terms of the reference exposure, subject to any applicable minimal payment threshold that is consistent with standard market practice and with a grace period that is closely in line with the grace period of the reference exposure; and

(ii) bankruptcy, insolvency, restructuring (for obligors not subject to bankruptcy or insolvency), or inability of the obligor on the reference exposure to pay its debts, or its failure or admission in writing of its inability generally to pay its debts as they become due, and similar events;

(D) the terms and conditions dictating the manner in which the derivative contract is to be settled are incorporated into the contract;

(E) if the derivative contract allows for cash settlement, the contract incorporates a robust valuation process to estimate loss with respect to the derivative reliably and specifies a reasonable period for obtaining post-credit event valuations of the reference exposure;

(F) if the derivative contract requires the protection purchaser to transfer an exposure to the protection provider at settlement, the terms of at least one of the exposures that is permitted to be transferred under the contract provides that any required consent to transfer may not be unreasonably withheld; and

(G) if the credit derivative is a credit default swap, the derivative contract clearly identifies the parties responsible for determining whether a credit event has occurred, specifies that this determination is not the sole responsibility of the protection provider, and gives the protection purchaser the right to notify the protection provider of the occurrence of a credit event.

(8) Eligible protection provider--An entity that is:

(A) a sovereign entity (a central government, including the U.S. government; an agency; department; ministry; or central bank);

(B) the Bank for International Settlements, the International Monetary Fund, the European Central Bank, the European Commission, or a multilateral development bank;

(C) a Federal Home Loan Bank;

(D) the Federal Agricultural Mortgage Corporation;

(E) a depository institution, as defined in section 3 of the Federal Deposit Insurance Act, 12 U.S.C. §1813(c);

(F) a bank holding company, as defined in section 2 of the Bank Holding Company Act, as amended, 12 U.S.C. §1841;

(G) a savings and loan holding company, as defined in section 10 of the Home Owners' Loan Act, 12 U.S.C. §1467a;

(H) a securities broker or dealer registered with the SEC under the Securities Exchange Act of 1934, 15 U.S.C. §§78o et seq.;

(I) an insurance company that is subject to the supervision of a State insurance regulator;

(J) a foreign banking organization;

(K) a non-U.S.-based securities firm or a non-U.S.-based insurance company that is subject to consolidated supervision and regulation comparable to that imposed on U.S. depository institutions, securities broker-dealers, or insurance companies; or

(L) a qualifying central counterparty.

(9) Federal capital adequacy guidelines--The federal reference entitled "Capital Adequacy Guidelines for Banks: Internal-Ratings-Based and Advanced Measurement Approaches," codified as Appendix D to 12 C.F.R. part 325 (or Appendix F to 12 C.F.R. part 208 in the case of a bank that is a member of the Federal Reserve System).

(10) Federal risk-based capital standards--The federal system for calculating a bank's equity capital and its specified components, set forth in Appendix A to 12 C.F.R. part 325 (or Appendix A to 12 C.F.R. part 208 in the case of a bank that is a member of the Federal Reserve System).

(11) Qualifying central counterparty--As defined in §2 of the federal capital adequacy guidelines.

(12) Qualifying master netting agreement--As defined in §2 of the federal capital adequacy guidelines.

(13) Sale of federal funds--A transaction between depository institutions involving the transfer of immediately available funds resulting from credits to deposit balances at Federal Reserve Banks, or from credits to new or existing deposit balances due from a correspondent depository institution.

(14) Securities financing transaction--A repurchase agreement, reverse repurchase agreement, securities lending transaction, or securities borrowing transaction.

(15) Tier 1 capital--A state bank's unimpaired capital and surplus. A state bank's Tier 1 capital is calculated under the federal risk-based capital standards, is reported in the bank's most recent call report, and is periodically re-calculated as provided by §12.11 of this title (relating to Calculation of Lending Limit).

(16) Unimpaired capital and surplus--A state bank's core capital, equal to its Tier 1 capital calculated under the federal risk-based capital standards, and referred to as Tier 1 capital in this chapter.

Source: *The provisions of this §12.2 adopted to be effective January 3, 2013, 37 TexReg 10195; amended to be effective November 7, 2013, 38 TexReg 7685.*

§12.3. Loans and Extensions of Credit. (a) Loans or extensions of credit for purposes of the Finance Code, §34.201, and this subchapter include:

(1) an overdraft, regardless of whether such overdraft was pre-arranged, other than an intra-day overdraft for which payment or deposit is received by the bank before the time at which the bank closes its accounting records for the business day on which the funds were advanced;

(2) a contractual obligation to advance funds to or on behalf of a person, including a bank's obligation to:

(A) make payment, directly or indirectly, to a third party contingent upon default by a customer of the bank in performing an obligation owed to the third party or upon another stated condition;

(B) guarantee or act as surety for the benefit of a person;

(C) advance funds under a legally binding commitment to lend; or

(D) advance funds under a standby letter of credit, a put, or other similar arrangement, however named or described, that represents an obligation to the beneficiary on the part of the issuing bank to repay money borrowed by or advanced to or for the account of the account party (the customer or applicant in a letter of credit transaction), make payment on account of any indebtedness undertaken by the account party, or make payment on account of a default by the account party in the performance of an obligation, but not including a bank's obligation under a commercial letter of credit or similar instrument if the issuing bank reasonably expects the beneficiary to draw on the issuer and the instrument neither guarantees payment nor provides for payment in the event of a default by a third party;

(3) a maker or endorser's obligation arising from the discount of commercial paper;

(4) third-party paper purchased to the extent it is subject to an agreement that the seller will repurchase the paper, including an obligation to repurchase the paper upon default or at the end of a stated period, less any applicable dealer reserves held by the bank as collateral security, unless such transaction is exempt under other provisions of the Finance Code or this subchapter;

(5) the sale of Federal funds with a maturity of more than one business day, but not Federal funds sold with a maturity of one day or less or Federal funds sold under a continuing contract, including contracts that provide for weekly settlement if the parties have the contractual right to obtain their funds at maturity of each transaction;

(6) loans or extensions of credit that have been charged off on the books of the bank, in whole or part, unless the loan or extension of credit is no longer legally enforceable by reason of:

(A) discharge in bankruptcy;

(B) expiration of the statute of limitations or judicial decision; or

(C) another reason, provided the bank maintains sufficient records to demonstrate that the loan is unenforceable;

(7) lease financing transactions made pursuant to the Finance Code, §34.204, unless otherwise exempt under §12.7 of this title (relating to Lease Financing);

(8) nonrecourse or limited recourse loans or extensions of credit;

(9) aggregate cash surrender value of life insurance policies from any one insurance company;

(10) any credit exposure to a person arising from a derivative transaction or a securities financing transaction between a state bank and the person, as determined pursuant to §12.12 of this title (relating to Credit Exposure Arising from Derivative and Securities Financing Transactions); and

(11) another category of transactions that is the equivalent of a loan or extension of credit as determined by the banking commissioner in the exercise of discretion.

(b) Loans or extensions of credit for purposes of the Finance Code, §34.201, and this subchapter do not include:

(1) funds advanced to or for the benefit of a borrower by a bank for taxes or insurance associated with collateral security for a loan or extension of credit, as well as funds advanced for utilities, security, and maintenance expenses associated with real property securing a loan or extension of credit, but only if necessary to preserve the value of the real property or other collateral security and consistent with safe and sound banking practices, provided the bank maintains sufficient records to demonstrate the necessity of the advance, and such advances are included in loans and extensions of credit thereafter until repaid for the purpose of determining whether additional loans or extensions of credit to the same borrower may be made within applicable lending limits;

(2) accrued and discounted interest on an existing loan or extension of credit, including interest that has been capitalized from prior notes and interest that has been advanced under terms and conditions of a loan agreement;

(3) that portion of a loan or extension of credit sold as a participation by a bank on a nonrecourse basis, provided the participation results in a pro rata sharing of credit risk proportionate to respective interests of the originating and participating lenders, except that:

(A) notwithstanding any requirement of Statement of Financial Accounting Standards No. 166 (Financial Accounting Standards Bd. 2009), for lending limit purposes, if the participation agreement provides that repayment must be applied first to the portions sold, a pro rata sharing will be considered to exist only if, in the event of default or comparable event provided in the agreement, the participants share in all subsequent repayments and collections in proportion to their actual percentage participation at the time of the occurrence of the event;

(B) if the originating bank funds the entire loan, the participants must be contractually obligated to remit their portion to the bank before the close of business (the time at which the bank closes its accounting records for the business day) on the next business day of the originating bank or its portion funded by the originating bank will be considered a loan by the originating bank to the borrower;

(C) in the case of a participation sold in an existing loan, the amount of the participation may not be subtracted from the outstanding loans and extensions of credit of the originating bank until the proceeds of sale are in the possession of the originating bank; and

(D) a loan participation agreement that provides for weekly settlement of amounts due to and from the participants meets the requirements of this paragraph if the outstanding balance to the borrower from the originating bank does not at any time exceed the bank's legal lending limit;

(4) an advance against uncollected funds in the normal course of collection pursuant to the bank's availability schedule issued in compliance with Regulation CC (12 C.F.R. §229.1 et seq.), including the amount of an item that must be credited to the customer under the bank's availability schedule but remains uncollected and unreturned because of a delay or defect in the collection system;

(5) the sale of Federal funds with a maturity of one day or less, or Federal funds sold under a continuing contract, including contracts that provide for weekly settlement if the parties have the contractual right to obtain their funds at maturity of each transaction;

(6) intra-day credit exposures arising from a derivative transaction or a securities financing transaction;

(7) a renewal or restructuring of a nonconforming loan as a new loan or extension of credit, subject to compliance with §12.10(b) of this title (relating to Nonconforming Loans); and

(8) that portion of one or more loans or extensions of credit, not to exceed 15% of the bank's Tier 1 capital, with respect to which the bank has purchased protection in the form of a single-name credit derivative that meets the requirements of §12.2(a)(7) of this title (relating to Definitions) from an eligible protection provider if the reference obligor is the same legal entity as the borrower in the loan or extension of credit and the maturity of the protection purchased equals or exceeds the maturity of the loan or extension of credit.

Source: *The provisions of this §12.3 adopted to be effective March 1, 1996, 21 TexReg 1383; amended to be effective January 2, 2003, 27 TexReg 12185; amended to be effective September 6, 2007, 32 TexReg 5655; amended to be effective January 3, 2013, 37 TexReg 10195; amended to be effective November 7, 2013, 38 TexReg 7685.*

§12.4. Loan Commitments. (a) A commitment to lend, when combined with all other loans or extensions of credit to a borrower, must be within the bank's legal lending limit at the time the commitment becomes binding, and advances may be made under a binding commitment to lend even if the advances would exceed the bank's lending limit on the date of funding. In determining whether a commitment to lend is within a bank's lending limit when made, the bank may deduct from the amount of the commitment the amount of each legally binding loan participation agreement executed before or concurrently with the bank's commitment that would be excluded from a loan or extension of credit under §12.3(b)(3) of this title (relating to Loans and Extensions of Credit).

(b) Pursuant to the Finance Code, §34.201(b)(2), a state bank may renew a commitment to lend and complete funding under that commitment to one borrower in circumstances where the renewed commitment would exceed the bank's current, general lending limit if:

(1) the completion of funding is consistent with safe and sound banking practices and is made to protect the position of the bank;

(2) the completion of funding will enable the borrower to complete the project for which the original, expiring commitment to lend was made; and

(3) the amount of the additional funding does not exceed the unfunded portion of the bank's original, expiring commitment to lend.

Source: *The provisions of this §12.4 adopted to be effective March 1, 1996, 21 TexReg 1383.*

§12.5. Percentage Lending Limits. (a) General lending limit. Generally, a bank's total outstanding loans and extensions of credit to one borrower, as provided in the Finance Code §34.201, may not exceed 25% of the bank's Tier 1 capital. However, certain loans or extensions of credit are subject to special lending limits as set forth in this section. These special lending limits are cumulative of one another and of the general lending limit under this subsection except as otherwise provided.

(b) Loans secured by title to readily marketable goods.

(1) Pursuant to the Finance Code, §34.201(a)(3), loans to one borrower secured by a bill of lading, bonded warehouse receipt, or similar document transferring or securing title to readily marketable goods may not exceed 50% of the bank's Tier 1 capital, in addition to the amount for that borrower allowed under the bank's general lending limit for loans and extensions of credit other than as provided by this subsection, provided the bank's interest in the collateral is adequately insured against loss if it is customary to do so. The market value of the goods securing the loan must at all times equal at least 115% of the amount of the outstanding loan that exceeds the general lending limit. The duration of the loan or extension of credit may not exceed six months if secured by goods that are refrigerated or frozen, or ten months if secured by nonperishable goods.

(2) The holder of the bonded warehouse receipts, order bills of lading, documents of title (as defined under the Business and Commerce Code), or other similar documents must have control and be able to obtain immediate possession of the goods so that the bank is able to sell the underlying goods and promptly transfer title to the buyer if default were to occur on a loan secured by such documents. The requirement under applicable law for a brief notice period or other similar procedural condition prior to disposal of the goods will not affect the eligibility of the instruments for this special lending limit.

(3) For purposes of this subsection, readily marketable goods are articles of commerce or industry in the form of fungible units that are easy to sell in a market with sufficiently frequent price quotations, and includes basic metals, such as tin, copper, or lead, consumer goods, and packaged processed foods, including refrigerated or frozen foods. The exact price must be easy to determine and the article itself must be easy to sell at any time at a price that would not be considerably less than the amount at which it is valued as collateral. Whether an article qualifies as readily marketable goods is determined on the basis of the conditions existing at the time the loan or extension of credit secured by the article is made. Whether goods are nonperishable must be determined on a case-by-case basis because of the differences in types of goods and differences in the shipping, handling, and storing of goods.

(c) Loans secured by liens on stored agricultural products.

(1) Pursuant to the Finance Code, §34.201(a)(4), loans to one borrower secured by liens on agricultural products in secure and properly documented storage in bonded warehouses or elevators may not exceed 50% of the bank's Tier 1 capital, in addition to the amount for that borrower allowed under the bank's general lending limit for loans and extensions of credit other than as provided by this subsection, provided the bank's interest in the collateral is adequately insured against loss. The market value of the agricultural products securing the loan must at all times equal at least 125% of the amount of the outstanding loan. The duration of the loan or extension of credit arising from a single transaction or the same agricultural products may not exceed six months if secured by agricultural products that are refrigerated or frozen, or exceed ten months if secured by nonperishable agricultural products.

(2) The bank must have control and be able to obtain immediate possession of the agricultural products so that the bank is able to sell the underlying products and promptly transfer title to the buyer if default were to occur on a loan secured by such products. The requirement under applicable law for a brief notice period or other similar procedural condition prior to disposal of the products will not affect the eligibility of the products for this special lending limit.

(3) Field warehouse receipts are an acceptable form of collateral when issued by a duly bonded and licensed grain elevator or warehouse having exclusive possession and control of the agricultural products even though the grain elevator or warehouse is maintained on the premises of the owner of the products. Warehouse receipts issued by the borrower-owner that is a grain elevator or warehouse company, duly bonded and licensed and regularly inspected by state or federal authorities, may be considered eligible collateral under this provision only when the receipts are registered with an independent registrar whose consent is required before the products may be withdrawn from the warehouse.

(4) Agricultural products are any product of agriculture, excluding livestock but not the products of livestock, and includes wheat and other grains, cotton, wool, flowers, eggs, and milk. Whether agricultural products are nonperishable must be determined on a case-by-case basis because of the differences in types of agricultural products and differences in the shipping, handling, and storing of agricultural products.

(d) Loans secured by readily marketable collateral.

(1) Pursuant to the Finance Code, §34.201(a)(12), loans or extensions of credit to one borrower may exceed the bank's general lending limit by an additional 15% of the bank's Tier 1 capital if the amount that exceeds the bank's general lending limit is fully secured by readily marketable collateral. The bank must properly perfect its security interest in the collateral to qualify for this added special lending limit and the collateral at all times must have a market value of at least 100% of the amount of the loan or extension of credit that exceeds the bank's general lending limit.

(2) For purposes of this subsection, readily marketable collateral must be financial instruments or bullion that can be promptly sold under ordinary market conditions at a fair market value determined by reliable and continuously available price quotations, based upon actual transactions on an auction or similarly available daily bid and ask price market. Financial instruments are stocks, bonds, notes, and debentures traded on a national securities exchange, over-the-counter margin stocks as defined in Regulation U (12 C.F.R. §§221.1 et seq), commercial paper, negotiable certificates of deposit, bankers' acceptances, and shares in a money market mutual fund of the type that issues shares in which banks may perfect a security interest, but not including individual mortgages. Financial instruments may be denominated in foreign currencies that are freely convertible into United States dollars.

(e) Loans secured by documents covering livestock.

(1) Pursuant to the Finance Code, §34.201(b)(2), loans or extensions of credit to one borrower secured by shipping documents or instruments that transfer or secure title to or grant a first lien security interest in livestock may not exceed 15% of the bank's Tier 1 capital, in addition to the amount allowed under the bank's general lending limit. The market value of the livestock securing the loan must at all times equal at least 115% of the amount of the outstanding loan that exceeds the general lending limit.

(2) The bank must maintain in its files an inspection and valuation for the livestock pledged that is reasonably current, taking into account the nature and frequency of turnover of the livestock to which the documents relate, but in no event more than 12 months old.

(3) For purposes of this subsection, livestock includes dairy and beef cattle, hogs, sheep, goats, poultry, and fish, whether or not held for resale.

(f) Loans secured by dairy cattle paper. Pursuant to the Finance Code, §34.201(b)(2), loans and extensions of credit to one borrower arising from the discount by dealers in dairy cattle of paper given in payment for the cattle may not exceed 15% of the bank's Tier 1 capital, in addition to the amount allowed under the bank's general lending limit. To qualify, the paper must carry the full recourse endorsement or unconditional guarantee of the seller and must be secured by the cattle sold, pursuant to liens that allow the bank to maintain a perfected security interest in the cattle under applicable law.

Source: *The provisions of this §12.5 adopted to be effective March 1, 1996, 21 TexReg 1383; amended to be effective September 6, 2007, 32 TexReg 5655.*

§12.6. Loans Not Subject to Lending Limits. (a) Loans arising from the discount of commercial or business paper.

(1) Pursuant to the Finance Code, §34.201(a)(1), loans or extensions of credit arising from the discount of negotiable commercial or business paper that evidences an obligation to the person negotiating the paper are not subject to the lending limits of the Finance Code, §34.201, or this subchapter, provided that:

(A) the paper is given in payment of the purchase price of commodities purchased for resale, fabrication of a product, or another business purpose that may reasonably be expected to provide funds for payment of the paper; and

(B) the paper bears the full recourse endorsement of the owner of the paper, except that paper discounted in connection with export transactions may be transferred without recourse or with limited recourse if supported by an assignment of appropriate insurance, acceptable to the banking commissioner, covering the political, credit, and transfer risks applicable to the paper, such as insurance provided by the Export-Import Bank.

(2) A default in the payment of principal or interest on commercial or business paper when due does not disqualify the exception under this subsection or result in a loan or extension of credit to the maker or endorser of the paper that is subject to lending limits, provided that the amount of such defaulted paper must be included in loans and extensions of credit thereafter until the default is remedied for the purpose of determining whether additional loans or extensions of credit to the same borrower may be made within applicable lending limits.

(b) Bankers' acceptances. Pursuant to the Finance Code, §34.201(a)(2), acceptance of drafts eligible for rediscount under 12 U.S.C. §372 and §373, or a bank's purchase of acceptances created by other banks that are eligible for rediscount under those sections, is not subject to the limits of the Finance Code, §34.201, or this subchapter. Bankers' acceptances within this exception do not include:

(1) acceptance of drafts ineligible for rediscount, thereby resulting in a loan from the bank to the customer for whom the acceptance was made, in the amount of the draft;

(2) purchase of ineligible acceptances created by other banks, thereby resulting in a loan from the purchasing bank to the accepting bank, in the amount of the purchase price; or

(3) a bank's purchase of its own acceptances, thereby resulting in a loan to the bank's customer for whom the acceptance was made, in the amount of the purchase price.

(c) Obligations of state or local government. Pursuant to the Finance Code, §34.201(a)(8), a loan or extension of credit to this state or an agency or political subdivision of this state, including a county or municipality or an agency or political subdivision of a county or municipality, is not subject to the limitations of the Finance Code, §34.201, or this subchapter to the extent the loan or extension of credit constitutes a legally created general obligation of the borrower, if the lending bank has obtained an opinion of counsel or the opinion of the attorney general that the loan or extension of credit is a valid and enforceable general obligation of the borrower.

(d) Loans secured by U.S. obligations. Pursuant to the Finance Code, §34.201, a loan or extension of credit to a borrower is not subject to the limitations of the Finance Code, §34.201, or this subchapter if the bank perfects a security interest in the collateral under applicable law and the bank is fully secured by the current market value of:

(1) bonds, notes, certificates of indebtedness, or Treasury bills of the United States or by similar obligations fully and unconditionally guaranteed as to principal and interest by the United States; or

(2) loans to the extent unconditionally guaranteed as to repayment of principal by the full faith and credit of the United States, as further described by subsection (f) of this section.

(e) Loans to a federal agency. Pursuant to the Finance Code, §34.201(b)(2), a loan or extension of credit to an agency or instrumentality of the United States including a department, agency, bureau, board, commission, or establishment of the United States, or any corporation wholly owned directly or indirectly by the United States, is not subject to the limitations of the Finance Code, §34.201, or this subchapter.

(f) Government guaranteed loans. Pursuant to Finance Code, §34.201(a)(8), a loan or extension of credit to a borrower is not subject to the limitations of the Finance Code, §34.201, or this subchapter to the extent secured by unconditional takeout commitments, insurance, or guarantees of a governmental entity described in subsection (c) or (e) of this section, provided the commitment or guarantee is payable only in cash or its equivalent. If the purchasing, insuring, or guaranteeing entity is described in subsection (c) of this section, the lending bank must obtain an opinion of counsel or the opinion of the attorney general that the unconditional takeout commitment, insurance, or guarantee is a valid and enforceable general obligation of the purchasing, insuring, or guaranteeing entity. A takeout commitment, insurance, or guarantee is considered unconditional if the protection afforded the bank is not substantially diminished or impaired if loss should result from factors beyond the bank's control. Protection against loss is not materially diminished or impaired by procedural requirements such as an agreement to pay on the obligation only in the event of default, including default over a specific period of time, a requirement that notification of default be given within a specific period after its occurrence, or a requirement of good faith on the part of the bank.

(g) Loans secured by segregated deposit accounts. Pursuant to the Finance Code, §34.201(a)(10), loans or extensions of credit are not subject to the limitations of the Finance Code, §34.201, and this subchapter to the extent secured by a segregated deposit account in the lending bank, provided that:

(1) the lending bank has perfected its security interest in the deposit under applicable law;

(2) if the deposit is eligible for withdrawal before the secured loan matures, the bank establishes internal procedures to prevent release of the security without the lending bank's prior consent;

(3) if the deposit is denominated and payable in a currency other than that of the loan or extension of credit that it secures, the deposit currency is freely convertible to U.S. dollars, except that only that portion of the loan or extension of credit that is fully secured by the U.S. dollar value of the deposit qualifies for exception and only if the lending bank establishes procedures to periodically revalue foreign currency deposits to ensure that the loan or extension of credit remains fully secured at all times.

(h) Discount of installment consumer paper.

(1) Loans and extensions of credit to one borrower arising from the discount of negotiable or nonnegotiable installment consumer paper that carries a full recourse endorsement or unconditional guarantee of payment by the person transferring the paper to the bank is considered a loan or extension of credit to the transferor, as well as the maker, and subject to the general lending limit, except that the loan or extension of credit will not be considered made to the transferor to the extent the bank has met the requirements of the Finance Code, §34.201(a)(11), and this subsection. If the transferor of the paper offers only partial recourse to the bank, the exception provided by the Finance Code, §34.201(a)(11), and this subsection is available only to the extent of the total amount of paper the transferor may be obligated to repurchase or has guaranteed. An unconditional guarantee may be in the form of a repurchase agreement, separate guarantee agreement, or other agreement having the same effect. A condition reasonably within the power or control of the bank to perform will not render conditional an otherwise unconditional guarantee.

(2) In order to claim the installment consumer paper exception under the Finance Code, §34.201(a)(11), and this subsection, the bank must demonstrate its reliance on the maker of the paper by maintaining records supporting the bank's independent credit analysis of the maker's ability to repay the loan or extension of credit, maintained by the bank or a third party that is contractually obligated to make those records available for examination purposes, and a written certification by an officer of the bank, specifically designated by the board of the bank for this purpose, that the bank is relying primarily on the maker for repayment of the loan or extension of credit and not on a full recourse endorsement or unconditional guarantee by the transferor. If installment consumer paper is purchased in substantial quantities, the required records, evaluation, and certification must be in a form appropriate for the class and quantity of paper involved. The bank may use sampling techniques, or other appropriate methods, to

independently verify the reliability of the credit information supplied by the seller.

(3) As used in this subsection, a consumer is the end user of a product, commodity, good, or service, whether leased or purchased, but not a person who purchases products or commodities for the purpose of resale or fabrication into goods for sale. Consumer paper includes paper relating to the lease or purchase of automobiles, mobile homes, residences, office equipment, household items, tuition fees, insurance premiums, and other consumer items. Consumer paper also includes paper relating to the lease or purchase of equipment for use in manufacturing, farming, construction, or excavation, if the bank is neither the lessor nor owner of the property.

(4) A bank may purchase and temporarily hold mortgages for sale to investors in the secondary market, and consider the purchases as loans to individual mortgagors rather than a mortgage warehouse facility, by purchasing without recourse to the transferor or, if purchased with recourse, by complying with this subsection. Whether an actual purchase is considered to occur depends on both the nature of the relationship established between the bank and other parties to the contractual arrangements and on assessment of the economic substance of the transaction. Failure to meet any one of the criteria applied by the department does not necessarily result in characterization of an ostensible purchase transaction as a mortgage warehouse facility to the originator. In determining whether the economic substance of a transaction constitutes a purchase, the department will consider whether:

(A) provisions of the contractual arrangements governing the mortgage transfers consistently reflect a relationship of buyer and seller between the bank and the transferor, and whether the bank in fact acts as the owner of the mortgages;

(B) the bank obtains possession or control of the bearer instruments conveying ownership, including the original note, deed of trust, assignment from the transferor, and a power of attorney from the transferor for instruments endorsed in blank, provided that possession or control may also be established through safekeeping or custodial arrangements between the bank and a third party agent or bailee;

(C) the bank takes possession or control of underlying underwriting documents, provided that possession or control of the underwriting documents by the investor is not inconsistent with characterization of the bank as a purchaser and owner of the mortgages;

(D) the bank receives and controls the sales proceeds when remitted from the investor;

(E) the bank demonstrates reliance on the maker by reviewing the credit quality and documentation underlying a mortgage prior to committing to make the purchase, provided that a bank purchasing mortgages in significant quantities may use sampling techniques or other appropriate methods to independently verify the reliability of the credit information supplied by the transferor;

(F) recourse and repurchase obligations of the transferor are subject to conditions outside the control of the transferor, such as a commitment to repurchase the mortgage if rejected by the investor for reasons other than fraud or underwriting deficiency; and

(G) the bank earns interest on the mortgages according to the interest rate on the face of each note rather than at a rate separately negotiated with the transferor.

(i) Credit exposures arising from transactions financing certain government securities. Pursuant to Finance Code, §34.201(b)(2), credit exposures arising from securities financing transactions in which the securities financed are securities in which a state bank may invest without limit pursuant to Finance Code, §34.101(d), are not subject to the limitations of Finance Code, §34.201, and this subchapter.

Source: *The provisions of this §12.6 adopted to be effective March 1, 1996, 21 TexReg 1383; amended to be effective July 10, 2003, 28 TexReg 5149; amended to be effective September 6, 2007, 32 TexReg 5655; amended to be effective January 3, 2013, 37 TexReg 10195.*

§12.7. Lease Financing. (a) Loans to industrial development authorities. Pursuant to the Finance Code, §34.201(b)(2), a loan or extension of credit to an industrial development authority or similar public entity created to construct and lease a plant facility, including a health care facility, to an industrial occupant is considered a loan to the lessee, provided that:

(1) the bank documents the basis for its reliance on the industrial occupant as the primary source of repayment before the loan is extended to the authority;

(2) the authority's liability on the loan is limited solely to whatever interest it has in the particular facility;

(3) the authority's interest is assigned to the bank as security for the loan or the industrial occupant issues a promissory note to the bank that provides a higher order of security than the assignment of a lease; and

(4) the industrial occupant's lease rentals are assigned and paid directly to the bank.

(b) Loans to or leases purchased from leasing companies. Pursuant to the Finance Code, §34.201(b)(2), a loan or extension of credit to a leasing company for the purpose of purchasing equipment for lease, or a lease purchased from a leasing company, is considered a loan to the lessee, provided that:

(1) the bank documents the basis for its reliance on the lessee as the primary source of repayment before the loan is extended to, or lease is purchased from, the leasing company;

(2) the loan is made, or lease is purchased, without recourse to the leasing company;

(3) the bank receives a security interest in the equipment and, in the event of default, may proceed directly against the equipment and the lessee for any deficiency resulting from the sale of the equipment;

(4) the leasing company assigns all of its rights under the lease to the bank;

(5) the lessee's lease payments are assigned and paid to the bank directly by the lessee; and

(6) the lease terms are subject to the same limitations that would apply to a state bank acting as a lessor under the Finance Code, §34.204.

Source: *The provisions of this §12.7 adopted to be effective March 1, 1996, 21 TexReg 1383; amended to be effective May 10, 2012, 37 TexReg 3395.*

§12.8. Other Exceptions. (a) By application. The banking commissioner in the exercise of discretion may grant an exception to any legal lending limit in the Finance Code, §34.201, or this subchapter, based on extenuating facts and circumstances. A decision to deny a requested exception is not appealable. In deciding whether to grant an exception under this subsection, the banking commissioner will consider:

(1) the proposed transaction for which the exception is sought;

(2) how the requested exception would affect the capital adequacy and safety and soundness of the requesting bank if the exception is not granted or, if the exception is granted, if the proposed borrower should ultimately default;

(3) how the requested exception would affect the loan portfolio diversification of the requesting bank;

(4) the competency of management to handle the proposed transaction and any resulting safety and soundness issues;

(5) the marketability and value of the proposed collateral; and

(6) the extenuating facts and circumstances that warrant an exception in light of the purpose of legal lending limits as set forth in §12.1 of this title (relating to Purpose and Scope).

(b) Emergency lending limits. In the event that a bank's Tier 1 capital declines sufficiently to seriously impair the bank's ability to effectively operate in its marketplace or serve the needs of its customers or the community in which it is located, the banking commissioner may, upon written application, grant the bank temporary permission to fund loans or extensions of credit in excess of the bank's legal lending limit. The banking commissioner in the exercise of discretion may limit emergency lending authority under this section to particular types or classes of loans or extensions of credit.

Source: *The provisions of this §12.8 adopted to be effective March 1, 1996, 21 TexReg 1383; amended to be effective September 6, 2007, 32 TexReg 5655.*

§12.9. Aggregation and Attribution. (a) General rule. A loan or extension of credit to one borrower is attributed to another person, and each person will be considered a borrower, if:

(1) proceeds of the loan or extension of credit are to be used for the direct benefit of the other person, to the extent of the proceeds so used, as provided by subsection (b) of this section;

(2) a common enterprise is deemed to exist between the persons as provided by subsection (c) of this section; or

(3) the expected source of repayment for each loan or extension of credit is the same for each person as provided by subsection (d) of this section; or

(4) notwithstanding another provision of this section, the banking commissioner determines that a loan should be attributed to another person pursuant to the Finance Code, §34.201(c).

(b) Direct benefit. The proceeds of a loan or extension of credit to a borrower is considered used for the direct benefit of another person and attributed to the other person if the proceeds, or assets purchased with the proceeds, are transferred in any manner to or for the benefit of the other person, other than in a bona fide arm's length transaction where the proceeds are used to acquire property, goods, or services.

(c) Common enterprise.

(1) A common enterprise is considered to exist and loans to separate borrowers will be aggregated in the case of:

(A) loans or extensions of credit made to affiliated borrowers if substantial financial interdependence exists between or among the borrowers; or

(B) loans made to separate persons for the purpose of acquiring more than 50% of the voting securities or voting interests of a business enterprise, in which case the acquisition loans are aggregated and attributed to the business enterprise.

(2) For purposes of paragraph (1)(A) of this subsection, borrowers are affiliated if one borrower directly or indirectly controls, is controlled by, or is under common control with another borrower. Substantial financial interdependence exists if 50% or more of one borrower's gross receipts or gross expenditures (on an annual basis) are derived from transactions with the other borrower and is presumed to exist, subject to rebuttal, if 25% or more of one borrower's gross receipts or gross expenditures (on an annual basis) are derived from transactions with the other borrower. Gross receipts and expenditures include gross revenues and expenses, intercompany loans, dividends, capital contributions, and similar receipts or payments.

(d) Source of repayment. The expected source of repayment for each loan or extension of credit is considered the same if the primary source of repayment is the same for each borrower. An employer will not be considered a primary source of repayment under this subsection solely because of wages and salaries paid to an employee, unless the standards of subsection (c)(1) of this section are met.

(e) Loans to a corporate group. Pursuant to the Finance Code, §34.201(c), loans or extensions of credit by a bank to a corporate group may not exceed 60% of the bank's Tier 1 capital. This limitation applies only to loans subject to the general lending limit. For purposes of this subsection, a corporate group is comprised of a person and all of its subsidiaries, and a corporation or other entity is a subsidiary of a person if the person owns or beneficially owns directly or indirectly more than 50% of the voting securities or voting interests of the corporation or other entity. Subject to the special limit of this subsection, loans or extensions of credit to a person and its subsidiary, or to different subsidiaries of a person, are not aggregated or attributed to other members of the corporate group unless either the direct benefit, common enterprise, or source of repayment test is met.

(f) Loans to partnerships or partners.

(1) A loan or extension of credit to a partnership, joint venture, or association is considered to be a loan or extension of credit to each member of the partnership, joint venture, or association other than those partners or members that, by the terms of the partnership or membership agreement, are not held generally liable for the debts or actions of the partnership, joint venture, or association, provided those provisions are valid against third parties under applicable law, and that have not otherwise agreed to guarantee or be personally liable on the loan or extension of credit.

(2) A loan or extension of credit to a member of a partnership, joint venture, or association is generally not attributed to the partnership, joint venture, or association, or to other members of the partnership, joint venture, or association, except as otherwise required by subsections (b)-(d) of this section, provided that a loan or extension of credit made to a member of a partnership, joint venture or association for the purpose of purchasing an interest in the partnership, joint venture or association, is attributed to the partnership, joint venture or association.

(g) Guarantors and accommodation parties. The derivative obligation of a drawer, endorser, or guarantor of a loan or extension of credit, including a contingent obligation to purchase collateral that secures a loan, is not aggregated with direct loans or extensions of credit to such drawer, endorser, or guarantor if the lending bank is relying primarily on the creditworthiness of the primary obligor and none of the tests set forth in this section are satisfied. The reliance of the lending bank on the primary obligor must be evidenced by the certification of an officer of the bank that the bank is, on stated facts, relying primarily on the responsibility and financial condition of the primary obligor for payment of the loan or extension of credit and not on the guarantee, or commitment in whatever form, of the guarantor, drawer, or endorser. In the event that the loan or extension of credit to the primary obligor, considered by the bank to be of sufficient credit quality at its inception, experiences subsequent deterioration to the point that the primary obligor is no longer performing in accordance with the terms of the initial loan agreement, such event will not result in a lending limit violation on behalf of the guarantor by virtue of the primary obligator's nonperformance. However, the total amount of the deteriorated loans guaranteed by such accommodating person must be combined with all other obligations of such guarantor in determining whether the guarantor may obtain additional loans or extensions of credit from the bank.

Source: *The provisions of this §12.9 adopted to be effective March 1, 1996, 21 TexReg 1383; amended to be effective September 6, 2007, 32 TexReg 5655; amended to be effective May 10, 2012, 37 TexReg 3395.*

§12.10. Nonconforming Loans. (a) A loan or extension of credit, within a bank's legal lending limit when made, will not be considered a violation of the applicable lending limit but will be cited as nonconforming if the loan no longer complies with the bank's legal lending limit because:

(1) the bank's Tier 1 capital has declined;

(2) borrowers have merged or otherwise become affiliated in such a way as to invoke aggregation under §12.9 of this title (relating to Aggregation and Attribution);

(3) the bank has merged with another depository institution or the bank has purchased all or substantially all of the assets of a failed depository institution from the Federal Deposit Insurance Corporation as receiver of such institution on or shortly after the date of its closing;

(4) the lending limit or capital definitions or standards have changed after the date the loan or extension of credit was originated;

(5) in the case of a credit exposure arising from a transaction identified in §12.12(a) of this title (relating to Credit Exposure Arising from Derivative and Securities Financing Transactions) and measured by the model method specified in §12.12(b)(1)(A) or (c)(1)(A), the current exposure method specified in §12.12(b)(1)(C), or the Basel collateral haircut method specified in §12.12(c)(1)(C), an increase in the credit exposure subject to the lending limits of Finance Code, §34.201, or this subchapter after execution of the transaction; or

(6) collateral securing the loan or extension of credit to satisfy the requirements of a special lending limit or lending limit exception has declined in value.

(b) A bank must exercise reasonable efforts to bring a loan or extension of credit that is nonconforming as a result of circumstances described in subsection (a)(1)-(5) of this section into conformity with the legal lending limit, consistent with safe and sound banking practices. As a last resort, a bank may renew or restructure an existing, nonconforming loan or extension of credit as a new, nonconforming loan or extension of credit without violating the Finance Code or this subchapter, unless:

(1) additional funds are advanced by the bank to the borrower, except as permitted by §12.4(b) of this title (relating to Loan Commitments);

(2) the original borrower is replaced by a new borrower; or

(3) the banking commissioner determines that the renewal or restructuring of the loan or extension of credit is designed to evade the bank's lending limit.

(c) A bank must bring a loan or extension of credit that is nonconforming as a result of the circumstance described in subsection (a)(5) of this section into conformity with the legal lending limit on or before the 31st day after the nonconformity is discovered unless judicial proceedings, regulatory action, or other extraordinary circumstances beyond the bank's control prevent the bank from taking action.

Source: *The provisions of this §12.10 adopted to be effective March 1, 1996, 21 TexReg 1383; amended to be effective September 6, 2007, 32 TexReg 5655; amended to be effective May 10, 2012, 37 TexReg 3395; amended to be effective January 3, 2013, 37 TexReg 10195; amended to be effective November 7, 2013, 38 TexReg 7685.*

§12.11. Calculation of Lending Limit. (a) Calculation date. For purposes of determining compliance with Finance Code, §34.201, and this subchapter, a state bank shall determine its lending limit as of the most recent of the following dates:

(1) the last day of the preceding calendar quarter; or

(2) the date on which there is a change in the bank's capital category for purposes of 12 U.S.C. 1831o and 12 C.F.R. §325.102 (or 12 CFR §208.32 in the case of a bank that is a member of the Federal Reserve System).

(b) Effective date.

(1) A bank's lending limit calculated in accordance with subsection (a)(1) of this section is effective as of the earlier of the following dates:

(A) the date on which the bank's call report is submitted; or

(B) the date on which the bank's call report is required to be submitted under applicable federal law.

(2) A bank's lending limit calculated in accordance with subsection (a)(2) of this section is effective on the date that the limit is required to be calculated.

(c) More frequent calculations. The banking commissioner may permit a state bank to recalculate its lending limit at a point during a quarter based on a material change in a bank's capital arising from corporate activities, such as a merger or stock issuance. For safety and soundness reasons, the banking commissioner may provide written notice to a state bank directing the bank to calculate its lending limit at a more frequent interval than required by subsection (a) of this section, and the bank shall thereafter calculate its lending limit at that interval until further notice.

Source: *The provisions of this §12.11 adopted to be effective September 6, 2007, 32 TexReg 5655.*

§12.12. Credit Exposure Arising from Derivative and Securities Financing Transactions.

(a) Scope. This section sets forth the rules for calculating the credit exposure arising from a derivative transaction or a securities financing transaction entered into by a state bank for purposes of determining the bank's lending limit pursuant to Finance Code, §34.201, and this subchapter.

(b) Derivative transactions.

(1) Non-credit derivatives. Subject to paragraphs (2)-(4) of this subsection, a state bank shall calculate the credit exposure to a counterparty arising from a derivative transaction by one of the following methods. Subject to paragraphs (3) and (4) of this subsection, a bank shall use the same method for calculating counterparty credit exposure arising from all of its derivative transactions.

(A) Model method.

(i) Credit exposure. The credit exposure of a derivative transaction under the model method is equal to the sum of the current credit exposure of the derivative transaction and the potential future credit exposure of the derivative transaction.

(ii) Calculation of current credit exposure. A bank shall determine its current credit exposure by the mark-to-market value of the derivative contract. If the mark-to-market value is positive, then the current credit exposure equals that mark-to-market value. If the mark-to-market value is zero or negative, then the current credit exposure is zero.

(iii) Calculation of potential future credit exposure. A bank shall calculate its potential future credit exposure by using an internal model that has been approved in writing for purposes of §32(d) of the federal capital adequacy guidelines, provided that the bank notifies the commissioner prior to its use for purposes of this section, or another model approved by the department based on the views of the bank's primary federal banking regulatory agency and any third party testing and evaluation reports submitted to the commissioner. Any substantive revisions to an internal model made after the bank has provided notice of its use, or after the commissioner has approved the use of an alternate model, must be approved by the commissioner before a bank may use the revised model for purposes of this section.

(iv) Net credit exposure. A bank that calculates its credit exposure by using the model method pursuant to this subparagraph may net credit exposures of derivative transactions arising under the same qualifying master netting agreement.

(B) Conversion factor matrix method. The credit exposure arising from a derivative transaction under the conversion factor matrix method is equal to and will remain fixed at the potential future credit exposure of the derivative transaction, which equals the product of the notional amount of the derivative transaction and a fixed multiplicative factor determined by reference to Table 1 of this section.

Figure: 7 TAC §12.12(b)(1)(B)

Table 1—Conversion Factor Matrix for Calculating Potential Future Credit Exposure.[1]

Original maturity[2]	Interest Rate	Foreign exchange rate and gold	Equity	Other[3] (includes commodities and precious metals except gold)
1 year or less	0.015	0.015	0.20	0.06
Over 1 to 3 years	0.03	0.03	0.20	0.18
Over 3 to 5 years	0.06	0.06	0.20	0.30
Over 5 to 10 years	0.12	0.12	0.20	0.60
Over ten years	0.30	0.30	0.20	1.00

[1] For an OTC derivative contract with multiple exchanges of principal, the conversion factor is multiplied by the number of remaining payments in the derivative contract.

[2] For an OTC derivative contract that is structured such that on specified dates any outstanding exposure is settled and the terms are reset so that the market value of the contract is zero, the remaining maturity equals the time until the next reset date. For an interest rate derivative contract with a remaining maturity of greater than one year that meets these criteria, the minimum conversion factor is 0.005.

[3] Transactions not explicitly covered by any other column in Table 1 are to be treated as "Other."

(C) Current exposure method. The credit exposure arising from a derivative transaction (other than a credit derivative transaction) under the current exposure method is calculated in the manner provided by §32(c)(5), (6) and (7) of the federal capital adequacy guidelines.

(2) Credit derivatives.

(A) Counterparty exposure.

(i) General rule. Notwithstanding paragraph (1) of this subsection and subject to clause (ii) of this subparagraph, a state bank that uses the conversion factor matrix method or the current exposure method, or that uses the model method without entering an effective margining arrangement as defined in §12.2 of this title (relating to Definitions), shall calculate the counterparty credit exposure arising from credit derivatives entered by the bank by adding the net notional value of all protection purchased from the counterparty on each reference entity.

(ii) Special rule for certain effective margining arrangements. A bank must add the effective margining arrangement threshold amount to the counterparty credit exposure arising from credit derivatives calculated under the model method. The effective margining arrangement threshold is the amount under an effective margining arrangement with respect to which the counterparty is not required to post variation margin to fully collateralize the amount of the bank's net credit exposure to the counterparty.

(B) Reference entity exposure. A state bank shall calculate the credit exposure to a reference entity arising from credit derivatives entered into by the bank by adding the net notional value of all protection sold on the reference entity. A bank may reduce its exposure to a reference entity by the amount of any eligible credit derivative purchased on that reference entity from an eligible protection provider.

(3) Special rule for central counterparties. In addition to amounts calculated under paragraphs (1) and (2) of this subsection, the measure of counterparty exposure to a central counterparty must also include the sum of the initial margin posted by the bank plus any contributions made by it to a guaranty fund at the time such contribution is made. However, this requirement does not apply to a bank that uses an internal model pursuant to paragraph (1)(A) of this subsection if such model reflects the initial margin and any contributions to a guaranty fund.

(4) Mandatory or alternative use of method. The commissioner may in the exercise of discretion require or permit a state bank to use a specific method or methods set forth in this subsection to calculate the credit exposure arising from all derivative transactions, from any category of derivative transactions, or from a specific derivatives transaction if the commissioner in the exercise of discretion finds that such method is consistent with the safety and soundness of the bank.

(c) Securities financing transactions.

(1) In general. Except as provided by paragraph (2) of this subsection, a state bank shall calculate the credit exposure arising from a securities financing transaction by one of the following methods. A state bank shall use the same method for calculating credit exposure arising from all of its securities financing transactions.

(A) Model method. A state bank may calculate the credit exposure of a securities financing transaction by using an internal model that has been approved in writing for purposes of §32(b) of the federal capital adequacy guidelines, provided that the bank notifies the commissioner prior to its use for purposes of this section, or another model approved by the department based on the views of the bank's primary federal banking regulatory agency and any third party testing and evaluation reports submitted to the commissioner. Any substantive revisions to an internal model made after the bank has provided notice of its use, or after the commissioner has approved the use of an alternate model, must be approved by the commissioner before a bank may use the revised model for purposes of this section.

(B) Basic method. A state bank may calculate the credit exposure of a securities financing transaction as follows:

(i) Repurchase agreement. The credit exposure arising from a repurchase agreement shall equal and remain fixed at the market value at execution of the transaction of the securities transferred to the other party less cash received.

(ii) Securities lending.

(I) Cash collateral transactions. The credit exposure arising from a securities lending transaction where the collateral is cash shall equal and remain fixed at the market value at execution of the transaction of securities transferred less cash received.

(II) Non-cash collateral transactions. The credit exposure arising from a securities lending transaction where the collateral is other securities shall equal and remain fixed as the product of the higher of the two haircuts associated with the two securities, as determined by reference to Table 2 of this section, and the higher of the two par values of the securities. Where more than one security is provided as collateral, the applicable haircut is the higher of the haircut associated with the security lent and the notional-weighted average of the haircuts associated with the securities provided as collateral.

(iii) Reverse repurchase agreements. The credit exposure arising from a reverse repurchase agreement shall equal and remain fixed as the product of the haircut associated with the collateral received, as determined by reference to Table 2 of this section, and the amount of cash transferred.

(iv) Securities borrowing.

(I) Cash collateral transactions. The credit exposure arising from a securities borrowed transaction where the collateral is cash shall equal and remain fixed as the product of the haircut on the collateral received, as determined by reference to Table 2 of this section, and the amount of cash transferred to the other party.

(II) Non-cash collateral transactions. The credit exposure arising from a securities borrowed transaction where the collateral is other securities shall equal and remain fixed as the product of the higher of the two haircuts associated with the two securities, as determined by reference to Table 2 of this section, and the higher of the two par values of the securities. Where more than one security is provided as collateral, the applicable haircut is the higher of the haircut associated with the security borrowed and the notional-weighted average of the haircuts associated with the securities provided as collateral.

Figure: 7 TAC §12.12(c)(1)(B)(iv)(II)

TABLE 2—COLLATERAL HAIRCUTS

SOVEREIGN ENTITIES

	Residual maturity	Haircut without currency mismatch[1]
OECD Country Risk Classification[2] 0-1…….	<= 1 year………………………. >1 year, <= 5 years………….. >5 years………………………..	………………………………..0.005 …………………………………0.02 …………………………………0.04
OECD Country Risk Classification 2-3………	<= 1 year………………………. >1 year, <= 5 years………….. >5 years………………………..	…………………………………0.01 …………………………………0.03 …………………………………0.06

CORPORATE AND MUNICIPAL BONDS THAT ARE BANK-ELIGIBLE INVESTMENTS

	Residual maturity for debt securities	Haircut without currency mismatch
All………………………… All………………………… All…………………………	<= 1 year……………………… >1 year, <= 5 years………… >5 years………………………	…………………………………0.02 …………………………………0.06 …………………………………0.12

OTHER ELIGIBLE COLLATERAL

Main index[3] equities (including convertible bonds)……………	0.15
Other publicly traded equities (including convertible bonds)…	0.25
Mutual funds……………………………………………………	Highest haircut applicable to any security in which the fund can invest
Cash collateral held……………………………………………	0

[1] In cases where the currency denomination of the collateral differs from the currency denomination of the credit transaction, an additional 8.0% haircut will apply.

[2] OECD Country Risk Classification means the country risk classification as defined in Article 25 of the OECD's February 2011 Arrangement on Officially Supported Export Credits Arrangement.

[3] Main index means the Standard & Poor's 500 Index, the FTSE All-World Index, and any other index for which the covered company can demonstrate to the satisfaction of the Federal Reserve that the equities represented in the index have comparable liquidity, depth of market, and size of bid-ask spreads as equities in the Standard & Poor's 500 Index and FTSE All-World Index.

(C) Basel collateral haircut method. A state bank may calculate the credit exposure of a securities financing transaction in the manner provided by §32(b)(2)(i) and (ii) of the federal capital adequacy guidelines.

(2) Mandatory or alternative use of method. The commissioner may in the exercise of discretion require or permit a state bank to use a specific method or methods set forth in this subsection to calculate the credit exposure arising from all securities financing transactions, from any category of securities financing transactions, or from a specific derivatives transaction if the commissioner finds in the exercise of discretion that such method is consistent with the safety and soundness of the bank.

Source: *The provisions of this §12.12 adopted to be effective January 3, 2013, 37 TexReg 10195; amended to be effective November 7, 2013, 38 TexReg 7685.*

Subchapter B. Loans

§12.31. Loans Secured By Affiliate-Issued Securities. A loan subject to Finance Code, §34.102(d), must be subtracted from the capital of a lending bank if the loan proceeds are used directly, or indirectly, for the purpose of recapitalizing the lending bank, unless the loan is fully secured by irrevocable letters of credit or other liquid assets.

Source: *The provisions of this §12.31 adopted to be effective May 17, 1996, 21 TexReg 3935; amended to be effective July 10, 2003, 28 TexReg 5149.*

§12.32. Loan Fees and Charges. (a) Applicability.

(1) Finance Code, §34.203, and this section apply to:

(A) closed end first lien residential real estate loans;

(B) loans other than for personal, family, or household use (i.e., commercial loans including all commercial real estate loans); and

(C) loans for personal, family, or household use that are repayable in a single installment (i.e., single pay consumer loans).

(2) Finance Code, §34.203, and this section do not apply to a consumer loan payable in two or more installments that is subject to Finance Code, Title 4, Subtitle B.

(b) Reasonable fees authorized. A bank may require a borrower to pay all reasonable expenses and fees incurred in connection with the making, closing, disbursing, extending, readjusting, or renewing of a loan subject to this section, including fees paid to third parties as well as charges and fees paid to the bank itself for the services of the bank employees. However, such charges may not include fees paid by the bank (in addition to regular salary or director's fee) to an officer or director for services rendered within the course and scope of his or her employment with the bank. Subject to limitations of other law, possible fees and charges which may be charged and collected under this section include fees for underwriting, appraisal, document preparation, title insurance or abstract and opinion, insurance (including casualty coverage for collateral and credit products), credit reports, escrows, and filing fees, among others.

(c) Calculation of reasonable fee.

(1) Authorized loan fees must be reasonably related to the costs incurred by the bank. In establishing loan fees, a bank may establish fixed fees for underwriting activities for various categories of loans. In establishing such fixed fees, the bank may take into consideration its average costs in various activities, including but not limited to the average cost of taking an application, obtaining necessary reports and documentation, review of credit reports, analysis of the loan proposal and the prospective borrower's ability to repay, preparation of documents, loan review, and closing activities, plus a reasonable overhead factor. In lieu of conducting its own analysis, where relevant a bank may accept as reasonable and rely on the functional cost analysis prepared by the Board of Governors of the Federal Reserve System.

(2) This section does not require a bank to charge its borrower the full, true cost of accepting and consummating a lending transaction. For example, a bank may choose to assess a lower than actual cost loan fee on smaller consumer single pay loans in the interest of making loans more affordable to low to moderate income borrowers, or may deliberately underestimate its actual costs to provide a margin of security regarding compliance with law.

(3) Fees and expenses charged and collected in accordance with the Finance Code, §34.203, and in accordance with this section are not considered interest or compensation charged by the bank for the use, forbearance, or detention of money. However, fees and expenses which do not comply with these requirements may be characterized in litigation as interest.

(d) Collection of fee. Loan fees may be collected separately or added to the amount of the promissory note and financed as part of the loan.

Source: *The provisions of this §12.32 adopted to be effective May 17, 1996, 21 TexReg 3935; amended to be effective November 13, 1997, 22 TexReg 10954; amended to be effective May 6, 2004, 29 TexReg 4141.*

§12.33. Debt Cancellation Contracts and Debt Suspension Agreements. (a) Definitions.

(1) "Actuarial method" means the method of allocating payments made on a debt between the amount financed and the finance charge pursuant to which a payment is applied first to the accumulated

finance charge and any remainder is subtracted from, or any deficiency added to, the unpaid balance of the amount financed.

(2) "Closed-end credit" means consumer credit other than open-end credit as defined in this section.

(3) "Contract" means a debt cancellation contract or a debt suspension agreement.

(4) "Customer" means an individual who obtains an extension of credit from a bank primarily for personal, family, or household purposes.

(5) "Debt cancellation contract" means a loan term or contractual arrangement modifying loan terms under which a bank agrees to cancel all or part of a customer's obligation to repay an extension of credit from that bank upon the occurrence of a specified event. The agreement may be separate from or a part of other loan documents.

(6) "Debt suspension agreement" means a loan term or contractual arrangement modifying loan terms under which a bank agrees to suspend all or part of a customer's obligation to repay an extension of credit from that bank upon the occurrence of a specified event. The agreement may be separate from or a part of other loan documents. The term "debt suspension agreement" does not include loan payment deferral arrangements in which the triggering event is the borrower's unilateral election to defer repayment, or the bank's unilateral decision to allow a deferral of repayment.

(7) "Open-end credit" means consumer credit extended by a bank under a plan in which:

(A) The bank reasonably contemplates repeated transactions;

(B) The bank may impose a finance charge from time to time on an outstanding unpaid balance; and

(C) The amount of credit that may be extended to the customer during the term of the plan (up to any limit set by the bank) is generally made available to the extent that any outstanding balance is repaid.

(8) "Residential mortgage loan" means a loan secured by a 1-4 family, residential real property.

(b) Authority, purpose, and scope.

(1) Authority. A state bank is authorized to enter into debt cancellation contracts and debt suspension agreements and charge a fee therefor under Finance Code, §32.001.

(2) Purpose. This section sets forth the standards that apply to debt cancellation contracts and debt suspension agreements entered into by state banks. The purpose of these standards is to ensure that state banks offer and implement such contracts and agreements consistent with safe and sound banking practices, and subject to appropriate consumer protections.

(3) Scope. This section applies to debt cancellation contracts and debt suspension agreements entered into by state banks in connection with an extension of credit they make. State banks' debt cancellation contracts and debt suspension agreements are governed by this section and applicable provisions in the Finance Code, and not by state insurance laws.

(c) Prohibited Practices.

(1) Anti-tying. A state bank may not extend credit nor alter the terms or conditions of an extension of credit conditioned upon the customer entering into a debt cancellation contract or debt suspension agreement with the bank.

(2) Misrepresentations. A state bank may not engage in any practice or use any advertisement that could mislead or otherwise cause a reasonable person to reach an erroneous belief with respect to information that must be disclosed under this section.

(3) Prohibited Contract Terms. A state bank may not offer debt cancellation contracts or debt suspension agreements that contain terms:

(A) giving the bank the right unilaterally to modify the contract or agreement unless:

(i) the modification is favorable to the customer and is made without additional charge to the customer; or

(ii) the customer is notified of any proposed change and is provided a reasonable opportunity to cancel the contract without penalty before the change goes into effect; or

(B) requiring a lump sum, single payment for the contract payable at the outset of the contract, where the debt subject to the contract is a residential mortgage loan.

(d) Refunds of fees on termination or prepayment.

(1) Refunds. If a debt cancellation contract or debt suspension agreement is terminated (including, for example, when the customer prepays the covered loan), the bank shall refund to the customer any unearned fees paid for the contract unless the contract provides otherwise. A state bank may offer a customer a contract that does not provide a refund only if the bank also offers that customer a bona fide option to purchase a comparable contract that provides for a refund.

(2) Method of calculating refund. The bank shall calculate the amount of a refund using a method at least as favorable to the customer as the actuarial method.

(e) Payment of fees. Except as provided in subsection (c)(3)(B) of this section, a state bank may offer a customer the option of paying the fee for a contract in a single payment, provided the bank also offers the customer a bona fide option of paying the fee for that contract in monthly or periodic payments. If the bank offers the customer the option to finance the single payment by adding it to the amount the customer is borrowing, the bank must also disclose to the customer, whether and under what terms the customer may cancel the agreement and receive a refund.

(f) Disclosures.

(1) Content of short form of disclosures. The short form of disclosures required by this section must include the information described in subparagraphs (A) through (F) of this paragraph that is appropriate to the product offered. Short form disclosures made in a form that is substantially similar to these disclosures will satisfy the short form disclosure requirements of this subsection.

(A) This product is optional. "Your purchase of (product name) is optional. Whether or not you purchase (product name) will not affect your application for credit or the terms of any existing credit agreement you have with the bank."

(B) Lump sum payment of fee (applicable if a bank offers the option to pay the fee in a single payment, prohibited where the debt subject to the contract is a residential mortgage loan). "You may choose to pay the fee in a single lump sum or in monthly or quarterly payments. Adding the lump sum of the fee to the amount you borrow will increase the cost of (product name)."

(C) Lump sum payment of fee with no refund (applicable if a bank offers the option to pay the fee in a single payment for a no-refund debt cancellation contract, prohibited where the debt subject to the contract is a residential mortgage loan). "You may choose (product name) with a refund provision or without a refund provision. Prices of refund and no-refund products are likely to differ."

(D) Refund of fee paid in lump sum (applicable where the customer pays the fee in a single payment and the fee is added to the amount borrowed, prohibited where the debt subject to the contract is a residential mortgage loan). Either:

(i) "You may cancel (product name) at any time and receive a refund;"

(ii) "You may cancel (product name) within _______ days and receive a full refund;" or

(iii) "If you cancel (product name) you will not receive a refund."

(E) Additional disclosures. "We will give you additional information before you are required to pay for (product name)." If applicable: "This information will include a copy of the contract containing the terms of (product name)."

(F) Eligibility requirements, conditions, and exclusions. "There are eligibility requirements, conditions, and exclusions that could prevent you from receiving benefits under (product name)." Either:

(i) "You should carefully read our additional information for a full explanation of the terms of (product name);" or

(ii) "You should carefully read the contract for a full explanation of the terms."

(2) Content of long form of disclosures. The long form of disclosures required by this section must include the information described in subparagraphs (A) through (I) of this paragraph that is appropriate to the product offered. Long form disclosures made in a form that is substantially similar to these disclosures will satisfy the long form

disclosure requirements of this subsection.

(A) This product is optional. "Your purchase of (product name) is optional. Whether or not you purchase (product name) will not affect your application for credit or the terms of any existing credit agreement you have with the bank."

(B) Explanation of debt suspension agreement (applicable if the contract has a debt suspension feature). "If (product name) is activated, your duty to pay the loan principal and interest to the bank is only suspended. You must fully repay the loan after the period of suspension has expired." If applicable: "This includes interest accumulated during the period of suspension."

(C) Amount of fee.

(i) For closed-end credit: "The total fee for (product name) is _____________."

(ii) For open-end credit, either:

(I) "The monthly fee for (product name) is based on your account balance each month multiplied by the unit-cost, which is ______________;" or

(II) "The formula used to compute the fee is ______________."

(D) Lump sum payment of fee (applicable if a bank offers the option to pay the fee in a single payment, prohibited where the debt subject to the contract is a residential mortgage loan). "You may choose to pay the fee in a single lump sum or in monthly or quarterly payments. Adding the lump sum of the fee to the amount you borrow will increase the cost of (product name)."

(E) Lump sum payment of fee with no refund (applicable if a bank offers the option to pay the fee in a single payment for a no-refund debt cancellation contract, prohibited where the debt subject to the contract is a residential mortgage loan.) "You have the option to purchase (product name) that includes a refund of the unearned portion of the fee if you terminate the contract or prepay the loan in full prior to the scheduled termination date. Prices of refund and no-refund products may differ."

(F) Refund of fee paid in lump sum (applicable where customer pays the fee in a single payment and the fee is added to the amount borrowed, prohibited where the debt subject to the contract is a residential mortgage loan). Either:

(i) "You may cancel (product name) at any time and receive a refund;"

(ii) "You may cancel (product name) within ______ days and receive a full refund;" or

(iii) "if you cancel (product name) you will not receive a refund."

(G) Use of card or credit line restricted (applicable if the contract restricts the use of card or credit line when customer activates protection). "If (product name) is activated, you will be unable to incur additional charges on the credit card or use the credit line."

(H) Termination of (product name). Either:

(i) "You have no right to cancel (product name)"; or

(ii) "You have the right to cancel (product name) in the following circumstances _____________:" and

(I) "The bank has no right to cancel (product name);" or

(II) "The bank has the right to cancel (product name) in the following circumstances ___________________."

(I) Eligibility requirements, conditions, and exclusions. "There are eligibility requirements, conditions, and exclusions that could prevent you from receiving benefits under (product name)." Either:

(i) "The following is a summary of the eligibility requirements, conditions, and exclusions (summary provided by bank);" or

(ii) "You may find a complete explanation of the eligibility requirements, conditions, and exclusions in paragraphs _________ of the (product name) agreement."

(3) Disclosure requirements; timing and method of disclosures.

(A) Short form disclosures. The bank shall make the short form disclosures orally at the time the bank first solicits the purchase of a contract.

(B) Long form disclosures. The bank shall make the long form disclosures in writing before the customer completes the purchase of the contract. If the initial solicitation occurs in person, then the bank shall provide the long form disclosures in writing at that time.

(C) Special rule for transactions by telephone. If the contract is solicited by telephone, the bank shall provide the short form disclosures orally and shall mail the long form disclosures and, if appropriate, a copy of the contract to the customer within 3 business days, beginning on the first business day after the telephone solicitation.

(D) Special rule for solicitations using written mail inserts or "take one" applications. If the contract is solicited through written materials such as mail inserts or "take one" applications, the bank may provide only the short form disclosures in the written materials if the bank mails the long form disclosures to the customer within 3 business days, beginning on the first business day after the customer contacts the bank to respond to the solicitation, subject to the requirements of subsection (g)(3) of this section.

(E) Special rule for electronic transactions. The disclosure described in this section may be provided electronically in a manner consistent with the requirements of the Uniform Electronic Transactions Act, Texas Business and Commerce Code Chapter 43, and the Electronic Signatures in Global and National Commerce Act, 15 U.S.C. §7001 et seq.

(4) Form of disclosures.

(A) Disclosures must be understandable. The disclosures required by this subsection must be in plain language, i.e., conspicuous, simple, direct, readily understandable, and designed to call attention to the nature and significance of the information provided.

(B) Disclosures must be meaningful. The disclosures required by this subsection must be in a meaningful form. Examples of methods that could call attention to the nature and significance of the information provided include:

(i) a plain-language heading to call attention to the disclosures;

(ii) a typeface and type size that are easy to read;

(iii) wide margins and ample line spacing;

(iv) boldface or italics for key words; and

(v) distinctive type style and graphic devices, such as shading or sidebars, when the disclosures are combined with other information.

(5) Advertisements and other promotional material. The short form disclosures are required in advertisements and promotional material for contracts unless the advertisements and promotional materials are of a general nature describing or listing the services or products offered by the bank.

(g) Affirmative election to purchase and acknowledgment of receipt of disclosures required.

(1) Affirmative election and acknowledgment of receipt of disclosures. Before entering into a contract the bank must obtain a customer's written affirmative election to purchase a contract and written acknowledgment of receipt of the disclosures required by subsection (f) of this section. The election and acknowledgment information must be in plain language, i.e., conspicuous, simple, direct, readily understandable, and designed to call attention to their significance. The election and acknowledgment satisfy these standards if they conform with the requirements in subsection (f)(2) of this section.

(2) Special rule for telephone solicitations. If the sale of a contract occurs by telephone, the customer's affirmative election to purchase may be made orally, provided the bank:

(A) maintains sufficient documentation to show that the customer received the short form disclosures and then affirmatively elected to purchase the contract;

(B) mails the affirmative written election and written acknowledgment, together with the long form disclosures required by subsection (f)(2) of this section, to the customer within 3 business days after the telephone solicitation, and maintains sufficient documentation to show it made reasonable efforts to obtain the documents from the customer; and

(C) permits the customer to cancel the purchase of the contract without penalty not later than

30 days after the date the bank has mailed the long form disclosures to the customer.

(3) Special rule for solicitations using written mail inserts or "take one" applications. If the contract is solicited through written materials such as mail inserts or "take one" applications and the bank provides only the short form disclosures in the written materials, then the bank shall mail the acknowledgment of receipt of disclosures, together with the long form disclosures required by subsection (f) of this section, to the customer within 3 business days, beginning on the first business day after the customer contacts the bank or otherwise responds to the solicitation. The bank may not obligate the customer to pay for the contract until after the bank has received the customer's written acknowledgment of receipt of disclosures unless the bank:

(A) maintains sufficient documentation to show that the bank provided the acknowledgment of receipt of disclosures to the customer as required by this section;

(B) maintains sufficient documentation to show that the bank made reasonable efforts to obtain from the customer a written acknowledgment of receipt of long form disclosures; and

(C) permits the customer to cancel the purchase of the contract without penalty within 30 days after the bank has mailed the long form disclosures to the customer.

(4) Special rule for electronic election. The affirmative election and acknowledgment may be made electronically in a manner consistent with the requirements of the Uniform Electronic Transactions Act, Texas Business & Commerce Code Chapter 322, and the Electronic Signatures in Global and National Commerce Act, 15 U.S.C. 7001 et seq.

(h) Safety and soundness. A state bank must manage the risks associated with debt cancellation contracts and debt suspension agreements in accordance with safe and sound banking principles. Accordingly, a state bank must establish and maintain effective risk management and control processes over its debt cancellation contracts and debt suspension agreements. These processes include appropriate recognition and financial reporting of income, expenses, assets and liabilities, and appropriate treatment of all expected and unexpected losses associated with the products. A bank should also assess the adequacy of its internal control and risk mitigation activities in view of the nature and scope of its debt cancellation contract and debt suspension agreement programs.

(i) Notwithstanding the foregoing, until further notice, compliance with the following provisions of this section will not be required when a state bank, in connection with closed-end consumer credit extended by the bank (other than a residential mortgage loan), offers a debt cancellation contract or debt suspension agreement through an unaffiliated, non-exclusive agent:

(1) the requirement set forth in subsection (e) of this section to offer a periodic payment option;

(2) the requirement set forth in subsection (d)(1) of this section that a bank offering a customer a debt cancellation contract or debt suspension agreement without a refund provision also must offer the customer an option to purchase a comparable debt cancellation contract or debt suspension agreement that provides for a refund;

(3) the long-form disclosure requirement set forth in subsection (f)(2) of this section;

(4) the second short form disclosure set forth in subsection (f)(1)(B) of this section, informing the customer that he or she has the option to pay the fee in a single lump sum or in periodic payments;

(5) the third short form disclosure set forth in subsection (f)(1)(C) of this section, informing the customer that he or she has the option to purchase a debt cancellation contract or debt suspension agreement with a refund provision;

(6) the fifth short form disclosure set forth in subsection (f)(1)(E) of this section, indicating that the customer will receive additional information before being required to pay for the debt cancellation contract or debt suspension agreement; and

(7) the requirement set forth in subsection (g)(1) of this section to obtain a customer's written acknowledgment of receipt of disclosures.

Source: *The provisions of this §12.33 adopted to be effective May 1, 2003, 28 TexReg 3494; amended to be effective September 6, 2007, 32 TexReg 5655; amended to be effective September 9, 2010, 35 TexReg 8101.*

Subchapter C. Investment Limits

§12.61. Calculation of Investment Limit. (a) The term "unimpaired capital and surplus" has the meaning assigned by §12.2 of this title (relating to Definitions).

(b) For purposes of determining compliance with investment restrictions under Finance Code, Chapter 34, a state bank shall determine its investment limit at the same time and in the same manner as it determines its lending limit under §12.11 of this title (relating to Calculation of Lending Limits), to be effective at the same time as its lending limit is effective under §12.11(b) of this title.

Source: *The provisions of this §12.61 adopted to be effective September 6, 2007, 32 TexReg 5655.*

§12.62. Hedging Investments. (a) A hedging investment is an asset held incidental to a permissible banking activity in order to hedge the bank's obligations, rather than as a security held by the bank for investment. The transaction is used to manage risks arising from otherwise permissible banking activities and not entered into for speculative purposes.

(b) A state bank may make an otherwise prohibited investment or exceed the statutory limits for an investment if for the purpose of hedging risks and not for engaging in speculative activities. Documentation underlying the investment decision must demonstrate that the hedging investment offers a particularly well matched and effective risk management mechanism for specific banking risks.

Source: *The provisions of this §12.62 adopted to be effective September 6, 2007, 32 TexReg 5655.*

Subchapter D. Investments[1]

§12.91. Other Real Estate Owned.[2] (a) Definitions. Words and terms used in this subchapter that are defined in the Finance Code, §31.002, have the same meanings as defined in the Finance Code. The following words and terms when used in this subchapter shall have the following meanings unless the context clearly indicates the contrary.

(1) Appraisal--A written report by a state certified or licensed appraiser containing sufficient information to support the state bank's evaluation of OREO taking into consideration market value, analyzing appropriate deductions or discounts, and conforming to generally accepted appraisal standards unless principles of safe and sound banking require stricter standards.

(2) Appraiser--A state certified or licensed staff appraiser or a state certified or licensed third party fee appraiser with relevant and competent experience and background as related to a particular appraisal assignment.

(3) Bank facility--Real property, including improvements, owned or leased to the extent of the lease by a state bank if the real estate is held for the purposes set forth in the Finance Code, §34.001, and is not disqualified under the Finance Code, §34.002(b). The term also includes capitalized leasehold improvements if held for the same purposes.

(4) Coterminous sublease--A lease with the same duration as the remainder of the master lease.

(5) Evaluation--A written report prepared by an evaluator describing the OREO and its condition, the source of information used in the analysis, the actual analysis and supporting information and the estimate of the OREO's market value, with any limiting conditions.

(6) Evaluator--An individual who has related real estate training or experience and knowledge of the market relevant to the OREO but who has no direct or indirect interest in the OREO. An appraiser may be an evaluator.

(7) Generally accepted appraisal standards--The Uniform Standards of Professional Appraisal Practice (USPAP) promulgated by the Appraisal Standards Board, Appraisal Foundation, Washington, D.C.

(8) Market value--The most probable price which a property should bring in a competitive and open market under all conditions requisite to a fair sale, the buyer and seller each acting prudently and knowledgeably, and assuming the price is not affected by undue stimulus. Implicit in this definition is the consummation of a sale as of a specified date and the passing of title from seller to buyer under conditions whereby:

(A) buyer and seller are typically motivated;

[1] Also see Supervisory Memorandum-1007, relating to policies for investment securities.

[2] Also see Supervisory Memorandum-1008, relating to policy for other real estate owned.

(B) both parties are well informed or well advised, and acting in what they consider their own best interests;

(C) a reasonable time is allowed for exposure in the open market;

(D) payment is made in terms of cash in U.S. dollars or in terms of financial arrangements comparable thereto; and

(E) the price represents the normal consideration for the property sold unaffected by special or creative financing or sales concessions granted by anyone associated with the sale.

(9) Non-coterminous sublease--A lease with a duration shorter than the remainder of the master lease.

(10) Other Real Estate Owned (OREO)--Real estate, including improvements, mineral interests, surface, and subsurface rights, owned in whole or in part or leased by a state bank, no matter how acquired, which is not a bank facility as defined by paragraph (3) of this subsection or leasehold property as permitted under the Finance Code, §34.204(a), but excluding nonparticipating royalty interests classified as personal property pursuant to Finance Code, §34.004.

(11) Staff appraiser--An appraiser on the staff of a state bank who has no direct or indirect interest in the OREO.

(12) Third party fee appraiser--An appraiser who has an independent contractor relationship with a state bank and has no direct or indirect interest in the OREO.

(13) Year--For the purposes of this section, a calendar year.

(b) Prohibition on real estate ownership. A state bank may not acquire or hold real estate except as specifically provided under the Finance Code, §§34.001-34.003 and 34.204(a), and this section.

(c) Acquisition of OREO. A state bank may hold OREO only if acquired by:

(1) purchase under judicial or nonjudicial foreclosure, or through a deed in lieu of foreclosure, of real estate that is security for a debt or debts previously contracted in good faith;

(2) purchase to protect its interest in a debt or debts previously contracted if prudent and necessary to avoid or minimize loss;

(3) purchase of an employee's principal residence to facilitate a change of duty assignment or relocation upon employment;

(4) with prior written approval of the banking commissioner, an exchange of OREO or personal property for real estate to avoid or minimize loss on the real estate exchanged or to facilitate the disposition of OREO;

(5) with prior written approval of the banking commissioner, purchase of additional real estate to avoid or minimize loss on OREO currently held;

(6) involuntary acquisition of an ownership interest or leasehold interest in real estate as a result of or incidental to a judicial or nonjudicial foreclosure, or by adverse possession, or by operation of law without any action on the part of the state bank to obtain such interest; or

(7) loss of designation of real estate owned or leased by the state bank as a bank facility.

(8) purchase for the purpose of providing temporary housing for employees if:

(A) a bank has two or more locations of sufficient distance that overnight travel is required in connection with business at either location; and

(B) the board has certified that the cost of purchasing and maintaining the property is reasonable in comparison to other options for temporarily housing employees.

(d) Appraisal requirements.

(1) Subject to paragraph (2) of this subsection, when OREO is acquired, a state bank must substantiate the market value of the OREO by obtaining an appraisal within 60 days of the date of acquisition. An evaluation may be substituted for an appraisal if the recorded book value of the OREO is less than $250,000.

(2) An additional appraisal or evaluation is not required when a state bank acquires OREO if a valid appraisal or appropriate evaluation was made in connection with the real estate loan that financed the acquisition of the OREO and the appraisal or evaluation is less than one year old.

(3) An evaluation shall be made on all OREO at least once a year. An appraisal shall be made at least once every three years on OREO with a recorded book value in excess of $250,000.

(4) Notwithstanding another provision of this section, the banking commissioner may require an appraisal of OREO if the banking commissioner considers an appraisal necessary to address safety and soundness concerns.

(e) Additional expenditures on OREO. A state bank may re-fit OREO for new tenants or make normal repairs and incur routine maintenance costs to preserve or protect the value of the OREO or to render the OREO in saleable condition without prior notification to or approval by the banking commissioner. Other advances or additional expenditures on OREO must have the prior written approval of the banking commissioner, and must not be:

(1) made for the purpose of speculation in real estate;

(2) made for the purpose of changing or altering the current status or intended use of the OREO; and

(3) inconsistent with safe and sound banking practices.

(f) Holding period.

(1) A state bank must dispose of OREO no later than five years after the date it was acquired, ceases to be used as a bank facility, or ceases to be a bank facility as provided by Finance Code, §34.002(b), unless an extension of time for disposing of the real estate is granted in writing by the banking commissioner pursuant to Finance Code, §34.003(d).

(2) The holding period commences on the date that:

(A) ownership is acquired by the state bank pursuant to subsection (c)(1)-(5) of this section;

(B) OREO is acquired by a state bank through merger/consolidation, conversion or purchase and assumption;

(C) the bank first learns of its ownership interest in real estate which has devolved to the bank by operation of law under subsection (c)(6) of this section;

(D) the bank ceases to use a former bank facility or completes its relocation from a former bank facility to a new bank facility; or

(E) is three years following the acquisition of real estate as a bank facility for future expansion or relocation of the bank if the real estate has not been occupied by the bank, unless the banking commissioner has granted written approval to a further delay in the improvement and occupation of the real estate.

(3) The banking commissioner may grant one or more additional extensions of time for disposing of OREO if the banking commissioner finds that the state bank has made a good faith effort to dispose of the OREO or that disposal of the OREO would be detrimental to the safety and soundness of the state bank.

(g) Disposition Efforts; Documentation. A state bank must make diligent and ongoing efforts to dispose of OREO and must maintain documentation adequate to reflect those efforts. Such documentation must be available for inspection by the banking commissioner.

(h) Disposition of OREO. A state bank may dispose of OREO by:

(1) selling the OREO in a transaction that qualifies as a sale under regulatory accounting principles;

(2) selling the OREO pursuant to a land contract or contract for deed;

(3) retaining the property for its own use as a bank facility, subject to the approval of the banking commissioner;

(4) transferring the OREO to a majority-owned subsidiary in compliance with 12 C.F.R. §362.4(b)(5)(i);

(5) transferring the OREO for market value to an affiliate, subject to the Finance Code, §33.109, and applicable federal law, including 12 U.S.C. §§371c, 371c-1, and 1828(j);

(6) if the OREO is a master lease, obtaining a coterminous sublease or an assignment of a coterminous sublease, provided that if the bank acquires or obtains assignment of a non-coterminous sublease, the holding period during which the master lease must be divested is suspended for the duration of

the sublease and will commence running again upon termination of the sublease; or

(7) entering into a transaction that does not qualify for disposal under paragraphs (1)-(5) of this section; provided that its obligation to dispose of the OREO is not met until the bank receives or accumulates from the purchaser an amount in cash, principal and interest payments, and private mortgage insurance totaling 10% of the sales price, as measured in accordance with regulatory accounting principles.

(i) Accounting for OREO. Investment in OREO, and disposition of OREO, must be accounted for in accordance with regulatory accounting principles.

Source: *The provisions of this §12.91 adopted to be effective March 1, 1996, 21 TexReg 1527; amended to be effective November 13, 1997, 22 TexReg 10954; amended to be effective July 10, 2003, 28 TexReg 5149; amended to be effective September 6, 2007, 32 TexReg 5655; amended to be effective November 7, 2013, 38 TexReg 7687.*

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CHAPTER 15. CORPORATE ACTIVITIES

CHAPTER 15. CORPORATE ACTIVITIES

Subchapter A. Fees and Other Provisions of General Applicability

§15.1. Definitions.

Words and terms used in this chapter that are defined in the Finance Code, Title 3, Subtitle A or Subtitle G, have the same meanings as defined in the Finance Code. The following words and terms, when used in this chapter, shall have the following meanings, unless the context clearly indicates otherwise.

(1) Accepted filing--An application, request, notice, or protest filed with the banking commissioner pursuant to the Finance Code, Title 3, Subtitle A or G, this chapter, or another rule adopted pursuant to the Finance Code if:

(A) the appropriate fee has been paid pursuant to §15.2 of this title (relating to Filing Fees and Cost Deposits); and

(B) the banking commissioner has received sufficient information to reach an informed decision and has notified the person or entity who submitted the filing, in writing, that the submission is complete and has been accepted for filing.

(2) Community--The area delineated by a state bank as the local community or communities that comprise a state bank's entire community pursuant to the Community Reinvestment Act (CRA), 12 United States Code (USC), §§2901 et seq and any rules or regulations adopted pursuant to CRA. The community may include the delineated area for the purposes of CRA in which the person or entity that is required or authorized to publish public notice proposes to engage in business, is currently engaged in business, or wishes to abandon.

(3) Day--A calendar day.

(4) Eligible bank--A state bank that:

(A) is well capitalized as defined in 12 Code of Federal Regulations (CFR), §325.103, or is operating in compliance with a capital plan approved in writing by the banking commissioner;

(B) received a composite rating of either 1 or 2 as defined by the Uniform Financial Institutions Rating System at the most recent examination by the department or federal regulatory agencies;

(C) received a CRA rating of either outstanding or satisfactory at the bank's most recent inspection by the appropriate federal regulatory agency;

(D) is not presently operating in violation of a regulatory condition or commitment letter imposed by a state or federal banking regulatory agency; and

(E) is not presently operating under a memorandum of understanding; determination letter or other notice of determination; order to cease and desist, or other state or federal administrative enforcement order issued by a state or federal banking regulatory agency.

(5) General interest items--Include, but are not limited to, local and international news, weather, sports, features, comics, entertainment and advertisements directed to the general public.

(6) Low or moderate income area--A designated geography for CRA purposes, as defined in 12 CFR, §228.12(l), (n)(1), and (n)(2), for state member banks, or 12 CFR, §345.12(l), (n)(1), and (n)(2), for state nonmember banks.

(7) Newspaper of general circulation--A newspaper that:

(A) devotes not less than 25% of its total column lineage to general interest items, provided that a newspaper of general circulation does not include a specialized newspaper or other periodical directed to a specific interest group or occupation, such as a legal notice or court related newspaper;

(B) is published at least once a week;

(C) is entered as second class postal matter in the county where published; and

(D) has been published regularly and continuously for at least 12 months before the applicant, protesting party or other entity publishes notice, provided that a weekly newspaper is considered to have been published regularly and continuously if the newspaper omits not more than three issues in a 12-month period.

(8) Public notice--A notice published in a newspaper of general circulation concerning the subject matter of a submitted filing.

(9) Submitted filing--An application, request, notice, or protest, that is neither an accepted filing nor an abandoned filing, filed under the Finance Code, Title 3, Subtitle A or G, this chapter, or another rule adopted pursuant to the Finance Code.

Source: *The provisions of this §15.1 adopted to be effective January 5, 1996, 20 TexReg 10999; amended to be effective September 15, 1997, 22 TexReg 8948; amended to be effective March 12, 1998, 23 TexReg 2287; amended to be effective November 12, 2003, 28 TexReg 9825.*

§15.2. Filing and Investigation Fees.

(a) Types of fees. Subsection (b) of this section contains filing fees for specified applications and notices filed with the department, and subsection (c) of this section requires a fee for protesting an application. These fees are due at the time of filing the application or protest. Subsection (d) of this section requires an investigation fee to be paid in certain cases once an application has been accepted by the department for filing, and in other cases may require payment of investigative costs upon written request of the department. Pursuant to subsection (e) of this section, an applicant may seek waiver or reduction of required fees.

(b) Filing fees. Simultaneously with a submitted application or notice, an applicant shall pay to the department:

(1) $15,000 for an application for bank charter pursuant to Finance Code, §32.003, provided that the department will not require a filing fee for an application for a bank charter to be located in a low or moderate income area and where no other depository institution operates a branch or home office;

(2) a fee for an application for conversion to a state bank charter pursuant to Finance Code, §32.502, and §15.108 of this title (relating to Conversion of a Financial Institution into a State Bank), based on total assets as follows, except that the listed fee may be reduced by 50% if the application is eligible for expedited treatment pursuant to §15.103 of this title (relating to Expedited Filings):

(A) $5,000 for an applicant with total assets of less than $100 million;

(B) $10,000 for an applicant with total assets of $100 million or more but less than $500 million;

(C) $15,000 for an applicant with total assets of $500 million or more but less than $1 billion; or

(D) $25,000 for an applicant with total assets of more than $1 billion;

(3) a fee for an application to authorize a merger or share exchange (including an interstate transaction) pursuant to Finance Code, §32.302, and §15.104 of this title (relating to Application for Merger or Share Exchange), based on total combined assets as follows:

(A) $7,500 for a merger or share exchange with combined assets of less than $1 billion, or $4,000 if the application is eligible for expedited treatment pursuant to §15.103 of this title; or

(B) $15,000 for a merger or share exchange with combined assets of $1 billion or more, or $7,500 if the application is eligible for expedited treatment pursuant to §15.103 of this title;

(4) $2,000 for each request to authorize an additional merger if more than one affiliated merger is to occur simultaneously;

(5) $5,000 for an application to authorize a purchase of assets exceeding three times the amount of the bank's unimpaired capital and surplus (including an interstate transaction) pursuant to Finance Code, §32.401, and §15.105 of this title (relating to Application for Authority to Purchase Assets of Another Financial Institution), or $2,500 if the application is eligible for expedited treatment pursuant to §15.103 of this title;

(6) $2,500 for an application to authorize the sale of assets exceeding three times the amount of unimpaired capital and surplus (including an interstate transaction) pursuant to Finance Code, §32.405, and §15.106 of this title (relating to Application for Authority to Sell Assets);

(7) $2,000 for an application to establish a branch office (including an interstate transaction) pursuant to Finance Code, §32.203, and §15.42 of this title (relating to Establishment and Closing of a Branch Office), or $1,000 if the application is eligible for expedited treatment pursuant to §15.3 of this title (related to Expedited Filings), provided that the department will not require a filing fee for an application for a new branch office to be located in a low or moderate income area and where no other depository institution operates a branch or home office;

(8) $200 for a notice of branch relocation pursuant to §15.42(j) of this title;

(9) $1,000 for a subsidiary notice letter pursuant to Finance Code, §34.103, plus an amount up to an additional $3,500 if the banking commissioner notifies the applicant that additional information and analysis is required;

(10) $10,000 for an application regarding acquisition of control pursuant to Finance Code, §33.002, and §15.81 of this title (relating to Application for Acquisition or Change of Control of State Bank), or $5,000 if the applicant has previously been approved to control another state bank and no material changes in the applicant's circumstances have occurred since the prior approval;

(11) $500 for a notice to change the home office to an existing branch office while retaining the existing home office as a branch office pursuant to Finance Code, §32.202, and §15.41(a) of this title (relating to Written Notice or Application for Change of Home Office);

(12) $2,000 for an application to relocate the home office pursuant to Finance Code, §32.202, and §15.41(b) of this title, or $1,000 if the application is eligible for expedited treatment pursuant to §15.3 of this title, provided that the fee is $5,000 for an application to relocate the home office of a to-be-acquired charter without significant business activities;

(13) $500 for a notice regarding establishment of an office pursuant to §3.91 of this title (relating to Loan Production Offices), or §3.93 of this title (relating to Deposit Production Offices);

(14) $5,000 for an application for a foreign bank branch or agency license pursuant to Finance Code, §204.101, and §3.41(a) of this title (relating to

Applications, Notices and Reports Related to Foreign Bank Branches and Agencies);

(15) $1,000 for the statement of registration of a foreign bank representative office pursuant to Finance Code, §204.201, and §3.44(b) of this title (relating to Statements of Registration, Notices and Filings Related to Foreign Bank Representative Offices);

(16) $300 for an application to amend a bank charter (certificate of formation) pursuant to Finance Code, §32.101;

(17) $2,500 for an application to authorize a reverse stock split subject to the substantive provisions of §15.122 of this title (relating to Amendment of Certificate to Effect a Reverse Stock Split);

(18) $2,000 for filing a copy of an application to acquire a bank or bank holding company pursuant to Finance Code, §202.001;

(19) $1,000 for filing a copy of an application to acquire a nonbank entity pursuant to Finance Code, §202.004;

(20) $100 for a request for a "no objection" letter to use a name containing a term listed in Finance Code, §31.005;

(21) $1,000 for an application to authorize acquisition of treasury stock pursuant to Finance Code, §34.102, and §15.121 of this title (relating to Acquisition and Retention of Shares as Treasury Stock);

(22) $1,000 for a request to authorize an increase or reduction in capital and surplus pursuant to Finance Code, §32.103; and

(23) $500 for an application for release from a final removal or prohibition order pursuant to Finance Code, §35.0071.

(c) Filing fee for protest. A person or entity filing a protest to the application of another person or entity shall pay a fee of $2,500 simultaneously with such protest filing. The purpose of the fee required under this subsection is to partially offset the department's increased cost of processing and reduce the costs incurred by the applicant resulting solely from the protest.

(d) Investigative fees and costs. An applicant for a bank charter or conversion to a state bank shall pay an investigation fee of $10,000 once the application has been accepted for filing. If required by the banking commissioner, an applicant under another type of application or filing listed in subsection (b) of this section shall pay the reasonable investigative costs of the department incurred in any investigation, review, or examination considered appropriate by the department, calculated as provided by §3.36(h) of this title (relating to Annual Assessments and Specialty Examination Fees). Such investigation fee or costs must be paid by the applicant upon written request of the department. Failure to timely pay the investigation fee or a bill for investigative costs constitutes grounds for denial of the submitted or accepted filing.

(e) Reduction or waiver of fees. Fees paid are nonrefundable and the banking commissioner shall charge fees on a consistent and nondiscriminatory basis. However, in the exercise of discretion, the banking commissioner may reduce, waive, or refund all or part of a filing fee, investigation fee, or bill for investigative costs if the banking commissioner concludes that:

(1) the application demonstrates that the fee creates an unreasonable hardship on the applicant; or

(2) the nature of the application will result in substantially reduced processing time compared to normal expectations for an application of that type.

(f) Severability. If any fee or cost recovery set forth in this section is finally determined by a court of competent jurisdiction to be invalid, that fee or cost recovery shall be severed from this section and the remainder of this section shall remain fully enforceable.

Source: *The provisions of this §15.2 adopted to be effective January 5, 1996, 20 TexReg 10999; amended to be effective November 13, 1997, 22 TexReg 10955; amended to be effective March 12, 1998, 23 TexReg 2287; amended to be effective November 12, 2003, 28 TexReg 9825; amended to be effective March 8, 2012, 37 TexReg 1497; amended to be effective November 8,* *2012, 37 TexReg 8779; amended to be effective January 2, 2014, 38 TexReg 9482; amended to be effective May 5, 2016, 41 TexReg 3099.*

§15.3. Expedited Filings.

(a) An eligible bank may file an expedited filing according to forms and instructions provided by the department solely for the following matters, together with the fee required by §15.2 of this title (relating to Filing and Investigation Fees):

(1) a branch application pursuant to Finance Code, §32.203, and §15.42 of this title (relating to Establishment and Closing of a Branch Office); and

(2) home office relocations less than one mile with no abandonment of the community pursuant to the Finance Code, §32.202(c), and §15.41 of this title (relating to Written Notice or Application for Change of Home Office).

(b) Notwithstanding another provision of this section, the banking commissioner may deny expedited filing treatment to an eligible bank, in the exercise of discretion, if the banking commissioner finds that the filing involves one or more of the following:

(1) the proposed transaction involves significant policy, supervisory, or legal issues;

(2) approval of the proposed transaction is contingent on additional statutory or regulatory approval by the banking commissioner or another state or federal regulatory agency;

(3) the proposed transaction will result in a fixed asset investment in excess of the limitation contained in the Finance Code, §34.002(a);

(4) the proposed transaction requires the approval of the banking commissioner under the Finance Code, §33.109(b);

(5) the proposed transaction involves an issue of parity between state and national banks pursuant to the Finance Code, §32.009;

(6) the proposed transaction significantly impacts the strategic plan of the bank;

(7) the proposed transaction will result in a decrease in capital below the levels required to meet the definition of "well capitalized" in 12 Code of Federal Regulations, §325.103;

(8) the proposed transaction will result in an abandonment of the community pursuant to the Finance Code, §32.202(d);

(9) the proposed transaction involves an issue of regulatory concern as determined by the banking commissioner in the exercise of discretion; or

(10) the application is deficient and specific additional information is required, or the filing fee has not been paid.

(c) The department shall notify the applicant on or before the 15th day after receipt of the application if expedited filing treatment is not available under this section. Such notification of denial must be in writing and must indicate the reason why expedited treatment is not available. Notification is effective when mailed by the department and is not subject to appeal.

(d) If expedited filing treatment is denied, the applicant shall submit any additional fee required by §15.2 of this title on or before the fifth business day after receipt of the notice.

(e) Unless the applicant is otherwise notified by the department, an expedited filing is approved on the 15th day after the later of the date the application is complete and accepted for filing, or expiration of the period for filing a comment, protest, response or reply, whichever is the last to occur, unless a protest is filed. If a protest is filed, the application will be processed under §15.41 or §15.42 of this title, whichever is applicable.

Source: *The provisions of this §15.3 adopted to be effective January 5, 1996, 20 TexReg 10999; amended to be effective November 13, 1997, 22 TexReg 10955; amended to be effective November 12, 2003, 28 TexReg 9825; amended to be effective November 8, 2012, 37 TexReg 8779; amended to be effective*

January 2, 2014, 38 TexReg 9482; amended to be effective May 5, 2016, 41 TexReg 3099.

§15.4. Required Information and Abandoned Filings.

(a) Required information. The banking commissioner may investigate and evaluate facts related to a submitted filing or accepted filing to the extent necessary to reach an informed decision. The banking commissioner may require any person or entity connected with the matter to which the submitted or accepted filing pertains to submit additional information, including, but not limited to, an opinion of counsel with respect to a matter of law or an opinion, review or compilation prepared by a certified public accountant.

(b) On or before the 15th day after initial submission of an application, the banking commissioner shall issue a written notice informing the applicant either that all filing fees have been paid and the application is complete and accepted for filing, or that the application is deficient and specific additional information is required.

(c) Time limit for providing required information. An applicant must provide all information necessary for the banking commissioner to declare that a submission is an accepted filing, whether the information is required by form or rule or is requested by the department. The information must be provided to the department on or before the 61st day after the date of initial submission of the filing, except as otherwise provided by law. Upon a finding of good and sufficient cause, the banking commissioner shall grant an applicant additional time to complete the application. Extensions will be communicated to the applicant before the expiration of the filing period.

(d) Abandoned filing. The banking commissioner may determine any submitted or accepted filing to be abandoned, without prejudice to the right to refile, if the information required by the Finance Code, this chapter, or any rule or regulation adopted pursuant to the Finance Code, or additional requested information, is not furnished within the time period specified by subsection (c) of this section or as requested by the banking commissioner in writing to the person or entity making the submission. The banking commissioner may determine a submitted or accepted filing for which fees required by the Finance Code or by this chapter are not paid within 30 days of receipt of the initial submission to be abandoned.

(e) Notice. The banking commissioner shall give written notice of any submitted or accepted filing considered to be abandoned. Notice of abandonment shall be effective upon mailing by the department. Fees paid related to an abandoned filing are nonrefundable.

Source: *The provisions of this §15.4 adopted to be effective January 5, 1996, 20 TexReg 10999; amended to be effective February 14, 1997, 22 TexReg 1311; amended to be effective November 12, 2003, 28 TexReg 9825; amended to be effective September 4, 2014, 39 TexReg 6824.*

§15.5. Public Notice.

(a) General. A person or entity required or authorized to file public notice, including a person or entity requesting authorization for a merger, purchase of assets, a conversion, an applicant for a foreign bank agency, or another application requiring public notice, shall publish notice in a newspaper of general circulation in its specified community or in an alternative form of publication acceptable to the banking commissioner and in such other locations as may be required by the banking commissioner.

(b) Contents. The public notice must state that a filing is being made; the date (or expected date) of the filing; sufficient information describing the proposed transaction, and other related information required by the Finance Code, Title 3, Subtitle A or G, this chapter, or another rule adopted pursuant to the Finance Code. The notice must also contain any other information as may be required by the banking commissioner. In addition, the notice must include substantially the following text as a separately stated paragraph:

"Any person wishing to comment on this application, either for or against, may file written comments with the Texas Department of Banking, 2601 North Lamar Boulevard, Austin, Texas 78705-4294 on or before the 14th day after the date of this publication. Such comments will be made a part of the record before and considered by the banking commissioner. Any person wishing to formally protest and oppose (describe type of application in general terms) and participate in the application process may do so by filing a written notice of protest with the Texas Department of Banking on or before the 14th calendar day after the date of this publication accompanied by a protest filing fee of $2,500. The protest fee may be reduced or waived by the banking commissioner upon a showing of substantial hardship."

(c) Publisher's affidavit. A person or entity required to file public notice under this section shall file with the banking commissioner a copy of the notice and a publisher's affidavit attesting to the date of publication.

(d) One Publication Sufficient. Unless otherwise required by the Finance Code or rules and regulations adopted pursuant to the Finance Code, one public notice publication per submitted or accepted filing in each community specified by the banking commissioner is sufficient if in substantial compliance with this section and chapter and with the Finance Code, as determined by the banking commissioner. The banking commissioner reserves the right to require additional publication based on a determination that a particular publication is insufficient or is otherwise not in compliance.

(e) Other acceptable public notice. The banking commissioner may determine that public notice required by another regulatory agency of a bank or other regulated entity satisfies the public notice requirements of this section. For example, if a state bank converts, merges, or organizes into a financial institution that is no longer regulated by the banking commissioner and the banking commissioner determines that public notice requirements imposed by the successor regulatory authority regarding the conversion, merger, or organization satisfy the notice requirements of the Act and this section, the banking commissioner may permit the notice required by the successor regulatory authority to serve as notice under the Act and this section.

Source: *The provisions of this §15.5 adopted to be effective January 5, 1996, 20 TexReg 10999; amended to be effective March 21, 1997, 22 TexReg 2608; amended to be effective November 12, 2003, 28 TexReg 9825; amended to be effective November 8, 2012, 37 TexReg 8779.*

§15.6. Applications for Bank Charter: Notices to Applicants; Application Processing Times; Appeals.

(a) Form of application. An application to engage in a business under the Finance Code, §32.003, must be filed on a form prescribed by the banking commissioner.

(b) Notice to applicant. The banking commissioner shall issue a written notice as required by §15.4 of this title (relating to Required Information and Abandoned Filings) informing the applicant either that all filing fees have been paid and the application is complete and accepted for filing, or that the application is deficient and specific additional information is required. If a protest is timely filed, the department will notify the applicant of the protest.

(c) Action on applications. If an application is not protested and if the banking commissioner has not ordered a hearing, the banking commissioner shall approve or deny an application for a state bank charter or an application for conversion of a financial institution to a state bank on or before the 180th day after the date the application is accepted for filing, unless extended by written agreement between the applicant and the banking commissioner. If the application is protested, the application will be acted on in accordance with §15.10 of this title (relating to Protested Applications).

(d) Violation of Processing Times. If an application is not pretested or a hearing is not convened, an applicant may appeal directly to the banking commissioner for a timely resolution of a dispute arising from a violation of a processing period set forth in this section. An applicant may appeal by filing a written request with the banking commissioner on or before the 30th day after the date the decision is made on the application, requesting review by the banking commissioner to determine whether the established period for the granting or denying of the application has been exceeded. The decision on the appeal shall be based on the written appeal filed by the applicant, any response by the department, and any agreements between the parties. The banking commissioner may convene a hearing to take evidence on the matter.

(e) Decision on Appeal. The banking commissioner shall decide the appeal in the applicant's favor if the banking commissioner determines that the time periods established in this section have been exceeded and the department has failed to establish good cause for the delay. The banking commissioner shall issue a written decision to the applicant on or before the 60th day after the filing of an appeal. If an appeal is decided in an applicant's favor, the department will reimburse the application fee paid by the applicant. A decision in favor of the applicant under this subsection does not affect a decision to grant or deny the application based on applicable substantive law without regard to whether the application was timely processed.

Source: *The provisions of this §15.6 adopted to be effective January 5, 1996, 20 TexReg 10999; amended to be effective November 13, 1997, 22 TexReg 10955; amended to be effective July 10, 2008, 33 TexReg 5275.*

§15.7. Submission of Reproductions.

(a) Scope. This section governs submission of specified forms of copies of original documents to the Texas Department of Banking (the department) for processing by the corporate activities division of the department pursuant to this chapter, and does not permit, prohibit, or affect correspondence with or documents submitted to the department for another purpose, including:

(1) applications submitted to the special audits division of the department; and

(2) documents submitted to the department as required or permitted by Government Code, Chapter 2001, and Chapter 9 of this title (relating to Rules of Procedure for Contested Case Hearings, Appeals, and Rulemakings).

(b) Reproduction. For purposes of this section, the term reproduction means:

(1) a photographic or photostatic copy or similar reproduction of an original document that is submitted to the department by mail or hand delivery;

(2) a facsimile copy of an original document submitted by telephonic document transmission to the telecopier telephone number specified by the department; or

(3) if permitted by the department with respect to a specific filing, an electronic copy of an original document submitted to the email address specified by the department.

(c) Filings. Subject to the length limitations of subsection (d) of this section, a document required or authorized to be filed with the department may be a reproduction, including an application or a supplement to or substitution for a portion of a previously filed and accepted application. Receipt of a reproduction by the department is not equivalent to accepted for filing.

(d) Page limitations. A reproduction submitted by telephonic document transmission to the department's telecopier machine may not exceed 25 pages in total length, including the transmittal document required by subsection (e) of this section, or it will be rejected for filing. The transmission of portions of any particular filing at different times is treated as one reproduction for purposes of this subsection.

(e) Transmittal document. A cover sheet or transmittal document must accompany every reproduction submitted under this section and must:

(1) clearly identify the sender by name, address, and phone number, the documents being delivered or transmitted, and the number of pages in the submission;

(2) contain clear and concise instructions concerning the sender's request with respect to the submission; and

(3) contain complete and accurate information regarding the payment of required filing fees, if any.

(f) Time of receipt. To be considered received by the department, a reproduction must be in clearly legible form. The date the submission is actually received by the department or the date and time imprinted by the department's telecopier on the last page of a reproduction submitted by telephonic document transfer will determine the time of receipt, provided that a reproduction received after 4:30 p.m. is considered received at 8:00 a.m. on the next business day. A reproduction will not be considered received until the department receives the entire document and the required filing fee, if any.

(g) Equivalent of original. For all purposes attendant to filing, a reproduction of a document filed with the department under this section, including reproduction of signatures thereon, is considered an original document.

Source: *The provisions of this §15.7 adopted to be effective July 17, 1997, 22 TexReg 6429; amended to be effective November 12, 2003, 28 TexReg 9825; amended to be effective November 8, 2012, 37 TexReg 8779.*

§15.8. [Repealed Effective September 9, 2010.]

§15.9. Corporate Filings.

(a) In accordance with the applicable provisions of the Finance Code, Title 3, Subtitle A or G, the following corporate forms regarding a state bank, along with the applicable filing fees, must be filed with the banking commissioner:

(1) a certificate of correction as authorized by Texas Business Organizations Code (TBOC), §4.101;

(2) certificate of amendment under the Finance Code, §32.101;

(3) restated, or, amended and restated, certificate of formation under the Finance Code, §32.101, and TBOC, §3.059 and §21.052;

(4) certificate of merger under the Finance Code, §32.301 et seq, as supplemented by the TBOC, §10.151;

(5) certificate of exchange under TBOC, §10.151;

(6) statement of event or fact pursuant to TBOC, §4.055;

(7) establishment of a series of shares by the board of directors under the Finance Code, §32.102, as supplemented by TBOC, §21.155 and §21.156;

(8) statement regarding a restriction on the transfer of shares under TBOC, §21.212; and

(9) abandonment of a merger or interest exchange prior to its effective date under TBOC, §4.057.

(b) For purposes of corporate filings with the banking commissioner under subsection (a) of this section, state banks may utilize a modified version of forms promulgated by the secretary of state if the banking commissioner or the finance commission has not promulgated an appropriate corporate form; however, the banking commissioner may require the submission of additional information. The modified corporate forms must:

(1) specifically reference the applicable provisions of the Finance Code;

(2) change references from "corporation" to "association"; and

(3) change the references to "stated capital" and similar terms defined in the TBOC to an appropriate reference to terms defined in the Finance Code.

(c) In accordance with the applicable provisions of the Finance Code and the TBOC, a state bank may file the following corporate forms with the secretary of state as instructed in the Finance Code or the TBOC:

(1) name registrations under TBOC, §§5.151-5.155;

(2) assumed name certificates under TBOC, §5.051;

(3) a statement appointing an agent authorized to receive service of process under Finance Code, §201.103;

(4) an amendment to a statement appointing an agent to receive service of process under Finance Code, §201.103; and

(5) a cancellation of the appointment of an agent to receive service of process under Finance Code, §201.103.

(d) The following corporate forms are inapplicable to state banks and are not required to be filed by a state bank with either the secretary of state or the banking commissioner:

(1) changes of registered office or agent under TBOC, §5.202 or §5.203;

(2) name reservations under TBOC, §5.101;

(3) certificate of termination under TBOC, §11.101; and

(4) certificate of reinstatement under TBOC, §11.202.

Source: *The provisions of this §15.9 adopted to be effective July 10, 2008, 33 TexReg 5275; amended to be effective September 9, 2010, 35 TexReg 8101; amended to be effective November 7, 2013, 38 TexReg 7687.*

§15.10. Protested Applications.

(a) A protest of a charter application must be received by the department before the 15th day after the date the organizers publish notice and must be accompanied by any fee required by §15.5(b) of this title (relating to Public Notice). If the protest is untimely, the department will return all fees and deposits to the protesting party. If the protest is timely, the department shall notify the applicant of the protest and mail or deliver a complete copy of the nonconfidential sections of the charter application to the protesting party before the 15th day after the later of the date of receipt of the protest or receipt of the charter application.

(b) A protesting party must file a detailed protest responding to each contested statement in the nonconfidential portion of the application not later than the 20th day after the date the protesting party receives the application from the department. The protesting party must relate each statement and response in his protest to the standards for approval set forth in Finance Code §32.003(b).

(c) The applicant must file a written reply to the protesting party's detailed response on or before the 10th day after the date the response is filed.

(d) The protesting party's response and the applicant's reply must be in the form and must be served as required by Finance Code §32.005(b). Any comment received by the department and any reply of the applicant to the comment shall be made available to the protesting party.

Source: *The provisions of this §15.10 adopted to be effective July 10, 2008, 33 TexReg 5275.*

§15.11. Hearings on Applications.

(a) The banking commissioner may not be compelled to hold a hearing before granting or denying the charter application. The banking commissioner may grant a hearing at the request of an applicant or a protesting party. The banking commissioner may order a hearing without any party having requested one.

(b) A party requesting a hearing must indicate with specificity the issues involved that cannot be determined on the basis of the record complied under §15.10(b) - (d) of this title (relating to Protested Applications) and why the issues cannot be determined.

(c) If the banking commissioner sets a hearing, the banking commissioner shall conduct a public hearing and one or more prehearing conferences as the banking commissioner considers advisable and consistent with applicable law. The banking commissioner shall also allow the parties to undertake such discovery as the banking commissioner considers advisable and consistent with applicable law, except that the banking commissioner may not permit discovery of confidential information in the charter application or the investigation report.

Source: *The provisions of this §15.11 adopted to be effective July 10, 2008, 33 TexReg 5275.*

§15.12. Waiver of Requirements.

The banking commissioner in the exercise of discretion may waive or modify any requirement imposed by this chapter, unless specifically required by statute.

Source: *The provisions of this §15.12 adopted to be effective July 10, 2008, 33 TexReg 5275.*

Subchapter B. Bank Charters

§15.23. Application for Interim Bank Charters.

(a) General. The banking commissioner may issue an interim state bank charter solely for the purpose of facilitating the acquisition, reorganization, or merger of a pre-existing bank, if the resulting bank will engage in the business of banking in substantially the same markets. The applicant must submit the application for an interim bank charter on a form prepared and prescribed by the banking commissioner and tender the required filing fee pursuant to §15.2 of this title (relating to Filing Fees and Cost Deposits). The applicant must describe in detail the entire transaction in which the interim bank charter is proposed to be used and identify the resulting bank after completion of the transaction.

(b) Public Notice. Upon submission of application, the applicant shall publish notice as required by §15.5 of this title (relating to Public Notice) and in the community where the resulting bank is to be located.

(c) Public Comment. No hearing will be held regarding the issuance of an interim bank charter unless the banking commissioner, in the exercise of discretion, sets and convenes a hearing. Persons or entities submitting comments will not be entitled to further notice of or participation in the interim bank charter application proceedings.

(d) Adequacy of Capital. The banking commissioner shall determine the adequacy of capital for a proposed interim bank charter, except that an interim bank may not be chartered with a capital less than $5,000.

Source: *The provisions of this §15.23 adopted to be effective January 5, 1996, 20 TexReg 10999.*

§15.24. Option to Withhold Identity of Officers.

An applicant for a state bank may, at its option, withhold the identity of prospective officers until such time as the banking commissioner issues a final order on the application. Approval of the application is conditioned upon filing, with the banking commissioner, the required information and authorizations on qualified proposed officers. Upon receipt of the required information, the banking commissioner shall review and investigate the qualification of the proposed officers and deliver the certificate of authority pursuant to the Finance Code, §32.006, if the banking commissioner finds that the proposed officers meet the requirements of the Finance Code, §32.003(b)(4).

Source: *The provisions of this §15.24 adopted to be effective January 5, 1996, 20 TexReg 10999; amended to be effective November 12, 2003, 28 TexReg 9825.*

Subchapter C. Bank Offices

§15.41. Written Notice or Application for Change of Home Office.

(a) Relocation by notice. Unless an application under subsection (b) of this section is required, a state bank may change its home office to one of its previously established branches pursuant to the Finance Code, §32.202(b), by filing a written notice containing the information required by subsection (c) of this section, accompanied by the filing fee required by §15.2 of this title (relating to Filing Fees and Cost Deposits). A bank may relocate its home office immediately after the required notice and fee has been acknowledged in writing as complete and accepted for filing by the banking commissioner. An application under subsection (b) of this section is required if the proposed home office relocation:

(1) will result in an abandonment of all or part of the community served by the bank's present home office location; or

(2) is anticipated to result in a reduction in banking services presently offered by the bank at its present home office location within the 18 month period after the effective date of the relocation.

(b) Relocation by application.

(1) A state bank relocating its home office must file an application setting forth the information required by subsection (c) of this section, accompanied by the required filing fee pursuant to §15.2 of this title if it is a relocation pursuant to:

(A) the Finance Code, §32.202(b) and subsection (a) of this section does not apply; or

(B) the Finance Code, §32.202(c).

(2) An eligible bank may file an expedited application pursuant to §15.3 of this title (relating to Expedited Filings).

(3) On or before the 15th day after initial submission of an application, the banking commissioner will issue the written notice required by §15.4(b) of this title (relating to Required Information and Abandoned Filings).

(4) Except as otherwise provided in this section and to the extent applicable, the banking commissioner will evaluate an application under this subsection in light of the Finance Code, §32.202(d), and apply the criteria applicable to an application for a branch office under §15.42(e) of this title (relating to Establishment and Closing of a Branch Office).

(5) An applicant under this subsection may not relocate its home office without the prior written approval of the banking commissioner.

(c) Contents of notice or application. The notice filed under subsection (a) of this section or the application submitted under subsection (b) of this section must disclose:

(1) the name of the bank requesting the home office relocation;

(2) the street address of the bank's home office before the requested home office relocation;

(3) the street address of the bank's proposed home office;

(4) the effective date of the home office relocation under subsection (a) of this section, or the requested effective date for a proposed home office relocation under subsection (b) of this section;

(5) a copy of the resolution adopted by the bank's board of directors authorizing the proposed home office relocation;

(6) a written statement signed by the principal executive officer of the bank or a majority of the bank's board of directors stating whether or not the proposed home office relocation will result in an abandonment of all or part of the community served by the bank's present home office location and, if so, an explanation of how the abandonment promotes the public convenience and advantage;

(7) written statement signed by the principal executive officer of the bank or a majority of the bank's board of directors stating whether or not, within the 18 month period after the proposed effective date of the relocation, a reduction in banking services presently offered by the bank at its present home office location is anticipated and, if so, an explanation of:

(A) the anticipated reduction in banking services; and

(B) how:

(i) the diminution in services is consistent with the original determination of public necessity for the establishment of the bank at its existing location; or

(ii) the public convenience and advantage would be promoted by the home office relocation;

(8) a description of any actual, proposed, or contemplated financial involvement in the home office relocation by an officer, director, manager, managing participant, or principal shareholder or participant of the state bank;

(9) evidence that the bank has considered the applicability of federal law governing main office or branch closing or relocation, such as 12 United States Code, §1828(d)(1), and regulations and policy statements issued thereunder; and

(10) other information as the banking commissioner may require.

(d) Public notice.

(1) Within 14 days prior to or 14 days after the initial submission of a written application under subsection (b) of this section, the applicant must publish notice of the submission, as required by §15.5 of this title (relating to Public Notice). Notice must be published in the community where the current home office of the bank is located and in the community of the proposed home office.

(2) The notice must contain the content required by §15.5(b) of this title, the current home office address, and the proposed home office address.

(e) Public comment and protest. For 14 days after publication of the notice or longer if the banking commissioner allows more time for good cause shown, the public may submit written comments or protests regarding an application under subsection (b) of this section. There is no fee or cost for submitting a comment, but persons commenting are not entitled to further notice of or participation in the proceedings. In the event of a properly filed protest, each protesting party has the rights and responsibilities of a protesting party to a branch application under §15.42 of this title.

(f) Certificate of Formation. An amendment to the certificate of formation of the state bank is not required to effect a change in the location of its home office. However, if the certificate of formation is subsequently amended or restated, the resulting certificate of formation must include the bank's current home office address.

Source: *The provisions of this §15.41 adopted to be effective January 5, 1996, 20 TexReg 10999; amended to be effective September 13, 1996, 21 TexReg 8455; amended to be effective January 7, 2004, 29 TexReg 80; amended to be effective November 8, 2012, 37 TexReg 8779; amended to be effective November 7, 2013, 38 TexReg 7687.*

§15.42. Establishment and Closing of a Branch Office.

(a) Forms. If a state bank wants to establish and operate a branch office in this state or an interstate branch office pursuant to Finance Code, §32.203 and §203.001(a), then a branch application must be completed and filed on forms prescribed by the department. An application for an interstate branch must also provide information regarding applicable host state law and evidence of compliance with the law. Eligible banks may file an expedited application pursuant to §15.3 of this title (relating to Expedited Filings).

(b) Filing. The banking commissioner will issue a written notice as required by §15.4 of this title (relating to Required Information and Abandoned Filings) informing the applicant either that all filing fees have been paid and the application is complete and accepted for filing, or that the application is deficient and specific additional information is required.

(c) Public notice.

(1) Within 14 days prior to or 14 days after the initial submission of its application, the applicant must publish notice of the application, as required by §15.5 of this title (relating to Public Notice), in the community of the proposed branch.

(2) The notice must comply with the content requirement of §15.5(b) of this title and include the proposed location of the branch or service area.

(3) With respect to an application to establish an interstate branch office pursuant to Finance Code, §32.203 and §203.001(a), the applicant must inform the department of the publication requirements in the host state for the banking commissioner to determine, pursuant to §15.5(e) of this title, whether those requirements satisfy the publication requirements of this subsection.

(d) Public comment and protest. For 14 days after publication of notice, or longer if the banking commissioner allows more time for good cause shown, the public may submit written comments or protests regarding the application. There is no fee or cost for submitting a comment, but persons commenting are not entitled to further notice of or participation in the branch application proceedings. Each protesting party has the rights and responsibilities set forth in subsections (f) and (g) of this section.

(e) Criteria for branch approval: "Significant supervisory or regulatory concerns."

(1) To determine whether there are significant supervisory concerns regarding a proposed branch, the banking commissioner will consider the financial condition of the applicant, the financial effect of the branch on the applicant, the management abilities of the applicant, and the history and prospects of the applicant and its affiliates regarding fulfillment of responsibilities to regulatory agencies and to the public, including, but not limited to, the responsibility of the applicant to meet the credit needs of its entire community pursuant to the Community Reinvestment Act (CRA), 12 United States Code, §2901 et seq. An application will ordinarily be denied if the applicant is in less than satisfactory financial condition as of its most recent examination or has a less than satisfactory rating regarding compliance with CRA.

(2) To determine whether there are significant regulatory concerns regarding a proposed branch, the banking commissioner will consider the need to maintain a sound banking system. The banking commissioner will follow the principles that the marketplace normally is the best regulator of economic activity, and that healthy competition promotes a sound and more efficient banking system that serves customers well. Accordingly, absent significant supervisory concerns, the general policy of the banking commissioner is to approve applications to establish and operate branches, provided that approval would not otherwise violate the provisions of federal or state law (including any requirements for federal banking agency approval).

(3) In determining whether there are significant supervisory or regulatory concerns as set forth in paragraphs (1) and (2) of this subsection, the banking commissioner will consider written material in the record, including the application, comments on file, protests on file, and any replies of the applicant, the department's files as they relate to the current financial condition of the applicant, and any data that the banking commissioner may properly officially notice. Specifically, the banking commissioner will approve a branch if:

(A) the department's files do not indicate significant regulatory concerns as they relate to the current financial condition of the applicant, including but not limited to its capital, asset quality, management, earnings and liquidity (these files are confidential pursuant to the Finance Code, Chapter 31, Subchapter D, and rules adopted pursuant to the Finance Code, are not open or available to either the applicant or a protesting party or to the public);

(B) the costs of establishing the proposed branch office, including costs of purchasing or leasing the branch site, necessary furnishings, staffing and equipment and the effect of these costs do not significantly affect the operations of the applicant as a whole;

(C) the projected earnings appear reasonable and sufficient to support expenses attributable to the branch without jeopardizing the safety and soundness of the applicant;

(D) the depth and quality of management of the applicant and the proposed branch is sufficient to justify a belief that the bank will operate in compliance with the Finance Code;

(E) the bank has demonstrated compliance with CRA as determined by the rating assigned in the applicant's most recent CRA evaluation;

(F) the applicant has demonstrated a responsiveness to recommendations made in past state and federal bank examination reports and the applicant has generally been operated in substantial compliance with all applicable state and federal laws; and

(G) the banking commissioner, in the exercise of discretion, determines there are no areas of general supervisory concern.

(4) The banking commissioner will direct the department to assemble, evaluate, and make a recommendation regarding all relevant documentation

and data as set forth in this subsection within 30 days after the application is complete and accepted for filing, or expiration of the period for filing a comment, protest, response or reply, whichever is the last to occur. If a hearing is granted pursuant to subsection (g) of this section, then the banking commissioner will request the administrative law judge for the Finance Commission of Texas (administrative law judge) to discharge this function through the hearings process. Portions of the assembled record that are confidential pursuant to the Finance Code, Chapter 31, Subchapter D, must be segregated and clearly marked as confidential.

(5) If no hearing is granted, the banking commissioner will either approve, conditionally approve, or deny the application on or before the 30th day after receipt of the department's recommendation.

(f) Protest.

(1) A person may initiate a protest by submitting a written notice of intent to protest the application with the department within the time period allowed by subsection (d) of this section, accompanied by the filing fee required by §15.2 of this title (relating to Filing and Investigation Fees). If the protest is untimely, the filing fee will be returned to the protesting party. If the protest is timely, the department will notify the applicant of the protest and mail or deliver a complete copy of the non-confidential sections of the application to the protesting party on or before the 14th day after receipt of the protest or the application, whichever occurs later.

(2) A protesting party must file a detailed protest responding to each substantive statement contained in the non-confidential sections of the application within 20 days after the protesting party receives the application from the department. The protesting party's response must indicate whether each substantive statement is admitted or denied. The applicant must file a written reply to the protesting party's detailed response on or before the tenth day after the response is filed. Both the protesting party's response and the applicant's reply must be verified by affidavit and certify that a copy was served upon the opposing party. When applicable, statements in the response and in the reply may be supported by references to data available in sources of which official notice may properly be taken. Comments received by the department and any replies of the applicant to the comments will be made available to the protesting party.

(3) The banking commissioner may extend any time period set forth in this subsection for good cause shown. Good cause includes, but is not limited to, failure of the department to furnish required documentation, forms or information within a reasonable time to permit its effective use by the recipient, or failure of a party to timely serve a filed document on an opposing party. The date a document is actually received by the department is its filing date and not the date it is mailed. Failure to timely file a required document is considered an abandonment of the application or protest, as applicable. Rule 21a, Texas Rules of Civil Procedure, will govern methods and manner of authorized service and the computation of time periods under this subsection.

(g) Hearing.

(1) Pursuant to the Finance Code, §32.203, the banking commissioner may not be compelled to hold a hearing prior to granting or denying approval to establish a branch.

(2) In the exercise of discretion, the banking commissioner may consider granting a hearing on a branch application at the request of either the applicant or a protesting party. The banking commissioner may order a hearing even if no hearing has been requested by the parties. A party requesting a hearing must indicate with specificity the issues involved that cannot be determined on the basis of the record compiled pursuant to subsection (e) of this section and why the issues cannot be so determined. The request for hearing and the banking commissioner's decision with regard to granting a hearing will be made a part of the record.

(3) If a hearing is not requested or if a request for hearing is denied, the banking commissioner will consider the application in the manner set forth in and solely on the basis of the written record established pursuant to subsection (e) of this section.

(4) The administrative law judge will enter appropriate order(s) and conduct a hearing within 30 days after the date a hearing is granted, or as soon thereafter as is reasonably possible, under Chapter 9 of this title (relating to Rules of Procedure for Contested Case Hearings, Appeals, and Rulemakings) and the Administrative Procedure Act (Texas Government Code, Chapter 2001). The administrative law judge may require submission of written and prefiled testimony. Evidence will not be received on matters not in dispute. The administrative law judge will not consider issues or evidence that are not relevant to the standards set forth in subsection (e) of this section or that are not supported by the application, response, or reply.

(5) A proposal for decision, exceptions and replies to the proposal for decision, the final decision of the banking commissioner, and motions for rehearing are governed by Chapter 9 of this title.

(h) Beginning operations. Any activity approved pursuant to this section must commence within 18 months from the date of approval unless the banking commissioner extends that date in writing. Approval will automatically expire 18 months from the date of approval if no extension is granted.

(i) Emergency branches. The banking commissioner may authorize banks to establish temporary branch locations in the event of an emergency as defined by the Finance Code, §37.001. The procedures set forth in subsections (c), (d), (f) and (g) of this section do not apply to:

(1) situations in which the banking commissioner has authorized a temporary branch location because of an emergency; or

(2) branch applications made as a part of a transaction for the purpose of assuming all or a portion of the assets and liabilities of any financial institution deemed by the banking commissioner to be in hazardous condition.

(j) Branch relocation. A bank may relocate a branch within a one-mile radius by submitting a completed written notice on a form prescribed by the banking commissioner and tendering the required filing fee pursuant to §15.2 of this title. A bank may relocate the branch immediately after the banking commissioner notifies the bank in writing that the required fee has been paid and the notice is complete and accepted for filing.

(k) Closing a branch. Before closing an approved branch, a bank must comply with the notice requirements of federal law, and provide the department with a copy of the branch closing notice filed with the appropriate federal banking regulator simultaneously with its filing. Once a bank closes a branch the bank cannot reopen the branch except upon application for a new branch in compliance with this section.

Source: *The provisions of this §15.42 adopted to be effective January 5, 1996, 20 TexReg 10999; amended to be effective January 7, 2004, 29 TexReg 80; amended to be effective November 8, 2012, 37 TexReg 8779; amended to be effective May 5, 2016, 41 TexReg 3099.*

§15.43. Establishment and Operation of a Remote Service Unit.

(a) "Remote service unit" means an automated facility, operated by a customer of a bank, that conducts banking functions such as receiving deposits, paying withdrawals, or lending money, and includes an unmanned or automated teller machine, an automated loan machine, and an automated device for receiving deposits. A remote service unit may be equipped with a telephone or video device that allows contact with bank personnel.

(b) A remote service unit is not a branch within the meaning of Finance Code, §31.002(a)(8). A remote service unit established, operated, and maintained by a state bank is not subject to licensing, registration, or prior regulatory approval.

Source: *The provisions of this §15.43 adopted to be effective July 5, 2007, 32 TexReg 3977.*

§15.44. Establishment and Operation of a Center of Monetary Education for Texans.

(a) "Center Of Monetary Education for Texans" (COMET) means a financial education program in which a state bank participates and provides services such as receiving deposits, paying withdrawals, or lending money.

(b) A COMET is not a branch within the meaning of Finance Code §31.002(a)(8), nor is it subject to licensing, registration, or prior regulatory approval, so long as it meets the following conditions:

(1) The service or services are provided on school premises, or a facility used by the school;

(2) The service or services are provided at the discretion of the school;

(3) The principal purpose of each program is financial education. For example, the principal purpose of a program would be considered to be financial education if the program is designed to teach students the principles of personal financial management, banking operations, or the benefits of saving for the future, and is not designed for the purpose of profit-making; and

(4) The program is conducted in a manner that is consistent with safe and sound banking practices and complies with applicable law.

(c) A state bank shall give the banking commissioner 30 days written notice before it begins providing services at a COMET, except that the banking commissioner may waive or shorten the notice period if the banking commissioner does not have a significant supervisory or regulatory concern regarding the bank or its planned COMET. The written notice must include the name of the school and the physical address of the planned COMET, a list of the specific activities to be performed at the planned COMET, the anticipated date for the opening of the COMET, and other information which the banking commissioner may reasonably request.

Source: *The provisions of this §15.44 adopted to be effective November 6, 2008, 33 TexReg 8906.*

Subchapter E. Change of Control Applications

§15.81. Application for Acquisition or Change of Control of State Bank.

(a) Definitions. Words and terms used in this chapter that are defined in the Finance Code, Title 3, Subtitle A, have the same meanings as defined in the Finance Code.

(b) General. Without the prior written consent of the banking commissioner, a person or entity may not, directly or indirectly, acquire a legal or beneficial interest in voting securities of a state bank or a corporation or other entity owning voting securities of a state bank if, after the acquisition, the person or entity would control the state bank. Except as otherwise provided in this section, an application must be filed with the banking commissioner for review and consideration of the proposed transaction.

(c) Form of application. The applicant must submit a fully completed, verified application in a form prescribed by the banking commissioner and simultaneously tender the required filing fee pursuant to §15.2 of this title (relating to Filing Fees and Cost Deposits). The Interagency Notice of Change of Control and the Interagency Biographical and Financial Report may be submitted in lieu of the commissioner prescribed forms if they are accompanied by the executed and notarized signature pages of the commissioner prescribed forms. The application must, except to the extent expressly waived in writing by the banking commissioner, disclose:

(1) the identity, biographical data, business background, and experience relating to banking matters, and a current statement of financial condition, a statement of changes in net worth and a statement of cash flows of each person by whom, or on whose behalf, the acquisition is to be made and by each person acting in concert with others seeking to acquire voting securities subject to the Finance Code and to this section. Financial statements will be considered current if audited and dated within 180 days of the date of the application or will be considered current if unaudited and dated within 90 days of the date of the application. All financial statements must be accompanied by an affidavit of no material change dated as of the date of application;

(2) a completed authorization to release employment, financial, credit, fingerprint information and criminal history records to the department;

(3) a completed confirmation inquiry form;

(4) the identity of each entity other than a natural person seeking to acquire control or working in concert with others to acquire control of a state bank or bank holding company and a copy of the entity's most recent audited financial statement. Financial statements will be considered current if audited and dated within 180 days of the date of the application or will be considered current if unaudited and dated within 90 days of the date of the application. All financial statements must be accompanied by an affidavit of no material change dated as of the date of application;

(5) a description of all material, pending or adjudicated legal or administrative proceedings in which each acquiring person or entity is or was a party. A material legal proceeding includes a proceeding in which the person or entity has been charged with, cited for, or convicted under a state or federal law relating to banking or other financial institutions, securities or financial instrument reporting, or a felony or crime involving moral turpitude under the laws of a state, the United States, or another country. A material legal proceeding also includes a proceeding that resulted in a material unsatisfied judgment, or may result in a judgment, against the acquiring person or entity and this loss contingency must be disclosed in the financial statements of the acquiring person or entity under generally accepted accounting principles, or is otherwise material. A material administrative proceeding includes a proceeding in which the person or entity is or has been subject to a cease and desist, removal, enforcement, or other order, including an order of supervision or conservatorship issued by a state, federal, or foreign regulatory agency;

(6) the terms and conditions of the proposed acquisition or change of control and the manner in which the acquisition or change of control is to be made;

(7) the identity, source, and amount of the funds or other consideration used or to be used in making the acquisition or change of control;

(8) if a portion of the funds or other consideration to be used in making the acquisition has been borrowed or is to be borrowed or otherwise obtained for the purpose of making the acquisition, a complete description of the transaction, the names of the parties to the transaction, and a summary of all arrangements, agreements, or understandings with the parties including terms of repayment;

(9) the applicant's current or proposed business or strategic plan including amendments to a current plan;

(10) plans or proposals to liquidate the state bank or bank holding company, to sell its assets or merge it with another bank or holding company, or to make other major changes in its business, corporate structure, or management;

(11) plans or proposals to change officers and directors of the state bank or bank holding company and the related bank or financial institution management experience of proposed or current officers and directors;

(12) the terms and conditions of an offer, invitation, agreement, or arrangement under which a voting security will be acquired and any contract affecting the security or its financing after it is acquired;

(13) pro forma financial statements with projections indicating whether the acquired or controlled state bank or bank holding company will be adequately capitalized for a period of not less than two years from the date of acquisition; and

(14) other information that the banking commissioner, in the exercise of discretion, considers necessary to make an informed decision to approve or reject the proposed acquisition. The applicant must supply all material information necessary for the banking commissioner to make a fully informed decision on the application.

(d) Public notice. Within 14 days prior to or 14 days after submission of the initial application, the applicant must publish notice as required by the Finance Code, §33.002(d), and §15.5 of this title (relating to Public Notice) in the county where the state bank's or bank holding company's home office is located. One publication under this subsection is adequate unless the banking commissioner expressly requires additional notice.

(e) Confidentiality. Information obtained by the banking commissioner under this section is confidential and may not be disclosed by the banking commissioner or an officer or employee of the department, subject only to disclosure as may be permitted by the Finance Code, §§31.301-31.308 or 33.002(d), or by §3.111 of this title (relating to Confidential Information).

(f) Grandfather clause. A person or entity considered to be in control solely as a result of changed standards in the Texas Banking Act as effective September 1, 1995 (codified as Finance Code, Title 3, Subtitle A, effective September 1, 1997), is exempt from filing an application under this section as long as the person or entity was in compliance with applicable law immediately prior to September 1, 1995, and has not acquired additional shares of voting securities on or after September 1, 1995. This subsection specifically applies to a principal shareholder or principal participant of a state bank or bank holding company that directly or indirectly owns or has the power to vote a greater percentage of voting securities of the state bank or holding company than another shareholder or participant.

(g) Exemptions. In addition to the acquisitions specifically exempted pursuant to the Finance Code, §33.005, these involuntary acquisitions of control do not require prior written approval of the banking commissioner pursuant to the Finance Code, §33.001:

(1) the inadvertent acquisition of control of a state bank or bank holding company by a shareholder as a result of a stock redemption or repurchase by the issuer if the potential controlling shareholder or participant of a state bank or bank holding company did not vote or have any direct or indirect input into the issuer's decision to repurchase or redeem the voting securities;

(2) the acquisition and control by a qualified employee stock ownership plan (ESOP) of less than 25% of voting securities of a state bank or bank holding company unless an officer, director, or principal shareholder or participant directly or indirectly controls the voting securities held by the ESOP, in which event an application for acquisition of control must be filed by the officer, director or principal shareholder or participant, if as a result that person would control over 25% of the voting securities;

(3) the acquisition of control of a state bank as a result of a shareholder receiving proportionate voting securities in a state bank arising from the liquidation of a bank holding company;

(4) the acquisition of additional shares of voting securities of a state bank or bank holding company by virtue of a pro-rata stock dividend or stock split not resulting in increased ownership percentage;

(5) the acquisition of control of a state bank or bank holding company as a result of a gift made in good faith, provided:

(A) the donee is related to the donor within the second degree of consanguinity or affinity;

(B) neither the donor nor donee is under an enforcement order; and

(C) notice of the gift is given to the banking commissioner pursuant to subsection (h) of this section; and

(6) the acquisition of control of a state bank or bank holding company as a result of the transfer of voting securities by gift to a limited partnership or other estate planning vehicle, if determined by the banking commissioner to have an equivalent effect, if:

(A) the limited partnership owns no other voting securities other than the securities transferred;

(B) the donor is the sole general partner of the limited partnership who retains sole voting authority over the voting securities;

(C) neither the donor nor donee is under an enforcement order; and

(D) notice of the gift is given to the banking commissioner pursuant to subsection (h) of this section.

(h) Notices in lieu of filing. If an applicant is not required to file an application because of an exemption under the Finance Code, §33.005, or subsection (g) of this section, but is required to file an application with a federal regulatory authority or a regulatory authority of another state, a copy of that application must be filed with the banking commissioner within seven days of the date of filing it with the federal or state agency. A notice in lieu of filing is required of a person claiming an exemption under the Finance Code, §33.005(1) or (3), or subsection (g) (5) or (6) of this section. This notice must be filed before the securities acquired are voted and must be accompanied by a completed authorization pursuant to subsection (c)(2) of this section. No filing fees are required for notices filed under this section; however, if the banking commissioner determines that an application is required, the appropriate filing fee pursuant to §15.2 of this title is required.

(i) Approval. Automatic approval; conditional approval. If an application filed under this section is not approved by the banking commissioner or is not set for hearing on or before the 60th day after the later of the date notice is published or the application is accepted for filing, the transaction may be consummated. Before the expiration of the initial 60-day period, the banking commissioner may give the applicant written notice that the application is approved; upon receipt of the notice, the applicant may immediately consummate the transaction. Before the expiration of the initial 60-day period, the banking commissioner may also give an applicant written notice that the application is conditionally approved subject to certain conditions. The applicant must enter into a written agreement with the banking commissioner concerning these conditions on or before the 30th day after the date the applicant receives notification of conditional approval. An agreement entered into by the applicant and the banking commissioner concerning conditional approval is enforceable against the applicant and the bank and is considered for all purposes an agreement under the provisions of the Finance Code. If an applicant receives conditional approval, but does not enter into an agreement with the banking commissioner as required by this subsection, the banking commissioner will set the matter for hearing.

(j) Consummation of an acquisition or change of control transaction. The acquisition or change of control of the voting securities must be consummated as proposed in the application, in the agreement concerning conditional approval as provided in subsection (i) of this section, or as provided in a final order pursuant to subsection (m) of this section. A transaction approved or conditionally approved under this section must be consummated within 12 months after the date of approval by the banking commissioner unless an extension is granted in writing. Until a transaction is consummated, the banking commissioner reserves the right to alter, suspend or withdraw approval if an interim development warrants it.

(k) Notification by banking commissioner. A notification by the banking commissioner under this section may be sent by registered or certified mail, return receipt requested, and is considered delivered upon deposit in the United States mail postage prepaid, return receipt requested, addressed to the applicant at the address furnished in the application.

(l) Abandoned filing. The banking commissioner may determine an application to be abandoned pursuant to §15.4 of this title (relating to Required Information and Abandoned Filings).

(m) Hearing on application. The banking commissioner will set an application for hearing on or before the 60th day after notice is published as required by the Finance Code, §33.002(d), and subsection (i) of this section. The notice of hearing must comply with Government Code, §2001.051, and will state that the purpose of the hearing is to give the applicant an opportunity to show that is has met all required qualifications for the banking commissioner's approval of the acquisition or change of control application. The applicant has the burden of showing all required qualifications by a preponderance of evidence. The hearing must comply with Government Code, Chapter 2001 (the Administrative Procedure

Act). After the hearing, the banking commissioner will grant or deny the application based solely upon the evidence presented at the hearing. An applicant may not appeal the denial of an application or conditional approval of an application until a final order is issued. If after a hearing is held, the banking commissioner enters an order denying the application, and the order has become final, the applicant may appeal the final order by filing a petition for judicial review under the substantial evidence rule in the District Court of Travis County, Texas, and not elsewhere, as provided by the Finance Code, §33.004, and the Government Code, Chapter 2001.

Source: *The provisions of this §15.81 adopted to be effective July 12, 1996, 21 TexReg 6073; amended to be effective November 13, 1997, 22 TexReg 10955; amended to be effective January 7, 2004, 29 TexReg 80; amended to be effective November 8, 2012, 37 TexReg 8779.*

Subchapter F. Applications for Merger, Conversion, and Purchase or Sale of Assets

§15.101. Definitions.

(a) Words and terms used in this subchapter that are defined in the Finance Code, Title 3, Subtitle A, have the same meanings as defined in the Finance Code.

(b) When these words and terms are used in this subchapter they will have these meanings, unless the context clearly indicates otherwise.

(1) Annual report–Formal financial statements and accompanying narrative of management issued yearly for the benefit of shareholders and other interested parties.

(2) Chartering agency–A government authority that has chartering jurisdiction over an entity involved in a transaction under this subchapter.

(3) Conversion–The conversion of a state bank into a successor form of financial institution pursuant to the Finance Code, §32.501, or the conversion of a financial institution into a state bank pursuant to the Finance Code, §32.502.

(4) Corporation or domestic corporation–A corporation for profit subject to the provisions of the Texas Business Organizations Code, except a foreign corporation.

(5) CRA–The federal Community Reinvestment Act, 12 United States Code, §§2901 et seq.

(6) Current financial statements– Audited financial statements dated as of a date not more than 180 days prior to the date of submission of an application, or unaudited financial statements dated as of a date not more than 90 days prior to the date of submission of an application.

(7) Financial institution–An entity defined as a financial institution under Finance Code §201.101(1)(A)-(D).

(8) Foreign corporation–A corporation for profit organized under laws other than the laws of this state.

(9) Low-quality asset–An asset as defined in 12 United States Code, §371c(b)(10), currently an asset that falls in any one or more of these categories:

(A) an asset classified as "substandard," "doubtful," or "loss," or treated as "other loans especially mentioned" in the most recent report of examination or inspection of an affiliate prepared by either a federal or state supervisory agency;

(B) an asset in a nonaccrual status;

(C) an asset on which principal or interest payments are more than 30 days past due; or

(D) an asset whose terms have been renegotiated or compromised due to the deteriorating financial condition of the obligor.

(10) Material administrative proceeding–A past or pending proceeding by a state, federal, or foreign regulatory agency against the applicant or other person involved in a transaction under this subchapter that resulted in or could result in the issuance of a cease and desist, removal, enforcement action, determination letter or other order, including an

order of supervision or conservatorship; excluding, however, a past proceeding that resulted in an order, other than a removal order, that has been satisfied or otherwise terminated more than five years prior to the date the application or notice requesting the information is submitted.

(11) Material legal proceeding–

(A) a past or pending criminal proceeding against the applicant or other person involved in a transaction under this subchapter that resulted or may result in conviction of the applicant or other person of a crime under a state or federal law or the law of a foreign country relating to banks, other financial institutions, securities, financial instrument reporting, or another crime involving moral turpitude; or

(B) a past or pending proceeding that has or may result in a judgment against the applicant or other person or entity involved in a transaction under this subchapter and the loss contingency must be disclosed in the financial statements of the entity under generally accepted accounting principles, or is otherwise material.

(12) Merger–A transaction that is:

(A) the division of a financial institution into two or more new financial institutions or into a surviving financial institution or one or more new financial institutions, domestic or foreign corporations, or other entities, at least one of which is a state bank or is not a financial institution; or

(B) the combination of one or more financial institutions with one or more financial institutions, domestic or foreign corporations, or other entities, at least one of which is a state bank, resulting in:

(i) one or more surviving financial institutions, domestic or foreign corporations, or other entities;

(ii) the creation of one or more new financial institutions, domestic or foreign corporations, or other entities; or

(iii) one or more surviving financial institutions, domestic or foreign corporations, or other entities and the creation of one or more new financial institutions, domestic or foreign corporations, or other entities; or

(C) another transaction involving a financial institution or other entity, at least one of which is a state bank, which is considered a merger under the Texas Business Organizations Code.

(D) an interstate merger transaction as defined in Finance Code, §201.002(a)(27).

(13) Other entity–An entity, whether or not organized for profit, other than a financial institution or a domestic or foreign corporation, including without limitation a not-for-profit corporation, limited or general partnership, joint venture, joint stock company, cooperative, association, insurance company, trust company, or other legal entity organized pursuant to the laws of this state or another state or country to the extent the laws or the constituent documents of that entity, consistent with the laws, permit that entity to enter into a merger or share exchange subject to this subchapter.

(14) Principal executive officer–An officer primarily responsible for the execution of board policies and operation of the bank in accordance with the Finance Code, §33.106.

(15) Purchase of assets–The purchase other than in the ordinary course of business of all or substantially all of the assets of a state bank or another entity. This may include an interstate merger transaction as defined in Finance Code, §201.002(a)(27)(B).

(16) Regulatory restriction–A memorandum of understanding, determination letter, notice of determination, order to cease and desist, or other state or federal administrative enforcement order issued by a state or federal banking regulatory agency, or another limitation imposed on a financial institution by a state or federal banking regulatory agency that restricts its ability to act without authorization from the regulatory agency imposing the condition.

(17) Resulting state bank–A state bank subject to the provisions of this subchapter that is a surviving entity in a merger.

(18) Sale of assets–The sale, lease, exchange, or other disposition of substantially all of the assets of a state bank other than in the ordinary course of business. This may include an interstate merger transaction as defined in Finance Code, §201.002(a)(27)(B).

(19) Share exchange–A transaction by which one or more financial institutions, domestic or foreign corporations, or other entities acquire all of the outstanding shares of one or more classes or series of one or more state banks under the authority of the Finance Code, §32.008, and the Texas Business Organizations Code.

(20) Substantially all of the assets–More than 50% of the assets or assets sufficient to materially impact the net earnings of a state bank involved in a transaction under this subchapter.

(21) Verified–Documents submitted by the applicant that have been attested to as true and correct. Attested documents filed pursuant to this subchapter are not required to be notarized.

Source: *The provisions of this §15.101 adopted to be effective September 15, 1997, 22 TexReg 8948; amended to be effective January 7, 2004, 29 TexReg 80; amended to be effective November 8, 2012, 37 TexReg 8779.*

§15.102. General.

Without the prior written consent of the banking commissioner, a state bank may not consummate a merger, conversion, sale of assets, purchase of assets, or share exchange. Except as otherwise provided in the Finance Code, Chapter 32, Subchapters D, E, and F, or in this subchapter, an application must be filed with the banking commissioner for review and consideration of the proposed transaction.

Source: *The provisions of this §15.102 adopted to be effective September 15, 1997, 22 TexReg 8948.*

§15.103. Expedited Filings.

(a) A financial institution that would be an eligible bank as defined in §15.1 of this title (relating to Definitions) if it was a state bank may file an expedited filing in lieu of an application required under §15.104 of this title (relating to Application for Merger or Share Exchange), §15.105 of this title (relating to Application for Authority to Purchase Assets of Another Financial Institution), or §15.108 of this title (relating to Conversion of a Financial Institution into a State Bank), and simultaneously tender the required filing fee pursuant to §15.2 of this title (relating to Filing Fees and Cost Deposits).

(b) An expedited filing consists of a letter application including, except to the extent waived by the banking commissioner, these items:

(1) a summary of the transaction;

(2) a current pro forma balance sheet and income statement for all parties to the transaction, with adjustments, reflecting the proposed transaction as of the most recent quarter ended immediately prior to the filing of the application, demonstrating that each resulting state bank is well capitalized as defined in 12 Code of Federal Regulations, §325.103;

(3) a completed Worksheet to Determine Eligibility form as prescribed by the commissioner;

(4) a completed Worksheet for Expedited Filings form as prescribed by the commissioner;

(5) an executed opinion of counsel conforming to the requirements of the section of this subchapter that would apply had the applicant not filed an expedited filing;

(6) copies of all other required regulatory notices or filings submitted concerning the transaction; and

(7) a copy of the public notice published in conformity with the section of this subchapter that would apply had the applicant not filed an expedited filing.

(c) The banking commissioner must notify the applicant on or before a date that is 15 days after receipt of the application if expedited filing treatment is not available under this section for any reason. Notification must be in writing and must indicate the reason expedited treatment is not available. Notification is effective when mailed by the banking commissioner and is not subject to appeal.

(d) The banking commissioner, in the exercise of discretion, may withdraw an application from expedited processing or may deny expedited filing treatment to an otherwise eligible applicant if the banking commissioner finds that the application involves one or more of these issues:

(1) the proposed transaction involves significant policy, supervisory, or legal issues;

(2) approval of the proposed transaction is contingent on additional statutory or regulatory approval by the banking commissioner or another state or federal regulatory agency;

(3) the proposed transaction contemplates a resulting entity that is not a financial institution;

(4) the proposed transaction involves a financial institution or other entity that is not domiciled in Texas;

(5) the proposed transaction would cause the assets of a resulting state bank to increase more than:

(A) 100% if it had total assets of one billion dollars or less prior to the transaction; or

(B) 35% if it had total assets of more than one billion dollars prior to the proposed transaction;

(6) the proposed transaction involves a state bank that has experienced, since the last commercial examination by a state or federal regulatory agency, asset growth, through acquisition or otherwise, greater than:

(A) 100% if it had total assets of one billion dollars or less at the last examination; or

(B) 35% if it had total assets of more than one billion dollars at the last examination;

(7) the proposed transaction involves a resulting state bank that would not be well capitalized as defined in 12 CFR §325.103;

(8) the proposed transaction involves an issue of regulatory concern as determined by the banking commissioner in the exercise of discretion; or

(9) the banking commissioner determines that a conversion examination is necessary for financial institutions converting into a state bank.

(e) The banking commissioner must approve or deny an expedited filing on or before a date that is 30 days after the date the expedited filing is accepted for filing pursuant to §15.4 of this title (relating to Required Information and Abandoned Filings). The banking commissioner may, in the exercise of discretion, before the expiration of the period for decision, give the applicant written notice that the banking commissioner will convene a hearing to obtain evidence related to the application, and the decision will thereafter be made in accordance with §15.113 of this title (relating to Approval; Conditional Approval; Denial of Application; Hearings).

(f) The applicant must supply all material information necessary for the banking commissioner to make a fully informed decision on the expedited filing.

Source: *The provisions of this §15.103 adopted to be effective September 15, 1997, 22 TexReg 8948; amended to be effective January 7, 2004, 29 TexReg 80; amended to be effective November 8, 2012, 37 TexReg 8779.*

§15.104. Application for Merger or Share Exchange.

(a) Scope. This section governs an application for merger or share exchange pursuant to the Finance Code, §§32.301-32.303 and 32.008[1], or §203.001(b). This section does not apply to a merger,

[1] Also see Finance Code, §32.304, relating to limitation on control of deposits in this state.

reorganization, or conversion of a state bank into another form of financial institution pursuant to the Finance Code, §32.501, governed by §15.107 of this title (relating to Notice of Merger, Reorganization, or Conversion of a State Bank into Another Form of Financial Institution).

(b) Form of application. The applicant must submit a fully completed, verified application on a form prescribed by the banking commissioner and simultaneously tender the required filing fee pursuant to §15.2 of this title (relating to Filing Fees and Cost Deposits). The Interagency Bank Merger Act application may be used in lieu of the commissioner prescribed form if it is accompanied by the signature page and supplemental page of the commissioner prescribed form. The application must, except to the extent waived by the banking commissioner, include:

(1) a summary of the proposed transaction;

(2) a copy of all agreements related to the proposed transaction executed by an authorized representative of each party to the merger or share exchange;

(3) certificate and plan of merger or share exchange in accordance with the Texas Business Organizations Code, which must include:

(A) a current draft of the certificate of merger or share exchange, and additional copies equal to the number of surviving, new, or acquired entities, executed and acknowledged by an authorized officer for each party to the merger or share exchange;

(B) the plan of merger or share exchange;

(C) the restated certificate of formation of each resulting state bank;

(D) the restated certificate of formation, or other constitutive documents, of each surviving entity other than the resulting state bank;

(E) the certificate of formation, or other constitutive documents, of each new resulting entity;

(F) if a party to a merger is an entity required to file documents with the Texas secretary of state before the transaction can be legally consummated, a provision in the certificate of merger conditioning the merger upon the approval of the banking commissioner, containing wording substantially as follows, as applicable: This merger will become effective upon the final approval and filing of the certificate of merger by the Secretary of State of Texas and with the Banking Commissioner of Texas which must be on or before ________ (date), which is the 90th day after the date of filing of the certificate of merger with the Secretary of State;

(4) for each party to the merger or share exchange, a certified copy of those portions of the minutes of board meetings and shareholder or participant meetings at which action was taken regarding approval of the merger or share exchange, or a certificate of an officer verifying the action taken by the board of directors and the shareholders or participants approving the merger or share exchange, or an explanation of the basis for concluding that this action was not required;

(5) for each resulting state bank, an assessment of its future prospects, proposed officers and directors, and proposed branches and other locations;

(6) an assessment of the current regulatory and financial condition of each party to the transaction;

(7) if a merger or share exchange will change the existing CRA delineated community of a resulting state bank, a copy of a map depicting the proposed delineated community of the resulting state bank;

(8) a copy of current financial statements for each entity involved in the proposed transaction, accompanied by an affidavit of no material change dated no earlier than 30 days prior to the date of submission of the application;

(9) a copy of the latest annual report for each financial institution and bank holding company involved in the proposed transaction;

(10) a copy of that portion of the most recent watch list for each financial institution involved in the proposed transaction that identifies low-quality assets;

(11) a description of the due diligence review conducted by or for a state bank that is a party to the transaction and a summary of findings;

(12) a description of all material legal or administrative proceedings involving any party to the merger or share exchange;

(13) an opinion of legal counsel that conforms with §15.109 of this title (relating to Opinion of Legal Counsel), concluding:

(A) the merger or share exchange has been duly authorized by the board and shareholders or participants of each participating state bank in accordance with the Finance Code, §32.301, and the Texas Business Organizations Code;

(B) the merger or share exchange will not cause or result in a material violation of the laws of this state relative to the organization and operation of state banks;

(C) all deposit and other liabilities of every state bank that is a party to the merger or share exchange will be discharged or otherwise assumed or retained by a financial institution that is authorized by law to do so;

(D) each surviving, new, or acquiring entity that is not a financial institution will not be engaged in the unauthorized business of banking, and each resulting state bank will not be engaged in a business other than banking or a business incidental to banking; and

(E) all conditions with respect to the merger or share exchange that have been imposed by the banking commissioner have been satisfied or otherwise resolved or, to the best knowledge of legal counsel, no conditions have been imposed;

(14) a copy of each filing or application regarding the proposed merger or share exchange required by another governmental authority, complete with all related attachments, exhibits, and correspondence;

(15) a current pro forma balance sheet and income statement for each party to the transaction, with adjustments, reflecting the proposed merger or share exchange as of the most recent quarter ended immediately prior to the filing of the application;

(16) a copy of the strategic plan that complies with the department's Memorandum 1009, including projections of the balance sheet and income statement of each resulting state bank as of the quarter ending one year from the date of the pro forma financial statement required by paragraph (15) of this subsection;

(17) an explanation of compliance with or nonapplicability of provisions of governing law relating to rights of dissenting shareholders or participants to the merger or share exchange;

(18) a copy of all securities offering documents, proxy statements, or other disclosure materials delivered or to be delivered to shareholders or participants of a party concerning the merger or share exchange;

(19) an explanation of the manner and basis of converting or exchanging any of the shares or other evidences of ownership of an entity that is a party to the merger or share exchange into shares, obligations, evidences of ownership, rights to purchase securities, or other securities of one or more of the surviving, acquiring, or new entities, into cash or other property, including shares, obligations, evidences of ownership, rights to purchase securities, or other securities of another person or entity, or into a combination of the foregoing;

(20) for antitrust purposes, an analysis of the anticipated competitive effect of the proposed transaction in the affected markets and a statement of the basis of the analysis of the competitive effects, or alternatively, a copy of the analysis of competitive effects of the proposed transaction addressed in the companion federal regulatory agency application;

(21) other information that the banking commissioner, in the exercise of discretion, considers necessary to make an informed decision to approve or deny the proposed merger or share exchange; and

(22) in addition to all other requirements of this subsection, with respect to an interstate merger transaction:

(A) any additional opinions and information the applicant, by contacting the department, determines the banking commissioner requires; and

(B) information regarding applicable host state law and evidence of compliance with the law.

(c) Applicant's duty to disclose. The applicant must supply all material information necessary for the banking commissioner to make a fully informed decision on the application.

(d) Public notice. Within 14 days prior to or 14 days after submission of the initial application, the applicant must publish notice in accordance with the requirements of §15.5 of this title (relating to Public Notice) in the specified communities where the home office of the applicant, the target entity, and the resulting bank are or will be located. With respect to an interstate merger transaction, the applicant must inform the department of the publication requirements in the host state for the banking commissioner to determine, pursuant to §15.5(e) of this title, whether those requirements satisfy the publication requirements of this subsection.

(e) Approval by the banking commissioner and filings with a chartering agency.

(1) The banking commissioner will approve a merger or share exchange only if the application indicates substantial compliance with all conditions of the Finance Code, §32.302(b) and §32.304.

(2) If a party is required to file certificate of merger or exchange with its chartering agency after acceptance for filing pursuant to §15.4(b) of this title (relating to Required Information and Abandoned Filings), an applicant for merger or share exchange must file the original certificate of merger or exchange as certified by the chartering agency with the banking commissioner.

(3) After approval of an application under this section, the banking commissioner will accept the certificate of merger or exchange previously filed with the chartering agency (if applicable), issue a certificate of merger or exchange, and perform the duties required by the Finance Code, §32.302(c). With respect to a transaction that requires filing with the Texas secretary of state, if the banking commissioner does not approve the certificate of merger or exchange on or before the 90th day after the filing of the certificate of merger or exchange with the Texas secretary of state, the applicant must refile the certificate of merger or exchange with both the Texas secretary of state and with the banking commissioner.

(4) After issuance of the certificate of merger or exchange by the banking commissioner, the applicant must file a statement with the chartering authority, if applicable, certifying as to the date that each future event upon which the effectiveness of the merger was conditioned has been satisfied.

(5) The date of issuance of the certificate of merger by the banking commissioner is the date of approval unless the merger agreement provides for a later effective date approved by the banking commissioner pursuant to the Finance Code, §32.302(d).

Source: *The provisions of this §15.104 adopted to be effective September 15, 1997, 22 TexReg 8948; amended to be effective January 7, 2004, 29 TexReg 80; amended to be effective November 8, 2012, 37 TexReg 8779; amended to be effective November 7, 2013, 38 TexReg 7687.*

§15.105. Application for Authority to Purchase Assets of Another Financial Institution.

(a) Scope. This section governs an application for the purchase of assets pursuant to the Finance Code, §§32.001(c) and 32.401 - 32.404 or Finance Code §203.001(b).

(b) Form of application. The applicant must submit a fully completed, verified application on a form prescribed by the banking commissioner and simultaneously tender the required filing fee pursuant to §15.2 of this title (relating to Filing Fees and Cost

Deposits). The application must, except to the extent waived by the banking commissioner, include:

(1) a summary of the proposed transaction, including a description of the types and total dollar amounts of liabilities and obligations expressly assumed;

(2) a copy of all agreements related to the proposed transaction executed by an authorized representative of each party to the transaction;

(3) for each party to the transaction, a certified copy of those portions of the minutes of board meetings and shareholder or participant meetings at which action was taken regarding approval of the transaction, or a certificate of an officer verifying the action taken by the board of directors and the shareholders or participants approving the transaction, or an explanation of the basis for concluding that this action was not required;

(4) an assessment of the applicant's future prospects, proposed officers and directors, and proposed branches and other locations;

(5) an assessment of the current regulatory and financial condition of each party to the transaction;

(6) if the proposed transaction will change the existing CRA delineated community of the applicant, a copy of the proposed CRA map depicting the proposed delineated community of the applicant;

(7) a copy of current financial statements for each entity involved in the proposed transaction, accompanied by an affidavit of no material change dated no earlier than 30 days prior to the date of submission of the application;

(8) a copy of the latest annual report for each financial institution and bank holding company involved in the proposed transaction;

(9) a copy of that portion of the most recent watch list for the applicant and that portion of the watch list of the selling party that identifies low-quality assets being acquired or liabilities being assumed;

(10) a description of the due diligence review conducted by or for the applicant and a summary of findings;

(11) a description of all material legal or administrative proceedings involving the applicant;

(12) an opinion of legal counsel that conforms with §15.109 of this title (relating to Opinion of Legal Counsel), concluding:

(A) the transaction will not cause or result in a material violation of the laws of this state relative to the organization and operation of state banks;

(B) the liabilities and obligations of the purchasing bank will be limited to those expressly assumed under the purchase agreement, unless otherwise required by law; and

(C) all conditions with respect to the transaction imposed by the banking commissioner have been satisfied or otherwise resolved or, to the best knowledge of legal counsel, no conditions have been imposed;

(13) a copy of each filing regarding the proposed transaction that is required by another governmental authority, complete with all related attachments, exhibits, and correspondence;

(14) a current pro forma balance sheet and income statement of the applicant, with adjustments, reflecting the proposed transaction as of the most recent quarter ended immediately prior to the filing of the application;

(15) a copy of the applicant's strategic plan that complies with the department's Memorandum 1009, including projections of the balance sheet and income statement of the applicant as of the quarter ending one year from the date of its current pro forma financial statement required in accordance with paragraph (14) of this subsection;

(16) an explanation of the manner and basis of valuing any of the shares or other evidences of ownership of an entity that is to constitute part of the consideration used to acquire assets;

(17) the location of each new branch of the applicant that will result from the transaction;

(18) for antitrust purposes, an analysis of the anticipated competitive effect of the proposed transaction in the affected markets and a statement of the basis of the analysis of the competitive effects, or alternatively, a copy of the analysis of competitive effects of the proposed transaction addressed in the companion federal regulatory agency application, if applicable;

(19) other information that the banking commissioner, in the exercise of discretion, considers necessary to make an informed decision to approve or deny the proposed transaction; and

(20) in addition to all other requirements of this subsection, with respect to an interstate merger transaction:

(A) any additional opinions and information the applicant, by contacting the department, determines the banking commissioner requires; and

(B) information regarding applicable host state law and evidence of compliance with the law.

(c) Applicant's duty to disclose. The applicant must supply all material information necessary for the banking commissioner to make a fully informed decision on the application.

(d) Public notice. Within 14 days prior to or 14 days after submission of the initial application, the applicant must publish notice in accordance with the requirements of §15.5 of this title (relating to Public Notice) in the specified communities where the home offices of the applicant and other financial institutions involved in the transaction are located. With respect to an interstate merger transaction, the applicant must inform the department of the publication requirements in the host state for the banking commissioner to determine, pursuant to §15.5(e) of this title, whether those requirements satisfy the publication requirements of this subsection.

Source: *The provisions of this §15.105 adopted to be effective September 15, 1997, 22 TexReg 8948; amended to be effective January 7, 2004, 29 TexReg 80; amended to be effective November 8, 2012, 37 TexReg 8779.*

§15.106. Application for Authority to Sell Assets.

(a) Scope. This section governs an application for the sale of assets pursuant to the Finance Code, §32.405. A state bank that seeks to continue engaging in the business of banking after selling assets for a sales price exceeding an amount equal to three times the bank's unimpaired capital and surplus, pursuant to Finance Code, §32.405(a), may not consummate the sale of assets without the written approval of the banking commissioner. A state bank seeking to sell all or substantially all of its assets after obtaining approval of its shareholders must submit a plan of voluntary dissolution and liquidation to the banking commissioner for approval under the Finance Code, §32.405(c) and §§36.101 et seq, and the transaction is outside the scope of this section. A sale of assets requiring shareholder approval in which all liabilities of the seller are assumed by a depository institution, which is in substance and intent a merger, is considered to be a merger subject to §15.104 of this title (relating to Application for Merger or Share Exchange) or §15.107 of this title (relating to Notice of Merger, Reorganization, or Conversion of a State Bank into Another Form of Financial Institution).

(b) Subsection (f) of this section specifically addresses a sale of assets without shareholder approval under the Finance Code, §32.405(a)(7) or Finance Code, §203.003.

(c) Form of application. The applicant must submit a fully completed, verified application on a form prescribed by the banking commissioner and simultaneously tender the required filing fee pursuant to §15.2 of this title (relating to Filing Fees and Cost Deposits). The application must, except to the extent waived by the banking commissioner, include:

(1) a summary of the proposed transaction, including a description of the types and total dollar amounts of assets and liabilities transferred;

(2) a copy of all agreements related to the proposed transaction executed by an authorized representative of each party to the transaction;

(3) for each party to the transaction, a certified copy of those portions of the minutes of board meetings and shareholder or participant meetings at which action was taken regarding approval of the transaction, or a certificate of an officer verifying the action taken by the board of directors and the shareholders or participants approving the transaction, or an explanation of the basis for concluding that this action was not required;

(4) an assessment of the continuing viability of the applicant, including a description of its future prospects, proposed officers and directors, and proposed branches and other locations;

(5) an assessment of the current regulatory and financial condition of each party to the transaction;

(6) if the proposed transaction will change the existing CRA delineated community of the applicant, a copy of the proposed CRA map depicting the proposed delineated community of the applicant;

(7) a copy of current financial statements for each entity involved in the proposed transaction, accompanied by an affidavit of no material change dated no earlier than 30 days prior to the date of submission of the application;

(8) a copy of the latest annual report for each financial institution and bank holding company involved in the proposed transaction;

(9) that portion of the watch list of the applicant that identifies low-quality assets being sold or related liabilities being transferred;

(10) a description of all material, legal or administrative proceedings involving the applicant;

(11) an opinion of legal counsel that conforms with §15.109 of this title (relating to Opinion of Legal Counsel), concluding:

(A) the sale of assets by the applicant has been duly authorized by the board and shareholders or participants of the applicant in accordance with the Texas Business Organizations Code, or that such authorization is not required, stating the basis for that conclusion;

(B) the transaction will not cause or result in a material violation of the laws of this state relative to the organization and operation of state banks;

(C) all deposit liabilities transferred in the transaction will be discharged or otherwise assumed or retained by a financial institution that is authorized by law to do so;

(D) each purchasing entity that is not a financial institution will not be engaged in the unauthorized business of banking; and

(E) all conditions with respect to the transaction imposed by the banking commissioner have been satisfied or otherwise resolved or, to the best knowledge of legal counsel, no conditions have been imposed;

(12) a copy of each filing regarding the proposed transaction that is required by another governmental authority, complete with all related attachments, exhibits, and correspondence;

(13) a current pro forma balance sheet and income statement of the applicant, with adjustments, reflecting the proposed sale of assets as of the most recent quarter ended immediately prior to the filing of the application;

(14) a copy of the applicant's strategic plan that complies with the department's Memorandum 1009, including projections of the balance sheet and income statement of the applicant as of the quarter ending one year from the date of its current pro forma financial statement required in accordance with paragraph (13) of this subsection;

(15) an explanation of compliance with or nonapplicability of the provisions of governing law relating to the rights of dissenting shareholders;

(16) an explanation of the manner and basis of valuing any of the shares or other evidences of

ownership of a party that will constitute part of the consideration received for the sold assets;

(17) for antitrust purposes, an analysis of the anticipated competitive effect of the proposed transaction in the affected markets and a statement of the basis of the analysis of the competitive effects, or alternatively, a copy of the analysis of competitive effects of the proposed transaction addressed in the companion federal regulatory agency application, if applicable; and

(18) other information that the banking commissioner, in the exercise of discretion considers necessary to make an informed decision to approve or deny the proposed transaction.

(d) Applicant's duty to disclose. The applicant must supply all material information necessary for the banking commissioner to make a fully informed decision on the application.

(e) Public notice. Within 14 days prior to or 14 days after submission of the initial application, the applicant must publish notice in accordance with the requirements of §15.5 of this title (relating to Public Notice) in the community where its home office is located and in other communities as the banking commissioner may direct.

(f) Sale of assets without shareholder approval under the Finance Code, §32.405(a). The board of a state bank, with the prior written approval of the banking commissioner, may cause a bank to sell all or substantially all of its assets without shareholder or participant approval if the banking commissioner finds the interests of depositors and creditors are jeopardized because of insolvency or imminent insolvency and that the sale is in their best interest.

(1) To obtain approval of the banking commissioner under this subsection, the applicant must submit a verified application on a form prescribed by the banking commissioner and simultaneously tender the required filing fee pursuant to §15.2 of this title. The application must, except to the extent waived by the banking commissioner under §15.12 of this title (relating to Waiver of Requirements), include:

(A) a copy of each filing regarding the sale that is required by another governmental authority, complete with all related attachments, exhibits, and correspondence;

(B) a copy of the transaction agreement executed by an authorized representative of each party to the transaction, which must include an assumption and promise by the buyer to pay or otherwise discharge:

(i) all of the applicant's liabilities to depositors;

(ii) all of the applicant's liabilities for salaries of the applicant's employees incurred before the date of the sale;

(iii) obligations incurred by the banking commissioner arising out of the supervision or sale of the applicant; and

(iv) fees and assessments due the department;

(C) for each party to the transaction, a certified copy of those portions of the minutes of board meetings and, with respect to the purchaser, shareholder or participant meetings at which action was taken regarding approval of the transaction or a certificate of an officer verifying the action taken by the board of directors and the shareholders or participants approving the transaction, or in the alternative, an explanation of the basis for concluding that this action was not required;

(D) a copy of current financial statements for each entity involved in the proposed transaction, accompanied by an affidavit of no material change dated no earlier than 30 days prior to the date of submission of the application;

(E) that portion of the most recent watch list of the applicant that identifies low-quality assets;

(F) a description of all material legal or administrative proceedings involving the applicant; and

(G) other information that the banking commissioner, in the exercise of discretion, considers necessary to make an informed decision to approve or deny the proposed transaction. With respect to a proposed interstate merger transaction, the applicant must contact the department to determine additional information that the banking commissioner requires in the application.

(2) The banking commissioner will expedite processing of an application under this subsection to the extent required to protect the interests of the depositors and creditors of the applicant. An application under this subsection is not subject to the notice and publication requirements of §15.5 of this title except as may otherwise be required by the banking commissioner.

Source: *The provisions of this §15.106 adopted to be effective September 15, 1997, 22 TexReg 8948; amended to be effective January 7, 2004, 29 TexReg 80; amended to be effective November 8, 2012, 37 TexReg 8779.*

§15.107. Notice of Merger, Reorganization, or Conversion of a State Bank into Another Form of Financial Institution.

(a) Scope. This section governs notice of the merger, reorganization, or conversion of a state bank into another form of financial institution pursuant to the Finance Code, §32.501 and §32.304.

(b) Form of notice. A state bank does not cease to be subject to the jurisdiction of the banking commissioner until the banking commissioner is given written notice of intent to merge, reorganize, or convert before the 31st day preceding the date of the proposed transaction and the merger, reorganization, or conversion has otherwise become effective. The notice must, except to the extent waived by the banking commissioner, include:

(1) a summary of the proposed transaction;

(2) a copy of all agreements or other documentation related to the proposed transaction executed by an authorized representative of the applicant and other parties, if any;

(3) a copy of each filing regarding the proposed transaction that is required by another governmental authority, complete with all related attachments, exhibits, and correspondence;

(4) a certified copy of those portions of the minutes of board meetings and shareholder or participant meetings at which action was taken regarding approval of the merger, reorganization, or conversion, or a certificate of an officer verifying the action taken by the board of directors and the shareholders or participants approving the merger, reorganization, or conversion;

(5) Opinion of legal counsel. An opinion of legal counsel that conforms with the requirements of §15.109 of this title (relating to Opinion of Legal Counsel), concluding:

(A) the merger, reorganization, or conversion of the state bank has been duly authorized by its board and shareholders or participants in accordance with the Finance Code, §32.501(b), and the Texas Business Organizations Code;

(B) all deposit and other liabilities of the state bank will be discharged or otherwise retained by the successor financial institution; and

(C) all conditions with respect to the merger, reorganization, or conversion imposed by the banking commissioner have been satisfied or otherwise resolved or, to the best knowledge of legal counsel, no conditions have been imposed;

(6) a publisher’s certificate showing publication of notice as required by subsection (c) of this section;

(7) an explanation of compliance with the provisions of the Texas Business Organizations Code relating to rights of dissenting shareholders or participants; and

(8) in addition to all other requirements of this subsection, with respect to an interstate merger transaction:

(A) any additional opinions and information the applicant, by contacting the department, determines the banking commissioner requires; and

(B) information regarding applicable host state law and evidence of compliance with the law.

(c) Notices, publication, and certificate of authority.

(1) The applicant must submit a copy of the published notice of the proposed transaction required by the successor regulatory authority or must publish notice as required by §15.5 of this title (relating to Public Notice). Submission of the notice, with the publisher's certificate required by subsection (b)(6) of this section, is considered notice of the transaction in accordance with the Finance Code, §32.501(c)(2). The banking commissioner may require, upon written notice to the applicant, other publication requirements at the times and places and in the manner considered appropriate.

(2) With respect to an interstate merger application, the banking commissioner must determine whether the notice required by the successor regulatory authority is considered adequate notice in accordance with Finance Code, §32.501(c)(2). The applicant must inform the department of the publication requirements in the host state of the acquiring financial institution for the banking commissioner to determine, pursuant to §15.5(e) of this title, whether those requirements satisfy the publication requirements of this subsection.

(3) Within 14 days after receipt of the certificate of authority to do business, or another document issued by the successor regulatory authority authorizing the consummation of the merger, reorganization, or conversion, the successor financial institution must provide written notice to the banking commissioner of the effective date and a copy of the certificate of authority or other document.

(d) Filing fees. A filing fee is not required in connection with notice under this section.

Source: *The provisions of this §15.107 adopted to be effective September 15, 1997, 22 TexReg 8948; amended to be effective January 7, 2004, 29 TexReg 80; amended to be effective November 8, 2012, 37 TexReg 8779.*

§15.108. Conversion of a Financial Institution into a State Bank.

(a) Scope. This section governs the application for conversion of a financial institution into a state bank pursuant to the Finance Code, §32.502.

(b) Form of application. The applicant must submit a fully completed, verified application on a form prescribed by the banking commissioner and simultaneously tender a filing fee in the amount required for the filing of an application for a new bank charter pursuant to §15.2 of this title (relating to Filing Fees and Cost Deposits). The application must, except to the extent waived by the banking commissioner, include:

(1) a summary of the proposed transaction;

(2) a statement explaining whether the proposed state bank will be in compliance with each standard detailed in the Finance Code, §32.502(b), certified by the principal executive officer of the applicant;

(3) a copy of the plan of conversion executed by an authorized representative of the applicant;

(4) certificate of conversion, including:

(A) the plan of conversion;

(B) the certificate of formation of the proposed state bank;

(C) a provision conditioning the conversion upon the approval of the banking commissioner;

(5) a certified copy of those portions of the minutes of board meetings and shareholder or participant meetings at which action was taken regarding approval of the conversion, or a certificate of an officer verifying the action taken by the board of directors and the shareholders or participants approving the conversion;

(6) an assessment of the future prospects, proposed officers and directors, and proposed

branches and other locations of the proposed state bank;

(7) an assessment of the current regulatory and financial condition of the applicant;

(8) if the conversion changes the existing CRA delineated community, a copy of a map depicting the proposed delineated community of the resulting state bank;

(9) a copy of the latest annual report for the applicant and, if applicable, its holding company;

(10) a copy of that portion of the most recent watch list for the applicant that identifies low-quality assets;

(11) a description of all material legal or administrative proceedings involving the applicant or an officer, director, or principal shareholder of the applicant;

(12) an opinion of legal counsel that conforms with §15.109 of this title (relating to Opinion of Legal Counsel), concluding:

(A) the conversion of the applicant has been duly authorized by its board and shareholders in accordance with governing law, and the applicant has in all material respects complied with the procedures prescribed by the federal, state, or foreign laws governing the exit of the applicant from its current regulatory system;

(B) the conversion will not cause or result in any material violation of the laws of this state concerning the organization and operation of state banks;

(C) the proposed state bank will not be engaged in a business other than banking or a business incidental to banking; and

(D) all conditions with respect to the conversion imposed by the banking commissioner have been satisfied or otherwise resolved or, to the best knowledge of legal counsel, no conditions have been imposed;

(13) a copy of each filing regarding the proposed conversion that is required by another governmental authority, complete with all related attachments, exhibits and related correspondence;

(14) a current pro forma balance sheet and income statement of the applicant, with adjustments, reflecting the proposed conversion as of the most recent quarter ended immediately prior to the filing of the application;

(15) a copy of the applicant's current strategic plan with a comparison to the strategic plan requirements contained in the department's Memorandum 1009, including projections of the balance sheet and income statement of the resulting state bank as of the quarter ending one year from the date of the pro forma financial statement required by paragraph (14) of this subsection;

(16) an explanation of compliance with or nonapplicability of the provisions of governing law relating to rights of dissenting shareholders to the conversion;

(17) a copy of all securities offering documents, proxy statements, or other disclosure materials delivered or to be delivered to shareholders in connection with the proposed conversion;

(18) an explanation of the manner and basis of converting any shares or other evidences of ownership of the applicant into shares, obligations, evidences of ownership, rights to purchase securities or other securities of the proposed state bank, into cash or other property, including shares, obligations, evidences of ownership, rights to purchase securities or other securities of another person or entity, or into any combination of these;

(19) other information that the banking commissioner, in the exercise of discretion, considers necessary to make an informed decision to approve or deny the proposed conversion; and

(20) in addition to all other requirements of this subsection, with respect to conversion of an out-of-state financial institution into a state bank:

(A) any additional opinions and information the applicant, by contacting the department, determines the banking commissioner requires; and

(B) information regarding applicable host state law and evidence of compliance with the law.

(c) Applicant's duty to disclose. The applicant must supply all material information necessary for the banking commissioner to make a fully informed decision on the application.

(d) Public notice. Within 14 days prior to or 14 days after submission of an initial application under this section, the applicant must publish notice in accordance with §15.5 of this title (relating to Public Notice) in the specified communities where the home office of the applicant is located, and where the home office of the proposed state bank will be located, if different. With respect to a conversion of an out-of-state financial institution into a Texas state bank, the applicant must inform the department of the publication requirements in the host state for the banking commissioner to determine, pursuant to §15.5(e) of this title, whether those requirements satisfy the publication requirements of this subsection.

(e) Approval by the banking commissioner. The banking commissioner will approve a conversion only if the application indicates substantial compliance with all conditions of the Finance Code, §32.502(b).

Source: *The provisions of this §15.108 adopted to be effective September 15, 1997, 22 TexReg 8948; amended to be effective January 7, 2004, 29 TexReg 80; amended to be effective November 8, 2012, 37 TexReg 8779; amended to be effective November 7, 2013, 38 TexReg 7687.*

§15.109. Opinion of Legal Counsel.

(a) An opinion of legal counsel required by this subchapter must be addressed to the banking commissioner and state the opinions expressed, the specific documents reviewed and the matters considered of both law and fact, as legal counsel has considered necessary or appropriate in the exercise of professional judgment for the opinions expressed, and the assumptions, qualifications, limitations, and exceptions made or taken with respect to the opinions expressed. A draft opinion may be submitted with an application under this chapter provided a final, signed opinion is delivered to the banking commissioner prior to final action on the application. Any variation in the final opinion from the draft version must be specifically called to the attention of the banking commissioner.

(b) An opinion letter required under this subchapter will be governed by and interpreted in accordance with the Third Party Legal Opinion Report, Including the Legal Opinion Accord, of the Section of Business Law (American Bar Association, 1991), available in pamphlet form as reprinted from the November 1991 issue of The Business Lawyer (Volume 47, Number 1, Page 167), (the Accord), or a successor document officially promulgated by an appropriate authority.

(c) Unless specifically noted in the opinion, the department will assume that the opinions expressed are based upon and subject to the assumptions, qualifications, limitations and exceptions set forth in the Accord, provided the Accord is incorporated by reference. In addition, whether or not stated in the Accord, if specifically noted in the opinion, counsel:

(1) need not express an opinion as to the laws of the United States or a foreign jurisdiction, except as required by §15.108(b)(12)(A) of this title (relating to Conversion of a Financial Institution into a State Bank), or the laws of a state jurisdiction other than this state;

(2) may assume that the parties to the transaction have engaged only in activities provided in their respective constitutive documents, and that all surviving parties to the transaction will engage only in activities provided in their respective constitutive documents;

(3) may assume that the transaction will be consummated in accordance with its terms as disclosed in the application; and

(4) may qualify the opinions given as opinions solely for the benefit of the department that may not be quoted in whole or in part or otherwise referred to in another document or report, and that may not be furnished to a person or entity other than the department and its representatives without the written consent of counsel, except as may be permitted or required by law, including the Finance Code, §31.303, and the Government Code, Chapter 552.

(d) Legal counsel must specifically notify the banking commissioner of any substantive deviation from the assumptions, qualifications, limitations and exceptions allowed in this section and the Accord, and any substantive deviation from the opinion requirements of the section of this subchapter that governs a particular application. Deviations may result in a processing delay of the application to the extent additional analysis is required to understand the purpose of the deviation. A substantive deviation from the requirements of this subchapter applicable to legal opinions that is not brought to the attention of the banking commissioner will be considered a material misrepresentation in the application.

(e) Legal counsel rendering an opinion under this subchapter must be an attorney in good standing admitted to practice before the highest court of a state, territory or district of the United States. However, legal counsel must be well versed and professionally competent in applicable Texas law, or should seek the advice and opinion of an attorney in good standing admitted to practice before the highest courts in this state if legal counsel may not properly and ethically render opinions regarding applicable Texas law. An opinion of local legal counsel must be disclosed if relied on by legal counsel. Additionally, with respect to an interstate merger transaction, conversion of an out-of-state financial institution into a Texas bank, or other transaction under Finance Code, Title 3, Subtitle G, legal counsel must be well versed and professionally competent in applicable home state and host state law and United States law regarding interstate banking and branching.

(f) Legal counsel rendering an opinion under this subchapter must be independent of the applicant, the notice provider, or another person or entity required to submit an opinion of counsel pursuant to this section. Legal counsel is considered independent if able to exercise independent professional judgment and render candid advice, whether in private practice or employed by an applicant.

Source*: The provisions of this §15.109 adopted to be effective September 15, 1997, 22 TexReg 8948; amended to be effective January 7, 2004, 29 TexReg 80.*

§15.110. Rights of Dissenting Shareholders.

The rights of dissenting shareholders or participants to a merger, share exchange, or conversion under this subchapter are governed by the Finance Code, §32.303, and the Texas Business Organizations Code or other applicable law relating to the rights of dissenters, and applicants must provide evidence of compliance with or inapplicability of these provisions of law.

Source: *The provisions of this §15.110 adopted to be effective September 15, 1997, 22 TexReg 8948; amended to be effective January 7, 2004, 29 TexReg 80; amended to be effective November 8, 2012, 37 TexReg 8779.*

§15.111. Investigation of Application.

(a) Authority. An application under this subchapter is subject to an investigation as considered necessary, in the banking commissioner's sole discretion, in order to make an informed decision regarding an application.

(b) Costs and fees. An applicant under this subchapter must pay reasonable costs incurred in the investigation including the cost of a required examination, as provided by §3.36(h) of this title (relating to Annual Assessments and Speciality Examination Fees) and §15.2(e) of this title (relating to Filing Fees and Cost Deposits).

(c) Examinations. The banking commissioner may consider these factors in determining whether to require an examination of one or more of the entities to the transaction:

(1) a question exists regarding the solvency or potential solvency of the applicant or one or more of the financial institutions or other entities involved in the proposed transaction;

(2) a financial institution involved in the transaction has not been examined by a state, federal, or foreign regulatory agency within the 18 month period immediately preceding the date of submission of the application;

(3) a financial institution involved in the proposed transaction has numerous substantive violations cited in its last examination report, or has a less than satisfactory regulatory rating;

(4) a question exists regarding the experience, ability, standing, trustworthiness, or integrity of the existing or proposed officers, directors, managers or managing participants of a party involved in the proposed transaction;

(5) a question exists whether a resulting state bank will operate in compliance with the law;

(6) a question exists whether a resulting state bank will be free from improper or unlawful influence or interference from its principal shareholders with respect to operation in compliance with the law;

(7) a question exists whether a resulting state bank will have adequate capitalization;

(8) one or more of the parties to the transaction is under a regulatory restriction; or

(9) other factors as determined in the sole discretion of the banking commissioner.

Source: *The provisions of this §15.111 adopted to be effective September 15, 1997, 22 TexReg 8948; amended to be effective January 7, 2004, 29 TexReg 80.*

§15.113. Approval; Conditional Approval; Denial of Application; Hearings.

(a) Approval, conditional approval, or denial. Except for expedited filings and applications for change of control governed by Finance Code, §33.003, the banking commissioner will approve or deny an application on or before a date that is 60 days after the date the application is accepted for filing pursuant to §15.4 of this title (relating to Required Information and Abandoned Filings). Provided, however, that the banking commissioner shall have the discretion to extend the timeframe for processing any application, if one of the conditions listed in §15.103(d) of this title (relating to Expedited Filings) exists.

(b) Pre-decision hearing. The banking commissioner may, in the exercise of discretion, before the expiration of the initial period for decision provided by subsection (a) of this section, give the applicant written notice that the banking commissioner will convene a hearing to obtain evidence related to the application. Notice by the banking commissioner suspends the specified period for approval or denial of an application, and the banking commissioner will approve or deny the application on or before a date that is 30 days after the date the final proposal for decision resulting from the hearing is provided to the banking commissioner and the applicant.

(c) Acceptance of conditional approval. The banking commissioner may give the applicant written notice that the application has been approved subject to certain conditions. The applicant must provide the banking commissioner with written confirmation of acceptance of the conditions on or before a date that is 10 days after the date of notification to the applicant of the conditional approval. An agreement between the applicant and the banking commissioner concerning conditional approval is enforceable against the applicant. In the event an applicant who has received conditional approval does not provide the banking commissioner with written confirmation as required by this subsection, consummation of the transaction constitutes confirmation of acceptance of the conditions imposed by the banking commissioner and is considered for all purposes an agreement enforceable against the applicant.

(d) Requests for hearing. An applicant may request a hearing on or before a date that is 30 days after the effective date of notice of denial or conditional approval of an application under this subchapter by the banking commissioner. The request for hearing must be in writing and state with specificity the reasons the applicant alleges that the decision of the banking commissioner is in error. The applicant has the burden of proof for each issue specified in the request for hearing. The request for hearing and the banking commissioner’s decision to deny or condition the application will be made a part of the record.

(e) Hearings on denial of applications. Requests for hearing under this subchapter will be forwarded to the administrative law judge who must enter appropriate orders and conduct the hearing on or before a date that is 60 days after the date the request for hearing was received, or as soon after that as is reasonably possible, under Chapter 9 of this title (relating to Rules of Procedure for Contested Case Hearings, Appeals, and Rulemakings) and the Government Code, Chapter 2001. A proposal for decision, exceptions and replies to the proposal for decision, the final decision of the banking commissioner, and motions for rehearing are governed by Chapter 9 of this title. An applicant may not appeal denial of an application or conditional approval of an application until a final order is issued. After a hearing and final order, the applicant may appeal the final order as provided in the Finance Code, §31.202.

Source: *The provisions of this §15.113 adopted to be effective September 15, 1997, 22 TexReg 8948; amended to be effective January 7, 2004, 29 TexReg 80; amended to be effective November 8, 2012, 37 TexReg 8779.*

§15.114. Consummation of a Transaction.

A transaction under this subchapter must be consummated as proposed in the application, in the agreement concerning conditional approval, or as provided in a final order. An approved transaction under this subchapter must be consummated within 12 months after the date of approval by the banking commissioner unless an extension is granted in writing. If an interim development warrants it, the banking commissioner may alter, suspend, or withdraw approval until a transaction is consummated.

Source: *The provisions of this §15.114 adopted to be effective September 15, 1997, 22 TexReg 8948; amended to be effective January 7, 2004, 29 TexReg 80.*

§15.115. Notification.

A notification by the banking commissioner under this subchapter may be by registered or certified mail, return receipt requested, and is complete when the notification is deposited in the United States mail postage prepaid, return receipt requested, mailed to the address furnished in the application. Notification may also be made in person to the applicant, or to another person, financial institution, foreign corporation or domestic corporation, or other entity subject to this subchapter, by agent-receipted delivery or by courier-receipted delivery to the address furnished in the application, or by telephonic document transfer to the applicant's telecopier number as furnished in the application. Notice by telephonic document transfer served after 6:00 p.m. local time of recipient is considered as notice served on the following day.

Source: *The provisions of this §15.115 adopted to be effective September 15, 1997, 22 TexReg 8948.*

§15.116. Abandoned Filing.

The banking commissioner may determine an application under this subchapter to be abandoned pursuant to §15.4 of this title (relating to Required Information and Abandoned Filings).

Source: *The provisions of this §15.116 adopted to be effective September 15, 1997, 22 TexReg 8948.*

§15.117. Confidentiality.

Information obtained by the banking commissioner under this subchapter is presumed to be public information unless such information is confidential under the Finance Code, §31.301 et seq, and §3.111 of this title (relating to Confidential Information), or under exceptions contained in Government Code, Chapter 552. The applicant has the burden to request confidential treatment for specified information, to segregate and mark documents claimed to be confidential, and to specifically reference the provision of law that allows confidential treatment.

Source: *The provisions of this §15.117 adopted to be effective September 15, 1997, 22 TexReg 8948.*

Subchapter G. Charter Amendments and Certain Changes in Outstanding Stock

§15.121. Acquisition and Retention of Shares as Treasury Stock.

(a) Permitted acquisition of treasury stock. Pursuant to Finance Code, §34.102, a state bank may acquire its own shares to be held as treasury stock if the acquisition is necessary to avoid or minimize a loss on a loan or investment previously made in good faith or is made in compliance with this section. An acquisition under the authority of this section may constitute an isolated transaction or a continuing plan of acquisition and may not be made for speculation or as a means of evading a requirement or obligation under federal or state banking laws.

(b) Application. A state bank that desires to acquire its own shares to be held as treasury stock under the authority of this section must file an application regarding its plan of acquisition with the banking commissioner, setting forth or including as exhibits:

(1) consistent with subsection (f) of this section, the pro forma effects of the plan of acquisition on the bank's liquidity and equity capital, and disclosure of the basis for calculations, including:

(A) the price or price range per share at which the shares will be acquired;

(B) the number of shares sought to be acquired, expressed as a maximum; and

(C) the source of funds for the acquisition;

(2) the date by which the plan of acquisition will be completed;

(3) a certified copy of a resolution duly adopted by the board of directors, approving the plan of acquisition; and

(4) a current draft of the securities offering document or other disclosure materials proposed to be delivered to shareholders considering the sale of bank shares to the bank.

(c) Action on application. The banking commissioner will approve or deny the application not later than the 30th day after the application is complete and accepted for filing pursuant to §15.4(b) of this title (relating to Required Information and Abandoned Filings), and may impose conditions on an approved plan of acquisition, including limitations on the number of shares to be acquired or a condition that the approval expire as of a specified date. The banking commissioner may deny the application if the banking commissioner concludes that the bank's plan of acquisition:

(1) will result in acquisition of treasury stock at an aggregate cost in excess of its undivided profits, or may otherwise threaten the adequacy of the bank's equity capital or its liquidity;

(2) appears to be for speculation or a means of evading a requirement or obligation under federal or state banking laws; or

(3) could otherwise place the bank in an unsafe or unsound condition.

(d) Compliance with securities law.

(1) An issuer's purchase of its own shares is a transaction subject to the antifraud provisions of federal securities law, see 15 United States Code, §78j, 17 Code of Federal Regulations, §240.10b-5, and Spector v. L Q Motor Inns, Inc., 517 F.2d 278 (5th Cir. 1975), cert. denied, 423 U.S. 1055 (1976). The transaction is also subject to the antifraud provisions of state securities law, see Texas Civil Statutes, Article 581-33(B). Potential liability of the state bank to the selling shareholder can therefore arise if the state bank withholds or misrepresents material facts that the seller would have considered important in making the decision to sell.

(2) Approval of an application under this section by the commissioner does not constitute a determination that the bank has complied with applicable securities law.

(e) Retention of treasury stock. Notwithstanding Finance Code, §34.102(c), treasury stock acquired by a state bank, whether to avoid or minimize a loss on a loan or investment previously made in good faith or under an approved plan of acquisition, may be held indefinitely as treasury stock; provided that the banking commissioner may require a state bank to cancel and retire all or part of shares held as treasury stock to the status of authorized and unissued shares if the banking commissioner concludes that holding treasury stock in the amount held by the bank creates safety and soundness or other regulatory concerns.

(f) Accounting for treasury stock. A state bank must account for the acquisition and retention of treasury stock in accordance with generally accepted accounting principles under either the cost method or the par value method (see Accounting Research Bulletin Number 43), although use of the cost method may avoid the reduction in capital and certified surplus that would be required under the par value method. The method used for accounting for treasury stock must be clearly reflected in the bank's accounting records.

(g) Status of treasury stock. Shares held by a state bank as treasury stock may not be voted, directly or indirectly, at any meeting of shareholders, and may not be counted in determining the total number of outstanding shares at any given time.

Source: *The provisions of this §15.121 adopted to be effective April 16, 1997, 22 TexReg 3399; amended to be effective January 7, 2004, 29 TexReg 80.*

§15.122. Amendment of Certificate to Effect a Reverse Stock Split.

(a) Definitions. When these words and terms are used in this section they will have these meanings, unless the context clearly indicates otherwise.

(1) Affiliate--A person that directly or indirectly through one or more intermediaries controls,

is controlled by, or is under common control with a state bank seeking to effect a reverse stock split. A person who is not an affiliate of the state bank at the commencement of its reverse stock split will not be considered an affiliate of the bank prior to the completion of the reverse stock split.

(2) Appraisal report--A report, opinion (other than an opinion of counsel), or appraisal from an outside party which is materially related to the reverse stock split, including a report, opinion, or appraisal relating to the consideration or the fairness of the consideration to be offered to shareholders in connection with the reverse stock split or the fairness of the transaction to the state bank or to unaffiliated shareholders.

(3) Reverse stock split--An amendment to the certificate of formation of a state bank that achieves a reduction in the number of issued shares of the bank by requiring exchange of all issued shares in a particular class for a proportionately smaller number of shares, generally with a proportionately increased par or stated value. The equity capital of the state bank remains substantially the same.

(4) Share--A unit representing ownership of at least part of the proprietary interests of a state bank, whether or not divided or subdivided by means of classes, series, relative rights, or preferences; and includes a stock or similar security; or a security convertible, with or without consideration, into such a security, or carrying a warrant or right to subscribe to or purchase such a security; or such warrant or right; or another security determined by the banking commissioner to be an equity security pursuant to the Finance Code, §31.002(a)(9)(B).

(5) ;Unaffiliated shareholder--A shareholder of a share subject to a reverse stock split who is not an affiliate of the state bank that issued the share.

(b) Procedure. Pursuant to the Finance Code, §32.101, to effectuate a reverse stock split in compliance with this section, a state bank must:

(1) obtain the approval of its shareholders as required by law; and

(2) obtain the approval of the banking commissioner pursuant to subsection (d) of this section, by filing an application setting forth the information and documents required by subsection (c) of this section and the filing fee required by §15.2 of this title (relating to Filing Fees and Cost Deposits).

(c) Application. A state bank proposing a reverse stock split transaction must file with the banking commissioner a written application seeking approval of the proposed amendment to its certificate of formation, stating the results of the vote of shareholders regarding the proposed reverse stock split and stating the percentage of shares of unaffiliated shareholders that were voted in favor of the proposed reverse stock split, or undertaking to supplement the application after conditional approval is obtained to provide shareholder approval information, setting forth or including as exhibits:

(1) the original and one copy of the proposed amendment to the certificate of formation, to be processed in the manner required by the Finance Code, §32.101(c), and a description of the material terms of the proposed reverse stock split, including terms or arrangements relating to any shareholder of the state bank which are not identical to those relating to other shareholders of the same class;

(2) any plan or proposal of the state bank, regarding activities or transactions which are to occur after the reverse stock split which relate to or would result in:

(A) an extraordinary corporate transaction, such as a merger, reorganization, or liquidation, involving the state bank or any of its subsidiaries;

(B) a sale or transfer of a material amount of assets of the state bank or any of its subsidiaries;

(C) a change in the present board of directors or management of the state bank, including a plan or proposal to change the number or term of directors, to fill an existing vacancy on the board or to change a material term of the employment contract of an executive officer;

(D) a material change in the present dividend rate or policy or indebtedness or capitalization of the state bank;

(E) any other material change in the state bank's corporate structure or business;

(3) the corporate purpose or purposes of the state bank for the reverse stock split, and alternative means, if any, considered by the state bank to accomplish the purposes and the reasons for their rejection, and the reason for choosing the structure of a reverse stock split and for undertaking the transaction at this time;

(4) a certified resolution of the board of directors of the state bank approving the proposed amendment to the certificate of formation, accompanied by a statement whether or not the board of directors of the state bank reasonably believes that the reverse stock split is fair or unfair to unaffiliated shareholders that:

(A) identifies each director, if any, that dissented to or abstained from voting on the merits of the reverse stock split, and describes, if known to the state bank after making reasonable inquiry, the reasons for each dissent or abstention; and

(B) states the number and percentage of disinterested directors that voted in favor of the proposed reverse stock split;

(5) whether or not the state bank obtained an appraisal report and, if an appraisal report was obtained, a copy of the appraisal report. To the extent not addressed in the appraisal report, the state bank must disclose:

(A) the identity, qualifications, and method of selection of the outside party that prepared the appraisal report, any material relationship between the outside party or its affiliates and the state bank or its affiliates which existed during the past two years or is mutually understood to be contemplated, and any compensation received or to be received as a result of the relationship;

(B) a summary of the performance of the appraisal report, including the procedures followed, the findings and recommendations, the bases for and methods of arriving at the findings and recommendations, instructions received from the state bank, and any limitation imposed by the state bank on the scope of the investigation; and

(C) whether the appraisal report will be made available for inspection and copying at the home office of the state bank during its regular business hours by any shareholder of the state bank or any shareholder's representative who has been so designated in writing;

(6) with respect to the class of shares to which the reverse stock split relates, the aggregate amount and percentage of shares beneficially owned by any pension, profit sharing, or similar plan of the state bank, and by each officer, director, principal shareholder, and subsidiary of the state bank;

(7) with respect to any purchases of the shares made by the state bank since the commencement of the bank's second full fiscal year preceding the date of the application, the amount of the shares purchased, the range of prices paid for the shares, and the average purchase price for each quarterly period of the bank during this period;

(8) to the extent known to the state bank after reasonable inquiry, any transaction in the class of shares subject to the proposed reverse stock split that was effected during the past 60 days by the state bank or by an officer, director, principal shareholder, or subsidiary of the state bank, including the identity of the person who effected the transaction, the date of the transaction, the amount of shares involved, the price per share, and where and how the transaction was effected;

(9) to the extent known to the state bank after reasonable inquiry, a description and/or a copy of any contract, arrangement, understanding, or relationship (whether or not legally enforceable) in connection with the reverse stock split between the state bank (or an officer, director, principal shareholder, or subsidiary of the state bank) and any person with respect to any shares of the state bank (including a contract, arrangement, understanding, or relationship concerning the transfer or the voting of these shares,

joint ventures, loan, or option arrangements, puts or calls, guaranties of loans, guaranties against loss or the giving or withholding of proxies, consents, or authorizations), naming the persons with whom these contracts, arrangements, understandings, or relationships have been entered into and giving the material provisions thereof, including information for any of these shares that are pledged or otherwise subject to a contingency, the occurrence of which would give another person the power to direct the voting or disposition of these shares, except that disclosure of standard default and similar provisions contained in loan agreements need not be included;

(10) to the extent known to the state bank after reasonable inquiry, whether or not any officer, director, principal shareholder, or subsidiary of the state bank has made a recommendation in support of or opposed to the reverse stock split and, if so, the reasons for the recommendation;

(11) whether or not appraisal rights are being voluntarily accorded by the state bank to shareholders in connection with the reverse stock split and whether or not any provision has been or will be made to allow unaffiliated shareholders to obtain counsel or appraisal services at the voluntary expense of the state bank and, if so, a detailed description of these appraisal rights or counsel or appraisal services;

(12) a reasonably itemized statement of all expenses incurred or estimated to be incurred in connection with the reverse stock split, including filing fees, legal, accounting, and appraisal fees, solicitation expenses, and printing costs, and disclosure of the person who has paid or will be responsible for paying such expenses;

(13) the proxy statement furnished to shareholders of the state bank in connection with obtaining shareholder approval for the reverse stock split, or a draft of the proxy statement to be furnished to shareholders in the event approval of the banking commissioner is sought prior to a shareholder vote; and

(14) such other information that the banking commissioner considers necessary to make an informed decision to approve or reject the proposed amendment effectuating a reverse stock split.

(d) Standards for approval.

(1) The banking commissioner will process the proposed reverse stock split in accordance with the Finance Code, §32.101(c). The banking commissioner will require that the reverse stock split be for valid business purposes of the bank itself, viewed as an entity distinct from its affiliates, and be accomplished through fair dealing with and a fair price to unaffiliated shareholders. The banking commissioner may impose conditions on approval, including a condition that an independent appraisal report be obtained regarding the value of the unaffiliated shareholders' shares, exclusive of any element of value arising from the accomplishment or expectation of the proposed transaction, and without minority discount. Share value determined by an independent and properly prepared appraisal report that is fully disclosed to bank shareholders or by the market price of publicly traded shares will be presumed to be a fair value unless extenuating circumstances to the contrary are specifically noted.

(2) In the event approval of the banking commissioner is obtained prior to approval by shareholders, the state bank must file a statement with the banking commissioner certifying that any future event or condition upon which the approval of the transaction was conditioned has been satisfied and the date that each such condition was satisfied. Upon receipt of such statement, the banking commissioner will file the approved amendment to the certificate of formation in accordance with the Finance Code, §32.101(c).

(3) An issuer's purchase of its own shares is a transaction subject to the antifraud provisions of federal securities law, see 15 United States Code, §78j, 17 Code of Federal Regulations (CFR), §240.10b-5, and Spector v. L Q Motor Inns, Inc., 517 F.2d 278 (5th Cir. 1975), cert. denied, 423 U.S. 1055 (1976). Such a transaction is also subject to the antifraud provisions of state securities law, see Texas Civil Statutes, Article 581-33(B). Potential liability of the state bank to the selling shareholder can therefore arise if the state bank withholds or misrepresents material facts that the seller would have considered important in making the decision to sell. Consequently, a state bank must disclose to the shareholders in writing, prior to or

simultaneously with the written notice of the shareholders meeting, all material information necessary to make an informed decision regarding the proposed reverse stock split. If the reverse stock split involves publicly traded shares and is subject to 15 CFR, §240.13e-3, the registration statement required by federal law is considered to satisfy this disclosure obligation. Approval of an application under this section by the banking commissioner does not constitute a determination that the bank has complied with applicable securities law.

(e) Exemptions.

(1) This section does not apply to a reverse stock split that:

(A) will not result in fractional shares;

(B) permits each shareholder to choose to cash in the resulting fractional share by selling it to the state bank or to round up to the next highest whole share by purchasing fractional interests, provided that:

(i) the specified sale and purchase prices are equivalent and reasonable; and

(ii) no fractional share resulting from the reverse stock split is less than 10% of a full share;

(C) is adopted by means of a unanimous written consent of shareholders; or

(D) the banking commissioner expressly exempts after written application as not within the purposes of this section.

(2) An amendment to the certificate of formation that implements a reverse stock split exempt from this section is filed and processed in accordance with the Finance Code, §32.101.

(3) The availability of an exemption from the requirements of this section does not relieve a state bank from its obligation to comply with applicable securities law.

Source: *The provisions of this §15.122 adopted to be effective April 16, 1997, 22 TexReg 3400; amended to be effective November 13, 1997, 22 TexReg 10955; amended to be effective January 7, 2004, 29 TexReg 80; amended to be effective November 7, 2013, 38 TexReg 7687.*

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CHAPTER 17. TRUST COMPANY REGULATION

Subchapter A. General

Subchapter B. Examination and Call Reports

CHAPTER 17. TRUST COMPANY REGULATION

Subchapter A. General

§17.1. [Repealed]

§17.2. Advertising. (a) An advertisement published by or on behalf of a trust company may not include the following:

(1) a guaranteed rate of return or interest rate on funds deposited in trust;

(2) a statement that tends to deceive or mislead the public; or

(3) a term that may deceive the public into belief that the trust company is engaged in the banking business.

(b) Advertisements published by or on behalf of a trust company must be retained in the trust company's records for examination by department personnel.

(c) A trust company that violates this section is subject to an enforcement action initiated by the banking commissioner under Finance Code, §§185.001, et seq.

Source: *The provisions of this §17.2 adopted to be effective March 12, 1998, 23 TexReg 2289; amended to be effective July 11, 2002, 27 TexReg 5962.*

§17.3. Sale or Lease Agreements With an Officer, Director, Principal Shareholder, or Affiliate. (a) Agreement in writing. A sale or lease agreement between a trust company and an officer, director, principal shareholder, or affiliate of the trust company must be in writing. Existing verbal agreements must be reduced to writing and approved by the board.

(b) Terms of agreement. A sale or lease agreement between a trust company and an officer, director, principal shareholder, or affiliate must comply with applicable laws and regulations, be subject to the exercise of prudent judgment, and have terms and rates that are substantially equivalent to or more favorable to the trust company than those prevailing at the time for comparable transactions with or involving nonaffiliated parties.

(c) Board action. All transactions subject to Finance Code, §183.009(a), must receive the prior approval of at least a majority of a quorum composed entirely of disinterested directors of the board or the transaction at issue must be submitted for prior approval of the banking commissioner. For purposes of this section, a quorum shall consist of a majority of the number of directors elected at the last meeting of shareholders. Even if the transaction is subject to the prior approval of the banking commissioner because a quorum composed entirely of disinterested directors cannot be obtained, as a matter of good corporate policy, a trust company proposing to enter into a transaction subject to Finance Code, §183.109, should obtain the affirmative vote of a majority of the disinterested directors of the board.

(d) Application for approval. If a sale or lease agreement requires the written approval of the banking commissioner prior to consummating, renewing, or extending a sale or lease agreement, a written request for approval must be submitted to the banking commissioner at least 60 days prior to the proposed effective date of the sale or lease agreement and must include the following information:

(1) a copy of the proposed sale or lease agreement;

(2) a complete description of the personal or real property to be sold or leased;

(3) a full disclosure of all existing transactions and/or relationships, whether direct or indirect, between the trust company and the parties involved;

(4) in the case of a lease agreement involving real property, a copy of the minutes of the board meeting reflecting an analysis of the information contained in this subsection;

(5) a certified copy of a board resolution approving the transaction and indicating those directors voting or abstaining, as the case may be, and either:

(A) evidence that the transaction received the affirmative vote of at least a majority of disinterested directors on the board; or

(B) a statement explaining the reasons the affirmative vote of at least a majority of disinterested directors on the board could not be obtained;

(6) copies of appropriate supporting documentation, including analysis of comparable terms and rates for the real or personal property to be sold or leased;

(7) in the case of a lease agreement, evidence demonstrating that the trust company will account for the lease in accordance with FASB ASC Topic 840, Leases; and

(8) other information which the banking commissioner may request.

(e) Records. A trust company shall maintain the originals of all sale or lease agreements with an officer, director, manager, managing participant, principal shareholder, or principal participant of the trust company, or an affiliate, which documents must be made available at all times to the Texas Department of Banking for examination and review. For purposes of this subsection, required documentation need not be retained beyond three years after the expiration of the sale or lease agreement to which the documentation pertains.

(f) Exemption. Subsection (d) of this section does not apply to a legally binding, written lease entered into by a trust company prior to June 16, 1991, until such lease is renewed or extended beyond its original term.

Source: *The provisions of this §17.3 adopted to be effective July 2, 1998, 23 TexReg 6715; amended to be effective July 11, 2002, 27 TexReg 5962; amended to be effective November 4, 2010, 35 TexReg 9696.*

§17.4. Bonding Requirements. (a) Compliance required. Pursuant to Finance Code, §183.112, a trust company is required to maintain a bond for protection and indemnity of clients, in reasonable amounts against dishonesty, fraud, defalcation, forgery, theft, and other insurable losses with a corporate insurance or surety company. Unless the banking commissioner waives the bonding requirement for a particular individual, a bond is required for each director, manager, managing participant, officer, and employee without regard to whether the person receives salary or other compensation. In addition to complying with Finance Code, §183.112, a trust company shall comply with this section.

(b) Types of bonds. Bonds must be obtained from a corporate insurance or surety company authorized to do business in this state, or acceptable to the banking commissioner and otherwise lawfully permitted to issue the coverage against all losses arising from dishonesty, fraud, defalcation, forgery, theft, errors and omission, and other similar insurable losses determined by the banking commissioner to be reasonably appropriate. In lieu of individual bonds, schedule or blanket bonds may be utilized, if in a form acceptable to the banking commissioner, to provide coverage for all directors, managers, managing participants, officers, and employees of a trust company. In addition, a trust company through its board must demonstrate that it has conducted a thorough review of the risks associated with the trust business conducted to determine if additional specialized bond coverages should be obtained. The board's review must be fully documented in its minutes.

(c) Holding company's comprehensive insurance coverage. In lieu of obtaining individual or blanket bond coverage, a trust company which is owned and controlled by a holding company, may utilize a holding company's comprehensive insurance coverage to satisfy the requirements of Finance Code, §183.112, and this section. Utilization by a trust company of its holding company's comprehensive insurance coverage must be lawfully permitted under terms of the comprehensive insurance policy and the insurance laws of this state. Evidence of bond coverage for a trust company's directors, officers, and employees must be provided to the banking commissioner.

(d) Records. A trust company shall retain all original bonds to demonstrate compliance with Finance

Code, §183.112, and this section, which documents must be available at all times to the department for examination and review.

Source: *The provisions of this §17.4 adopted to be effective September 3, 1998, 23 TexReg 8832; amended to be effective July 11, 2002, 27 TexReg 5962.*

Subchapter B. Examination and Call Reports

§17.21. Physical Location of Books and Records. (a) Purpose. The purpose of this section is to provide for the preservation and location of trust company records to enhance the examination process by the department and to provide flexibility to trust companies in conducting their affairs. A trust company that maintains fiduciary records at one or more locations other than its principal place of business should be aware that a separate examination may be required at each such location, the cost of which will be borne by the trust company. This section may not be construed to prevent the maintenance of a duplicate set of records if the trust company considers such to be advisable.

(b) Corporate records. Those books and records of a trust company that are related to corporate governance and operations must be kept and maintained at the trust company's principal place of business in this state. Such books and records include but are not necessarily limited to:

(1) general and subsidiary ledgers;

(2) income and expense ledgers;

(3) supporting documentation for assets and liabilities;

(4) contracts with suppliers and service providers;

(5) corporate state and federal tax information and documentation;

(6) correspondence with the department;

(7) directors minutes;

(8) shareholders minutes;

(9) corporate governance documents such as bylaws, certificate of formation, and stock register; and

(10) reports of condition and income.

(c) Fiduciary records. Those books and records of a trust company that are related to fiduciary accounts and operations may be kept and maintained either at the trust company's principal place of business in this state or at the place where the trust company's fiduciary accounts are administered; provided that such books and records may not be divided and kept partially at different locations without the prior consent of the department. Such books and records include but are not necessarily limited to:

(1) governing documents for each trust, custodial account, agency or other type of account administered;

(2) documentation supporting the purchase or sale of any investments from or to the accounts administered, including broker confirmations and safekeeping receipts;

(3) documentation on any assets accepted in-kind with supporting documentation justifying the amount booked;

(4) account reviews, including administrative and asset reviews;

(5) copies of all correspondence on each account administered, including documents relating to litigation, bankruptcy proceedings or other court action;

(6) copies of income tax returns on any accounts which are required to submit income tax returns;

(7) copies of customer account statements;

(8) trial balance of all accounts administered reflecting all investments, including principal cash and income cash, at market value and cost;

(9) overdraft listing of any overdrawn account administered and reflecting date of overdraft;

(10) large cash balance listing of accounts administered;

(11) safekeeping report from each institution holding items for safekeeping, with reconcilement to the trust company account trial balance;

(12) master asset listing of all investments by type, reflecting account holder, number of units held with cost and market values;

(13) assets by account holder reflecting investments with number of units, cost and market values;

(14) broker commission report reflecting all brokers utilized for purchase or sale of investments, dollar volume, commissions paid and number of transactions;

(15) reconcilement of fiduciary cash accounts including copies of bank account statements;

(16) reconcilement of suspense accounts with listing of items outstanding and origination dates;

(17) complaint file; and

(18) copies of quarterly report of trust assets.

Source: *The provisions of this §17.21 adopted to be effective March 12, 1998, 23 TexReg 2289; amended to be effective November 7, 2013, 38 TexReg 7689.*

§17.22. Examination and Investigation Fees.[1] (a) Calculation of fees. A trust company shall pay to the department a fee for examination, whether a regular or special examination, or for an investigation in connection with an application, calculated at a rate not to exceed $110 per examiner hour, to recoup the salary expense of examiners plus a proportionate share of the department's overhead allocable to the examination or investigation function. The banking commissioner in the exercise of discretion may lower the rate in connection with a specific examination or investigation for equitable reasons, without the prior approval of the finance commission.

(b) Travel expenses. In connection with an examination or investigation, a trust company shall reimburse the department for actual travel expenses incurred, including mileage, public transportation, food, and lodging, in addition to paying the fees set forth in subsection (a) of this section.

(c) Payment due. Fees and expenses charged under this section are due no later than the 30th day after a bill for fees and expenses is submitted to the trust company. Failure to pay such fees and expenses or file a request for hearing within the time period may subject the trust company to enforcement proceedings.

(d) Dispute of fees and expenses.

(1) A trust company may dispute the amount of a bill for fees and expenses assessed under this section by paying the amount of fees and expenses that are undisputed and filing a written request for hearing with the banking commissioner on or before the 30th day after a bill for fees and expenses is submitted to the trust company. If the trust company does not request a hearing in writing within the time period allowed, the assessed fees and expenses are final and nonappealable.

(2) A requested hearing must be held not later than the 30th day after the date the request was received by the banking commissioner unless the parties agree to a later hearing date. Each party shall be given written notice by personal delivery or by registered or certified mail, return receipt requested, of the date set by the banking commissioner for the hearing not later than the 11th day before that date. The hearing shall be conducted as provided by Chapter 9 of this title (relating to Rules of Procedure for Contested Case Hearings, Appeals, and Rulemakings).

(3) After the hearing, the banking commissioner shall affirm or modify the bill for fees and expenses by written order.

(e) Examination frequency. In general, the frequency of examination by the department of a state trust company under Finance Code, §181.105, will be determined in the manner described by Commissioner Policy Memorandum Number 1004.

Source: *The provisions of this §17.22 adopted to be effective March 12, 1998, 23 TexReg 2289; amended to be effective September 4, 2003, 28 TexReg 7348; amended to be effective January 2, 2014, 38 TexReg 9483.*

§17.23. Call Reports. (a) Call report. As used in this section, the term "call report" means a statement of condition and income and results of operations of a trust company as mandated by the banking commissioner pursuant to Finance Code, §181.107.

(b) Reporting requirements of trust companies.

(1) Public trust companies. Each trust company that transacts business with the public shall file four call reports annually with the banking commissioner. Such call reports must be filed with the banking commissioner no later than April 30, July 31, and October 31 of each year, and by January 31 of the subsequent year.

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[1] Also see Supervisory Memorandum Nos. 1002, 1004, 1006, and 1012, relating generally to policies for examinations.

(2) Exempt trust companies. Each trust company that is exempt pursuant to Finance Code, §182.011 or §182.019 shall file an annual call report with the banking commissioner no later than April 30 of each year relating to the preceding calendar year, accompanied by its annual certification, required by Finance Code, §182.013(a), that the trust company is maintaining the conditions and limitations of its exemption.

(3) Call report forms. The call report forms, the instructions for completing the reports and the accompanying materials will be furnished by the banking commissioner to all trust companies subject to this subsection, or may be obtained upon request from the Texas Department of Banking, 2601 North Lamar Boulevard, Austin, Texas 78705-4294. The banking commissioner may make such modifications and additions to call report form and contents under this subsection as considered necessary in the discretionary discharge of the banking commissioner's duties. A trust company must submit all information requested on the call report form.

(c) Special call reports. In addition to the requirements of subsections (b) of this section, the banking commissioner may require a trust company to file and submit a special call report, in such form and manner and containing such information as may be requested, on dates fixed, whenever in the banking commissioner's discretion the special call report is necessary in the performance of the banking commissioner's supervisory duties related to the safety and soundness of the trust company. Special call reports must contain only such information as is specifically requested by the banking commissioner.

(d) Call report declarations and attestations. Each call report or special call report required to be filed under subsections (b) and (c) of this section must contain a declaration by an executive officer, or by another officer designated by the board of directors of the trust company to make such declaration, that the report is true and correct to the best of such individual's knowledge and belief. The correctness of the call report or special call report must also be attested by the signatures of at least two of the directors of the trust company other than the officer making the declaration. The declaration of the directors must state that the call report or special call report has been examined by them and is true and correct to the best of their knowledge and belief.

(e) Lobby notice and publication for public trust companies. The latest call report filed with the banking commissioner pursuant to subsection (b) of this subsection or a Notice of Call Report Availability must be posted in the lobby of each trust company that transacts business with the public at a point accessible to the public. A trust company is not required to publish its call report in a newspaper or other media unless specifically directed to do so by the banking commissioner. A trust company required to publish its call report by the banking commissioner shall publish the report in a newspaper or other medium of general circulation as directed by the banking commissioner.

(f) Confidentiality. Call reports filed under subsection (b)(2) of this section are confidential as provided by Finance Code, §181.107(c)(2). Call reports filed under subsection (b)(1) are public information except for those portions designated as confidential by the banking commissioner, and may be published or otherwise disclosed to the public. Special call reports filed pursuant to subsection (c) of this section and non-public portions of call reports filed pursuant to subsection (b) of this section are confidential, subject only to such disclosure as may be permitted by Finance Code, §§181.301, et seq. or by §3.111 of this title (relating to Confidential Information).

(g) Reports containing significant errors and penalties for failure to file or for filing a report with false or misleading information.

(1) Public trust companies. A trust company that transacts business with the public which fails to make, file, or submit a timely call report or a special call report as required by this section is subject to a penalty not exceeding $500 a day to be collected by the attorney general on behalf of the banking commissioner.

(2) Exempt trust companies. Failure of a trust company that is exempt pursuant to Finance Code, §182.011 or §182.019 to make, file, or submit a timely call report or a special call report as required by this section is grounds for revocation of its exempt status.

(3) Corrections. Any trust company which makes, files, submits or publishes a call report or special call report which contains a significant error, shall file a corrected call report within 20 days from the date of request. For purposes of this subsection, a significant error refers to any difference in the report of condition and/or supporting schedules equating to 5.0% or more of total assets, provided the amount is greater than $50,000, or any difference in the report of income and/or supporting schedules equating to 5.0% or more of total operating income, provided the amount is greater than $5,000. Any trust company which makes,

files, submits or publishes a false or misleading call report or special call report is subject to an enforcement action pursuant to Finance Code, §§185.001, et seq.

Source: *The provisions of this §17.23 adopted to be effective May 14, 1998, 23 TexReg 4564; amended to be effective July 11, 2002, 27 TexReg 5962; amended to be effective January 2, 2014, 38 TexReg 9483, amended to be effective January 7, 2016, 41 TexReg 109.*

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CHAPTER 19. TRUST COMPANY LOANS AND INVESTMENTS

CHAPTER 19. TRUST COMPANY LOANS AND INVESTMENTS

Subchapter A. Loans [Repealed Effective May 5, 2016.]

Subchapter B. Investments

§19.21. [Repealed Effective May 5, 2016.]

§19.22. Investments in Mutual Funds.

(a) Subject to Finance Code, §184.101(f), and this section, a trust company may invest for its own account in a mutual fund as defined in Finance Code, §181.002(a)(31), unless the mutual fund portfolio contains an investment that the trust company could not make directly.

(b) Notwithstanding the limits stated in Finance Code, §184.101(c), a trust company may invest in a mutual fund not more than an amount equal to 15% of the trust company's restricted capital unless a larger investment is permitted under subsection (c) of this section. Pursuant to Finance Code, §184.101(c), the banking commissioner may authorize investments in excess of this limitation on written application if the banking commissioner concludes that:

(1) the excess investment is not prohibited by other applicable law; and

(2) the safety and soundness of the requesting trust company is not adversely affected.

(c) Notwithstanding the limits stated in Finance Code, §184.101(c), and subsection (b) of this section, a trust company may invest in a mutual fund without limit if:

(1) the mutual fund's stated investment objective is to invest solely in securities that the trust company could invest in directly for its own account without limit under Finance Code, §184.101(d); and

(2) the mutual fund's portfolio in fact consists wholly of investments in which the trust company could invest directly without limitation under Finance Code, §184.101(d).

(d) A trust company that invests in a mutual fund as permitted by subsection (b) of this section shall periodically determine that its pro rata share of any security in the portfolio of the mutual fund is not in excess of applicable investment and lending limits by reason of being combined with the trust company's pro rata share of that security held by all other mutual funds in which the trust company has invested and with the trust company's own direct investment and loan holdings. Documentation of periodic reviews must be maintained by the trust company for examination purposes.

(e) A trust company's investment in a mutual fund made prior to September 1, 1997, is subject to §19.21 of this title (relating to Grandfathered Investments). Pursuant to §19.21, without the written approval of the banking commissioner, a trust company may not increase its grandfathered investment in a mutual fund on or after September 1, 1997, including by means of an election to reinvest dividends, unless subsection (c) of this section applies.

Source: *The provisions of this §19.22 adopted to be effective March 12, 1998, 23 TexReg 2289; amended to be effective July 11, 2002, 27 TexReg 5962.*

Subchapter C. Real Estate

§19.51. Other Real Estate Owned.[1]

(a) Definitions. Words and terms used in this subchapter that are defined in Finance Code, §§181.001 et seq. have the same meanings as defined therein. The following words and terms when used in this subchapter shall have the following meanings unless the context clearly indicates the contrary.

(1) Appraisal--A written report by a state certified or licensed appraiser containing sufficient information to support the trust company's evaluation of OREO taking into consideration market value, analyzing appropriate deductions or discounts, and conforming to generally accepted appraisal standards, unless principles of safety and soundness applicable to trust companies require stricter standards.

(2) Appraiser--A state certified or licensed staff appraiser or a state certified or licensed third party fee appraiser with relevant and competent experience and background as related to a particular appraisal assignment.

(3) Trust company facility--Real property, including improvements, owned or leased, to the extent the lease or the leasehold improvements are capitalized, by a trust company if the real estate is held for the purposes set forth in Finance Code, §184.001, and is not disqualified under Finance Code, §184.002(b). The term also includes capitalized leasehold improvements if held for the same purposes.

(4) Coterminous sublease--A lease with the same duration as the remainder of the master lease.

(5) Evaluation--A written report prepared by an evaluator describing the OREO and its condition, the source of information used in the analysis, the actual analysis and supporting information, and the estimate of the OREO's market value, with any limiting conditions.

(6) Evaluator--An individual who has related real estate training or experience and knowledge of the market relevant to the OREO but who has no direct or indirect interest in the OREO. An appraiser may be an evaluator.

(7) Generally accepted appraisal standards--The Uniform Standards of Professional Appraisal Practice (USPAP) promulgated by the Appraisal Standards Board, Appraisal Foundation, Washington, D.C.

(8) Market value--The most probable price which a property should bring in a competitive and open market under all conditions requisite to a fair sale, the buyer and seller each acting prudently and knowledgeably, and assuming the price is not affected by undue stimulus. Implicit in this definition is the consummation of a sale as of a specified date and the passing of title from seller to buyer under conditions whereby:

(A) buyer and seller are typically motivated;

(B) both parties are well informed or well advised, and acting in what they consider their own best interests;

(C) a reasonable time is allowed for exposure in the open market;

(D) payment is made in terms of cash in U.S. dollars or in terms of financial arrangements comparable thereto; and

(E) the price represents the normal consideration for the property sold unaffected by special or creative financing or sales concessions granted by anyone associated with the sale.

(9) Non-coterminous sublease--A lease with a duration shorter than the remainder of the master lease.

(10) Other Real Estate Owned (OREO)--Real estate, including improvements, mineral interests, surface, and subsurface rights, owned in whole or in part or leased by a trust company, no matter how acquired, which is not a trust company facility as defined by paragraph (3) of this subsection or leasehold property as permitted under Finance Code, §184.203.

(11) Staff appraiser--An appraiser on the staff of a trust company who has no direct or indirect interest in the OREO.

(12) Third party fee appraiser--An appraiser who has an independent contractor relationship with

[1] Also see Supervisory Memorandum -1032, relating to policy for other real estate owned.

a trust company and has no direct or indirect interest in the OREO.

(13) Year--For the purposes of this section, a calendar year.

(b) Prohibition on real estate ownership. A trust company may not acquire or hold real estate except as specifically provided under Finance Code, §§184.001-184.003 and 184.203, and this section.

(c) Acquisition of OREO with restricted capital. A trust company may hold OREO purchased with the restricted capital of the trust company only if acquired:

(1) by purchase under judicial or nonjudicial foreclosure, or through a deed in lieu of foreclosure, of real estate that is security for a debt or debts previously contracted in good faith;

(2) by purchase to protect its interest in a debt or debts previously contracted if prudent and necessary to avoid or minimize loss;

(3) with prior written approval of the banking commissioner, by an exchange of OREO or personal property for real estate to avoid or minimize loss on the real estate exchanged or to facilitate the disposition of OREO;

(4) with prior written approval of the banking commissioner, by purchase of additional real estate to avoid or minimize loss on OREO currently held;

(5) by involuntary acquisition of an ownership interest or leasehold interest in real estate as a result of or incidental to a judicial or nonjudicial foreclosure, or by adverse possession, or by operation of law without any action on the part of the trust company to obtain such interest; or

(6) by loss of designation of real estate owned or leased by the trust company as a trust company facility.

(d) Acquisition of OREO with secondary capital. A trust company may hold OREO purchased with the secondary capital of the trust company, subject to the exercise of prudent judgment using the factors set forth in Finance Code, §184.101(f).

(e) Appraisal requirements.

(1) Subject to paragraph (2) of this subsection, when OREO is acquired, a trust company must substantiate the market value of the OREO by obtaining an appraisal within 60 days of the date of acquisition. An evaluation may be substituted for an appraisal if the recorded book value of the OREO is less than $250,000.

(2) An additional appraisal or evaluation is not required when a trust company acquires OREO if a valid appraisal or appropriate evaluation was made in connection with a real estate loan that financed the acquisition of the OREO and the appraisal or evaluation is less than one year old.

(3) An evaluation shall be made on all OREO at least once a year. An appraisal shall be made at least once every three years on OREO with a recorded book value in excess of $250,000.

(4) Notwithstanding another provision of this section, the banking commissioner may require an appraisal of OREO if the banking commissioner considers an appraisal necessary to address safety and soundness concerns.

(f) Additional expenditures on OREO. A trust company may re-fit OREO for new tenants or make normal repairs and incur routine maintenance costs to preserve or protect the value of the OREO or to render the OREO in saleable condition without prior notification to or approval by the banking commissioner. Other advances or additional expenditures on OREO acquired with the restricted capital of the trust company must have the prior written approval of the banking commissioner, and must not be:

(1) made for the purpose of speculation in real estate;

(2) made for the purpose of changing or altering the current status or intended use of the OREO; or

(3) inconsistent with principles of safety and soundness applicable to trust companies.

(g) Holding period.

(1) A trust company must dispose of OREO acquired with the restricted capital of the trust company no later than five years after it was acquired or ceases to be used as a trust company facility, unless an extension of time for disposing of the real

estate is granted in writing by the banking commissioner pursuant to Finance Code, §184.003(d).

(2) The holding period commences on the date that:

(A) ownership is acquired by the trust company pursuant to subsection (c)(1)-(5) of this section;

(B) OREO is acquired by the trust company through merger/consolidation, conversion, or purchase and assumption;

(C) the trust company first learns of its ownership interest in real estate which has devolved to the trust company by operation of law under subsection (c)(6) of this section;

(D) the trust company ceases to use a former trust company facility or completes its relocation from a former trust company facility to a new trust company facility; or

(E) is three years following the acquisition of real estate as a trust company facility for future expansion or relocation of the trust company if the real estate has not been occupied by the trust company, unless the banking commissioner has granted written approval to a further delay in the improvement and occupation of the real estate.

(3) The banking commissioner may grant one or more additional extensions of time for disposing of OREO acquired with the restricted capital of the trust company if the commissioner finds that the trust company has made a good faith effort to dispose of the OREO or that disposal of the OREO would be detrimental to the safety and soundness of the trust company.

(h) Disposition efforts; documentation. A trust company must make diligent and ongoing efforts to dispose of OREO acquired with the restricted capital of the trust company and must maintain documentation adequate to reflect those efforts. Such documentation must be available for inspection by the commissioner. If secondary capital is adequate to reclassify OREO in a manner that does not impinge on restricted capital, this disposition requirement does not apply.

(i) Disposition of OREO. A trust company may dispose of OREO by:

(1) selling the OREO in a transaction that qualifies as a sale under regulatory accounting principles;

(2) selling the OREO pursuant to a land contract or contract for deed;

(3) retaining the property for its own use as a trust company facility, subject to the approval of the commissioner;

(4) transferring the OREO for market value to an affiliate, subject to Finance Code, §183.109, and applicable federal law, including 12 United States Code, §§371c, 371c-1, and 1828(j);

(5) if the OREO is a master lease, obtaining a coterminous sublease or an assignment of a coterminous sublease, provided that if the trust company acquires or obtains assignment of a non-coterminous sublease, the holding period during which the master lease must be divested is suspended for the duration of the sublease and will commence running again upon termination of the sublease; or

(6) entering into a transaction that does not qualify for disposal under paragraphs (1)-(5) of this subsection; provided that its obligation to dispose of the OREO is not met until the trust company receives or accumulates from the purchaser an amount in cash, principal and interest payments, and private mortgage insurance totaling 10% of the sales price, as measured in accordance with regulatory accounting principles.

(j) Accounting for investments in facilities and OREO. A state trust company shall comply with regulatory accounting principles in accounting for its:

(1) investment in and depreciation of facilities, furniture, fixtures, and equipment; and

(2) investment in OREO and disposition of OREO.

Source: *The provisions of this §19.51 adopted to be effective December 31, 1998, 23 TexReg 13030; amended to be effective July 11, 2002, 27 TexReg 5962; amended to be effective November 7, 2013, 38 TexReg 7689.*

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CHAPTER 21. TRUST COMPANY CORPORATE ACTIVITIES

CHAPTER 21. TRUST COMPANY CORPORATE ACTIVITIES

Subchapter A. Fees and Other Provisions of General Applicability

§21.1. Definitions.

Words and terms used in this chapter that are defined in the Trust Company Act, have the same meanings as defined therein. The following words and terms, when used in this chapter, shall have the following meanings, unless the context clearly indicates otherwise.

(1) Accepted filing--An application, request, notice, or protest filed under the Trust Company Act, this chapter, or another rule adopted pursuant to the Trust Company Act, for which the appropriate fee has been paid pursuant to §21.2 of this title (relating to Filing and Investigative Fees), and regarding which the banking commissioner has notified the person or entity who submitted the filing, in writing, that the submission is complete and has been accepted for filing.

(2) Additional office--A location of a trust company other than the trust company's home office, at which the trust company engages in the trust business.

(3) Day--A calendar day.

(4) Eligible trust company--A Texas chartered trust company that:

(A) possesses capital and surplus that equals or exceeds current minimum statutory or regulatory requirements;

(B) received a satisfactory rating at the most recent examination by the department or federal regulatory agencies;

(C) is not operating in violation of a regulatory condition or commitment letter; and

(D) is not operating under a memorandum of understanding, determination letter or other notice of determination, order to cease and desist, or other state or federal administrative enforcement order.

(5) General interest items--Include, but are not limited to, local and international news, weather, sports, features, comics, entertainment and advertisements directed to the general public.

(6) Newspaper of general circulation--A newspaper that:

(A) devotes not less than 25% of its total column lineage to general interest items, provided that a newspaper of general circulation does not include a specialized newspaper or other periodical directed to a specific interest group or occupation, such as a legal notice or court related newspaper;

(B) is published at least once a week;

(C) is entered as second class postal matter in the county where published; and

(D) has been published regularly and continuously for at least 12 months before the applicant, protesting party or other entity publishes notice, provided that a weekly newspaper is considered to have been published regularly and continuously if the newspaper omits not more than three issues in a 12 month period.

(7) Public notice-A matter, including an application, request, notice, or protest, whether by proclamation or declaration, required or authorized to be published in a newspaper of general circulation by the Trust Company Act, this chapter, or another rule adopted pursuant to the Trust Company Act, or required to be published by the banking commissioner.

(8) Submitted filing--An initial application, request, notice, or protest filed under the Trust Company Act, this chapter, or another rule adopted pursuant to the Trust Company Act, that has not been abandoned and is not an accepted filing.

(9) Trust Company Act--Finance Code, Title 3, Subtitle F (§§181.001 et seq).

Source: *The provisions of this §21.1 adopted to be effective July 2, 1998, 23 TexReg 6715; amended to be effective September 5, 2002, 27 TexReg 8203.*

§21.2. Filing and Investigation Fees.

(a) Types of fees. Subsection (b) of this section contains filing fees for specified applications and notices submitted to the department, and subsection (c) of this section requires a fee for protesting an application. These fees are due at the time the application or protest is submitted. Subsection (d) of this section requires an investigation fee to be paid in certain cases once an application has been accepted by the department for filing, and in other cases may require payment of investigative costs upon written request of the department. Pursuant to subsection (e) of this section, an applicant may seek waiver or reduction of required fees.

(b) Filing fees. Simultaneously with a submitted application or notice, an applicant shall pay to the department:

(1) $10,000 for an application for trust company charter pursuant to Finance Code, §182.003;

(2) $5,000 for an application for conversion of exempt trust company to non-exempt pursuant to Finance Code, §182.011(d);

(3) $7,500 for an application to authorize a merger or share exchange pursuant to Finance Code, §182.302, and §21.64 of this title (relating to Application for Merger or Share Exchange), or $4,000 for an application accepted for expedited treatment pursuant to §21.63 of this title (relating to Expedited Filings);

(4) $2,000 for each request to authorize an additional merger if more than one affiliated merger is to occur simultaneously;

(5) $5,000 for an application to authorize a purchase of assets pursuant to Finance Code, §182.401, if the purchase price exceeds an amount equal to three times the sum of the trust company's equity capital less intangible assets;

(6) $2,500 for an application to authorize the sale of substantially all assets pursuant to Finance Code, §182.405;

(7) $1,000 for a subsidiary notice letter pursuant to Finance Code, §184.103(c), plus an amount up to an additional $3,500 if the banking commissioner notifies the applicant that additional information and analysis is required;

(8) $10,000 for an application regarding acquisition of control pursuant to Finance Code, §183.002, or $5,000 if the applicant has previously been approved to control another trust company and no material changes in the applicant's circumstances have occurred since the prior approval;

(9) $500 for a notice to change home office with no abandonment of existing office pursuant to Finance Code, §182.202(c), and §21.41(a) of this title

(relating to Written Notice and Application for Change of Home Office);

(10) $2,000 for an application to relocate the home office with abandonment of existing office pursuant to Finance Code, §182.202(d), and §21.41(b) of this title, or $1,000 for an application accepted for expedited treatment pursuant to §21.3 of this title (related to Expedited Filings);

(11) $500 for a notice of additional office pursuant to Finance Code, §182.203(a), and §21.42 of this title (relating to Establishment, Relocation and Closing of an Additional Office), plus an additional $1,500 if the banking commissioner notifies the applicant pursuant to Finance Code, §182.203(b), and §21.42(c) of this title that additional information and analysis is required;

(12) $500 for an application for release from a final removal or prohibition order pursuant to Finance Code, §185.0071;

(13) $300 for an application to amend a trust company charter (certificate of formation) pursuant to Finance Code, §182.101;

(14) $2,500 for an application to authorize a reverse stock split subject to the substantive provisions of §21.92 of this title (relating to Amendment of Certificate to Effect a Reverse Stock Split);

(15) $100 for a request for a "no objection" letter to use a name containing a term listed in Finance Code, §181.004, by an entity other than a depository institution or a trust company;

(16) $1,000 for an application to authorize acquisition of treasury stock pursuant to Finance Code, §184.102, and §21.91 of this title (relating to Acquisition and Retention of Shares as Treasury Stock);

(17) $1,000 for an application to authorize an increase or reduction in capital and surplus pursuant to Finance Code, §182.103;

(18) $2,500 for an application by an existing trust company for exemption pursuant to Finance Code, §182.012, and §21.24 of this title (relating to Exemptions for Trust Companies Administering Family Trusts);

(19) $2,500 for an application for authority to accept deposits pursuant to Finance Code, §§182.101, 184.301, and 184.302, and §21.31 of this title (relating to Notice to Engage in Trust Deposits);

(20) $100 for the annual certification filing for an exempt trust company pursuant to Finance Code, §182.013;

(21) $10,000 for an application to convert from a trust institution to a state trust company pursuant to Finance Code, §182.502; and

(22) $500 for a request to the banking commissioner to exempt an acquisition of control transaction from the requirements of Finance Code, §183.001, pursuant to Finance Code, §183.001(d)(4), which fee will be applied to a subsequent application for approval of an acquisition of control if the exemption is denied.

(c) Filing fee for protest. A person or entity filing a protest to the application of another person or entity shall pay a fee of $2,500 simultaneously with such protest filing. The purpose of the fee required under this subsection is to partially offset the department's increased cost of processing and reduce the costs incurred by the applicant resulting solely from the protest.

(d) Investigative fees and costs. An applicant for a trust company charter, conversion from an exempt trust company to a non-exempt trust company or limited trust association, or conversion of a trust institution to a state trust company shall pay an investigation fee of $10,000 once the application has been accepted for filing. If required by the banking commissioner, an applicant under another type of application or filing listed in subsection (b) of this section shall pay the reasonable investigative costs of the department incurred in any investigation, review, or examination considered appropriate by the department, calculated as provided by §17.22(a) of this title (relating to Examination and Investigation Fees). Such investigation fee or costs must be paid by the applicant upon written request of the department. Failure to timely pay the investigation fee or a bill for investigative costs constitutes grounds for denial of the submitted or accepted filing.

(e) Reduction or waiver of fees. Fees paid are nonrefundable and the banking commissioner shall charge fees on a consistent and nondiscriminatory basis. However, in the exercise of discretion, the banking commissioner may reduce, waive, or refund all or part of a filing fee, investigation fee, or bill for investigative costs if the banking commissioner concludes that:

(1) the application demonstrates that the fee creates an unreasonable hardship on the applicant; or

(2) the nature of the application will result in substantially reduced processing time compared to normal expectations for an application of that type.

(f) Severability. If any fee or cost recovery set forth in this section is finally determined by a court of competent jurisdiction to be invalid that fee or cost recovery shall be severed from this section and the remainder of this section shall remain fully enforceable.

Source: *The provisions of this §21.2 adopted to be effective March 12, 1998, 23 TexReg 2290; amended to be effective July 2, 1998, 23 TexReg 6715; amended to be effective December 31, 1998, 23 TexReg 13022; amended to be effective September 5, 2002, 27 Tex Reg 8203; amended to be effective January 2, 2014, 38 TexReg 9484.*

§21.3. Expedited Filings.

(a) Eligible trust companies may file an expedited filing according to forms and instructions provided by the department solely for home office relocations within the same city pursuant to Finance Code, §182.202(d), and §21.41(b) of this title (relating to Written Notice and Application for Change of Home Office), together with the fee required by §21.2 of this title (relating to Filing and Investigation Fees). Notice must be published as required by §21.41(e) of this title.

(b) Notwithstanding another provision of this section, the banking commissioner may deny expedited filing treatment to an eligible trust company, in the exercise of discretion, if the banking commissioner finds that the filing involves one or more of the following:

(1) the proposed transaction involves significant policy, supervisory, or legal issues;

(2) approval of the proposed transaction is contingent on additional statutory or regulatory approval by the banking commissioner or another state or federal regulatory agency;

(3) the proposed transaction will result in a fixed asset investment in excess of the limitation contained in Finance Code, §184.002(a);

(4) the proposed transaction significantly impacts the strategic plan of the trust company;

(5) the proposed transaction would cause capital and surplus to fall below current minimum statutory or regulatory requirements;

(6) the proposed transaction involves an issue of regulatory concern as determined by the banking commissioner in the exercise of discretion; or

(7) the application is deficient and specific additional information is required, or the filing fee has not been paid.

(c) The banking commissioner may deny or withdraw expedited filing treatment if a protest is filed. If a protest is filed, the application will be processed under §21.41 of this title.

(d) The department shall notify the applicant on or before the 15th day following the date the application is accepted for filing if expedited filing treatment is not available under this section. Such notification must be in writing and must indicate the reason why expedited treatment is not available. Notification is effective when mailed by the department and is not subject to appeal.

(e) Unless the applicant is otherwise notified by the department, an expedited filing is approved on the

15th day after the date the applicant is notified that expedited filing treatment is available or the expiration of the period for filing a public comment or protest, whichever is the last to occur.

Source: *The provisions of this §21.3 adopted to be effective July 2, 1998, 23 TexReg 6715; amended to be effective September 5, 2002, 27 TexReg 8203.*

§21.4. Required Information and Abandoned Filings.

(a) Required information. The banking commissioner may investigate and evaluate facts related to a submitted filing or accepted filing to the extent necessary to reach an informed decision. The banking commissioner may require any person or entity connected with the matter to which the submitted or accepted filing pertains to submit additional information, including, but not limited to, an opinion of counsel with respect to a matter of law or an opinion, review or compilation prepared by a certified public accountant.

(b) Accepted for filing. On or before the 15th day after initial submission of an application, the banking commissioner shall issue a written notice informing the applicant either that all filing fees have been paid and the application is complete and accepted for filing, or that the application is deficient and specific additional information is required.

(c) Time limit for providing required information. Unless otherwise provided for in the Trust Company Act, this chapter or rules and regulations adopted pursuant to the Trust Company Act, all required information necessary for the banking commissioner to declare that a submission is an accepted filing shall be provided to the department on or before the 61st day after the date of the initial submission of the filing. Upon a finding of good and sufficient cause, the banking commissioner shall grant an applicant additional time to complete the application. Extensions will be communicated to the applicant before the expiration of the filing period.

(d) Abandoned filing. The banking commissioner may determine any submitted or accepted filing to be abandoned, without prejudice to the right to refile, if the information required by the Trust Company Act, this chapter, or any rule or regulation adopted pursuant to the Trust Company Act, or additional requested information, is not furnished within the time period specified by subsection (c) of this section or as requested by the banking commissioner in writing to the person or entity making the submission. The banking commissioner may determine a submitted or accepted filing for which fees required by the Trust Company Act or by this chapter are not paid within 30 days of receipt of the initial submission to be abandoned.

(e) Notice. The banking commissioner shall give written notice of any submitted or accepted filing considered to be abandoned. Notice of abandonment shall be effective upon mailing by the department. Fees paid related to an abandoned filing are nonrefundable.

Source: *The provisions of this §21.4 adopted to be effective May 14, 1998, 23 TexReg 4565; amended to be effective September 5, 2002, 27 TexReg 8203; amended to be effective September 4, 2014, 39 TexReg 6825.*

§21.5. Public Notice.

(a) General. A person or entity required or authorized to file public notice in connection with a trust company notice or application, including a person or entity requesting authorization for a merger, purchase of assets, or another application requiring public notice, shall publish notice in a newspaper of general circulation in its specified community and in such other locations as may be required by the banking commissioner.

(b) Contents. The public notice must state that a filing is being made; the date (or expected date) of the filing; sufficient information describing the proposed transaction, and other related information required by the Trust Company Act, this chapter or rules and regulations adopted pursuant to the Trust Company Act, and any other information as may be required by the banking commissioner. In addition, the notice must include substantially the following text as a separately stated paragraph: "Any person wishing to comment on this application, either for or against, may file written comments with the Texas Department of Banking, 2601 North Lamar Boulevard, Austin, Texas 78705-4294 on or before the 14th day after the date of this publication. Such comments will be made a part of the record before and considered by the banking commissioner. Any person wishing to formally protest and oppose (describe type of application in general terms) and participate in the application process may do so by filing a written notice of protest with the Texas Department of Banking on or before the 14th calendar day after the date of this publication accompanied by a protest filing fee of $2,500. The protest fee may be reduced or waived by the banking commissioner upon a showing of substantial hardship."

(c) Publisher's affidavit. A person or entity required to file public notice under this section shall file with the banking commissioner a copy of the notice and a publisher's affidavit attesting to the date of publication.

(d) One publication sufficient. Unless otherwise required by the Trust Company Act or rules and regulations adopted pursuant to the Trust Company Act, one public notice publication per submitted or accepted filing in each community specified by the banking commissioner is sufficient if in substantial compliance with this section and chapter and with the Trust Company Act, as determined by the banking commissioner. The banking commissioner reserves the right to require additional publication based on a determination that a particular publication is insufficient or is otherwise not in compliance.

(e) Other acceptable public notice. The banking commissioner may determine that public notice required by another regulatory agency of a trust company satisfies the public notice requirements of this section. For example, if a trust company converts, merges, or organizes into a financial institution that is no longer regulated by the banking commissioner and the banking commissioner determines that public notice requirements imposed by the successor regulatory authority satisfy the notice requirements of the Trust Company Act and this section, the banking commissioner may permit the notice required by the successor regulatory authority to serve as notice under this section.

Source: *The provisions of this §21.5 adopted to be effective May 14, 1998, 23 TexReg 4565; amended to be effective September 5, 2002, 27 TexReg 8203.*

§21.6. Applications for Trust Charter: Notices to Applicants; Application Processing Times; Appeals.

(a) Form of application. An application to engage in a business under Finance Code, §182.003, must be filed on a form prescribed by the banking commissioner.

(b) Notice to applicant. The banking commissioner shall issue a written notice as required by §21.4 of this title (relating to Required Information and Abandoned Filings) informing the applicant either that all filing fees have been paid and the application is complete and accepted for filing, or that the application is deficient and specific additional information is required. If a protest is timely filed, the department will notify the applicant of the protest.

(c) Action on applications. If an application is not protested and if the banking commissioner has not ordered a hearing, the banking commissioner shall approve or deny an application for a trust company charter on or before the 180th day after the date the application is accepted for filing, unless extended by written agreement between the applicant and the banking commissioner. If the application is protested, the application will be acted on in accordance with §21.10 of this title (relating to Protested Applications).

(d) Violation of processing times. If an application is not protested or a hearing is not convened, an applicant may appeal directly to the banking commissioner for a timely resolution of a dispute arising from a violation of a processing period set forth in this section. An applicant may appeal by filing a written request with the banking commissioner on or before the 30th day after the date the decision is made on the application, requesting review by the banking commissioner to determine whether the established period for the granting or denying of the application has been exceeded. The decision on the appeal shall be based on the written appeal filed by the applicant, any response by the department, and any agreements between the parties. The banking commissioner may convene a hearing to take evidence on the matter.

(e) Decision on appeal. The banking commissioner shall decide the appeal in the applicant's favor if the banking commissioner determines that the time periods established in this section have been exceeded and the department has failed to establish good cause for the delay. The banking commissioner shall issue a written decision to the applicant on or before the 60th day after the filing of an appeal. If an appeal is decided in an applicant's favor, the department will reimburse the application fee paid by the applicant. A decision in favor of the applicant under this subsection does not affect a decision to grant or deny the application based on applicable substantive law without regard to whether the application was timely processed.

Source: *The provisions of this §21.6 adopted to be effective May 14, 1998, 23 TexReg 4565; amended to be effective September 5, 2002, 27 TexReg 8203; amended to be effective July 10, 2008, 33 TexReg 5277.*

§21.7. Submission of Reproductions.

(a) Scope. This section governs submission of specified forms of copies of original documents to the Texas Department of Banking (the department) for processing by the corporate activities division of the department pursuant to this chapter, and does not permit, prohibit, or affect correspondence with or documents submitted to the department for another purpose, including:

(1) applications submitted to the special audits division of the department; and

(2) documents submitted to the department as required or permitted by Government Code, Chapter 2001, and Chapter 9 of this title (relating to Rules of Procedure for Contested Case Hearings, Appeals, and Rulemaking).

(b) Reproduction. For purposes of this section, the term reproduction means a photographic or photostatic copy or similar reproduction of an original document that is submitted to the department by mail, hand delivery, or telephonic document transmission to the telecopier machine specified by the department.

(c) Filings. Subject to the length limitations of subsection (d) of this section, a document required or authorized to be filed with the department may be a reproduction, including an application or a supplement to or substitution for a portion of a previously filed and accepted application. Receipt of a reproduction by the department is not equivalent to accepted for filing.

(d) Page limitations. A reproduction submitted by telephonic document transmission to the department's telecopier machine may not exceed 25 pages in total length, including the transmittal document required by subsection (e) of this section, or it will be rejected for filing. The transmission of portions of any particular filing at different times is treated as one reproduction for purposes of this subsection.

(e) Transmittal document. A cover sheet or transmittal document must accompany every reproduction submitted under this section and must:

(1) clearly identify the sender by name, address, and phone number, the documents being delivered or transmitted, and the number of pages in the submission;

(2) contain clear and concise instructions concerning the sender's request with respect to the submission; and

(3) contain complete and accurate information regarding the payment of required filing fees, if any.

(f) Time of receipt. To be considered received by the department, a reproduction must be in clearly legible form. The date the submission is actually received by the department or the date and time imprinted by the department's telecopier on the last page of a reproduction submitted by telephonic document transfer will determine the time of receipt, provided that a reproduction received after 4:30 p.m. is considered received at 8:00 a.m. on the next business day. A reproduction will not be considered received until the department receives the entire document and the required filing fee, if any.

(g) Equivalent of original. For all purposes attendant to filing, a reproduction of a document filed with the department under this section, including reproduction of signatures thereon, is considered an original document.

Source: *The provisions of this §21.7 adopted to be effective May 14, 1998, 23 TexReg 4565.*

§21.8. [Repealed effective September 9, 2010.]

§21.9. Corporate Filings.

(a) In accordance with the applicable provisions of the Trust Company Act, the following corporate forms regarding a state trust company, along with the applicable filing fees, must be filed with the banking commissioner:

(1) a certificate of correction as authorized by Texas Business Organizations Code (TBOC), §4.101;

(2) certificate of amendment under the Finance Code, §182.101;

(3) restated, or, amended and restated, certificate of formation under the Finance Code, §182.101, and TBOC §3.059 and §21.052;

(4) certificate of merger under the Finance Code, §182.301 et seq, as supplemented by the TBOC §10.151;

(5) certificate of exchange under TBOC, §10.151;

(6) statement of event or fact pursuant to TBOC §4.055;

(7) establishment of a series of shares by the board of directors under the Finance Code, §182.102, as supplemented by TBOC §21.155 and §21.156;

(8) statement regarding a restriction on the transfer of shares under TBOC, §21.212; and

(9) abandonment of a merger or interest exchange prior to its effective date under TBOC §4.057.

(b) For purposes of corporate filings with the banking commissioner under subsection (a) of this section, state trust companies may utilize a modified version of forms promulgated by the secretary of state if the banking commissioner or the finance commission has not promulgated an appropriate corporate form; however, the banking commissioner may require the submission of additional information. The modified corporate forms must:

(1) specifically reference the applicable provisions of the Finance Code;

(2) change references from “corporation” to “association”; and

(3) change the references to “stated capital” and similar terms defined in the TBOC to an appropriate reference to terms defined in the Finance Code.

(c) In accordance with the applicable provisions of the Finance Code and the TBOC, a state trust company may file the following corporate forms with the secretary of state as instructed in the Finance Code or the TBOC:

(1) name registrations under TBOC §§5.151-5.155;

(2) assumed name certificates under TBOC §5.051;

(3) a statement appointing an agent authorized to receive service of process under Finance Code §201.103;

(4) an amendment to a statement appointing an agent to receive service of process under Finance Code §201.103; and

(5) a cancellation of the appointment of an agent to receive service of process under Finance Code §201.103.

(d) The following corporate forms are inapplicable to state trust companies and are not required to be filed by a state trust company with either the secretary of state or the banking commissioner:

(1) changes of registered office or agent under TBOC §5.202 or §5.203;

(2) name reservations under TBOC §5.101;

(3) certificate of termination under TBOC §11.101; and

(4) certificate of reinstatement under TBOC §11.202.

Source: *The provisions of this §21.9 adopted to be effective July 10, 2008, 33 TexReg 5277; amended to be effective September 9, 2010, 35 TexReg 8102; amended to be effective November 7, 2013, 38 TexReg 7690.*

§21.10. Protested Applications.

(a) A protest of a charter application must be received by the department before the 15th day after the date the organizers publish notice and must be accompanied by any fee required by §21.5(b) of this title (relating to Public Notice). If the protest is untimely, the department will return all fees and deposits to the protesting party. If the protest is timely, the department shall notify the applicant of the protest and mail or deliver a complete copy of the nonconfidential sections of the charter application to the protesting party before the 15th day after the later of the date of receipt of the protest or receipt of the charter application.

(b) A protesting party must file a detailed protest responding to each contested statement in the nonconfidential portion of the application not later than the 20th day after the date the protesting party receives the application from the department. The protesting party must relate each statement and response in his protest to the standards for approval set forth in Finance Code §182.003(b).

(c) The applicant must file a written reply to the protesting party's detailed response on or before the 10th day after the date the response is filed.

(d) The protesting party's response and the applicant's reply must be in the form and must be served as required by Finance Code §182.005(b). Any comment received by the department and any reply of the applicant to the comment shall be made available to the protesting party.

Source: *The provisions of this §21.10 adopted to be effective July 10, 2008, 33 TexReg 5277.*

§21.11. Hearings on Applications.

(a) The banking commissioner may not be compelled to hold a hearing before granting or denying the charter application. He may grant a hearing at the request of an applicant or a protesting party. He may order a hearing without any party having requested one.

(b) A party requesting a hearing must indicate with specificity the issues involved that cannot be determined on the basis of the record complied under §21.10(b) - (d) of this title (relating to Protested Applications) and why the issues cannot be determined.

(c) If the banking commissioner sets a hearing, he shall conduct a public hearing and one or more prehearing conferences as he considers advisable and consistent with applicable law. He shall also allow the parties to undertake such discovery as he considers advisable and consistent with applicable law, except that he may not permit discovery of confidential information in the charter application or the investigation report.

Source: *The provisions of this §21.11 adopted to be effective July 10, 2008, 33 TexReg 5277.*

§21.12. Waiver of Requirements.

The banking commissioner in the exercise of discretion may waive or modify any requirement imposed by this chapter.

Source: *The provisions of this §21.12 adopted to be effective July 10, 2008, 33 TexReg 5277.*

Subchapter B. Trust Company Chartering and Powers

§21.23. Option to Withhold Identity of Officers.

An applicant for a trust company charter may, at its option, withhold the identity of prospective officers until such time as the banking commissioner issues a final order on the application. Approval of the application will be conditional upon the applicant's submitting resumes of qualified proposed officers to the banking commissioner. Upon receipt of the resumes, the banking commissioner shall review and investigate the qualification of the proposed officers and deliver the certificate of authority pursuant to Finance Code, §182.006, if the banking commissioner finds that the proposed officers meet the requirements of Finance Code, §182.003(b)(3).

Source: *The provisions of this §21.23 adopted to be effective May 14, 1998, 23 TexReg 4565; amended to be effective September 5, 2002, 27 TexReg 8203.*

§21.24. Exemptions for Family Trust Companies.

(a) Definitions. Definitions in Finance Code, §182.011(a - 1), are incorporated herein by reference except for the term "family member." As used in this section and in Finance Code, Title 3, Subtitle F (the Trust Company Act), the following words and terms shall have the following meanings, unless the context clearly indicates otherwise:

(1) "Family" means individuals who are related within the seventh degree of affinity or consanguinity to a shared common ancestor.

(2) "Family member" means each individual included in the definition of "family," provided that a foster child is considered the child of the foster parent and a person for whom a guardian was appointed before the person's 18th birthday is considered the child of the guardian. The term "family member" also includes the shared common ancestor.

(3) "Key employee" means the president of the trust company, any of its officers in charge of a principal business unit, division or function (such as administration or finance), an officer who performs a policymaking function for the trust company, or another person who performs similar policymaking functions for the trust company.

(b) Application for exemption.

(1) Pursuant to Finance Code, §182.011 and §182.012, a trust company may request in writing that it be exempted from specified provisions of the Trust Company Act, if it has only family clients, transacts business solely on behalf of family clients and their related interests, is wholly owned, directly or indirectly, legally or beneficially, by one or more family members, and does not hold itself out to the general public as a corporate fiduciary for hire.

(2) The application must:

(A) be accompanied by the appropriate filing fee required by §21.2 of this title (relating to Filing and Investigation Fees);

(B) specify the specific exemptions requested and the reasons or justification for requesting the exemptions; and

(C) include a copy of the trust company's certificate of formation containing, or a proposed amendment to the certificate of formation that would cause it to contain, the following statement in its purposes clause: "The sole purpose for which the trust company is organized is to act as a corporate fiduciary for accounts in which all beneficiaries are descendants of and related within the seventh degree of affinity or consanguinity to ______________ (name of common ancestor), and their related interests to the extent permitted by the Texas Finance Code or applicable rules and regulations."

(c) Exemption. Subject to conditions or limitations being imposed by the banking commissioner, a family trust company may request exemption from the following provisions of the Trust Company Act:

(1) the requirement of Finance Code, §183.103(a), that five is the minimum number of directors, managers, or managing participants that can be specified in the certificate of formation, provided

that the certificate of formation must specify the number of directors, managers, or managing participants, consistent with paragraph (2) of this subsection;

(2) the requirement of Finance Code, §183.103(a), that the number of directors, managers, or managing participants of a trust company cannot be less than five or more than 25, the majority of whom must be residents of this state, provided that the board of a trust company seeking exemption under this section must consist of not fewer than three or more than 25 directors, managers, or managing participants, at least one of whom must be a resident of this state;

(3) the restrictions of Finance Code, §183.109(a) - (c), regarding transactions with management and affiliates;

(4) the limitations of Finance Code, §184.002, on investment in trust company facilities;

(5) the limitations of Finance Code, §184.101, on securities investments, provided that the exemption request must address each limitation and the reasons for exemption separately;

(6) the restrictions of Finance Code, §184.102, regarding transactions in state trust company shares or participation shares;

(7) the limitations of Finance Code, §184.003, on other real estate investments; and

(8) the limitations of Finance Code, §§184.201 - 184.203, regarding lending limit and lease financing transaction restrictions, provided that no loans may be made from a trust company's minimum restricted capital amount.

(d) Notice to applicant. The banking commissioner shall issue a written notice as required by §21.4 of this title (relating to Required Information and Abandoned Filings) informing the applicant either that all filing fees have been paid and the application is complete and accepted for filing, or that the application is deficient and specific additional information is required.

(e) Notice to clients. A family trust company which has been granted an exemption under subsection (c) of this section must provide each family client with a copy of the exemption granted by the banking commissioner. The trust company must maintain an acknowledged receipt of such notice in its files.

(f) Transition period for certain former family clients. Pursuant to Finance Code, §182.011(a - 1)(1)(C) and (I), a family trust company may continue providing services to a former key employee or a formerly revocable trust that is no longer an eligible family client for a period of one year after the date of the disqualifying event. The banking commissioner may grant an extension of up to one year in response to a written request if the commissioner determines that:

(1) the trust company has acted diligently and in good faith in its efforts to terminate the disqualified relationship in a manner consistent with its fiduciary duties; and

(2) additional time is needed to avoid harm to the affected beneficiaries and appropriately discharge the trust company's fiduciary duties with respect to the disqualified relationship.

(g) Effect on existing family trust company. A family trust company with exemptions granted prior to September 1, 2015, under Finance Code, §182.011 and §182.012, is not required to take any action to preserve its exemption as a result of changes in law made by Acts 2015, 84th Leg., R.S., Ch. 250, §5. However, unless and until any such family trust company amends its certificate of formation to name a new shared common ancestor, the control person named in its certificate of formation is considered to be the shared common ancestor for purposes of determining eligibility of family members under Finance Code, §182.011, and this section.

Source: *The provisions of this §21.24 adopted to be effective September 3, 1998, 23 TexReg 8832; amended to be effective September 5, 2002, 27 TexReg 8203; amended to be effective May 10, 2007, 32 TexReg 2463; amended to be effective November 7, 2013, 38 TexReg 7690; amended to be effective*

January 7, 2016, 41 TexReg 110; amended to be effective May 5, 2016, 41 TexReg 3100.

Subchapter C. Trust Deposits

§21.31. Notice To Engage in Trust Deposits.

(a) Compliance required. A trust company may not deposit trust funds with itself as an investment pursuant to Finance Code, §184.301, unless it first complies with this section and §21.32 of this title (relating to Acceptance of Trust Deposits).

(b) Notice of activity. At least 30 days before accepting trust deposits, a trust company shall file a notice with the banking commissioner containing the following information, together with the filing fee required by §21.2 of this title (relating to Filing and Investigation Fees):

(1) an estimate of the anticipated dollar volume of trust deposits, an estimate of the maximum trust deposit for any one account, and an estimate of the total number of accounts that will invest in trust deposits;

(2) a copy of the added or revised portion of the trust company's strategic plan that addresses the acceptance of trust deposits, in compliance with Texas Department of Banking Policy Memorandum Number 1009, regarding strategic plans;

(3) if trust deposits are to be insured by the Federal Deposit Insurance Corporation (FDIC), or its successor, evidence of such insurance;

(4) if trust deposits are to be secured by a pledged fund of securities:

(A) a description of the initial fund of securities securing the anticipated trust deposits, including disclosure of current market value and an evaluation of the securities under the standards of Finance Code, §184.101(e); and

(B) identification of the federal reserve bank, state or nationally chartered depository institution, or clearing corporation, that controls the securities pledged against the trust deposits and a copy of the executed pledge agreement with such institution;

(5) if trust deposits are to be secured by a pledged certificate of deposit:

(A) evidence of the certificate of deposit that discloses its value and associated costs, including penalties, for early redemption or withdrawal; and

(B) identification of the FDIC-insured depository institution that issued the certificate of deposit, a copy of the executed pledge agreement with such institution, and an acknowledgment of the pledge from the issuing institution;

(6) a certified copy of a board resolution directing management of the trust company to:

(A) maintain adequate security and/or FDIC insurance to fully secure and/or insure the trust deposits; and

(B) maintain adequate policies, procedures, and records regarding trust deposits; and

(7) such other information that the banking commissioner may reasonably request.

(c) Action by banking commissioner.

(1) The trust company may begin accepting trust deposits on the 31st day after the date the banking commissioner receives the trust company's completed notice letter unless the banking commissioner specifies an earlier or later date, requests additional information, or prohibits the activity as provided in this subsection. The banking commissioner may prohibit the trust company from accepting trust deposits only if the banking commissioner concludes that:

(A) the trust deposits would not be fully insured or secured as required by Finance Code, §184.301, and this section;

(B) the activity would adversely affect the safety and soundness of the trust company;

(C) the trust company has a less than satisfactory rating as of the trust company's most recent examination; or

(D) the trust company is subject to an enforcement order issued pursuant to Finance Code, Chapter 185, or is not otherwise operating in substantial compliance with all applicable state and federal laws and regulations.

(2) The banking commissioner may extend the 30-day period under paragraph (1) of this subsection if the banking commissioner determines that the trust company's notice raises issues requiring additional information or additional time for analysis. If the 30-day period is extended, the trust company may accept trust deposits 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 Finance Code, §181.201, not later than the 60th day after the date the banking commissioner receives the trust company's notice. 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.

(3) A trust company that is denied the right to accept trust deposits by the banking commissioner under this section may appeal as provided by Finance Code, §§181.202-181.204, or may file a new notice under this section with additional information relevant to the banking commissioner's determination, with applicable filing fee.

(d) Authority to accept trust deposits. Only a trust company which transacts business with the public may deposit trust funds with itself as an investment pursuant to Finance Code, §184.301. An exempt trust company under Finance Code, §§182.011-182.019, may not accept trust deposits.

(e) Records. A trust company shall maintain written documentation adequate to demonstrate compliance with this section, which documents must be available at all times to the department for examination and review. For purposes of this subsection, required documentation need not be retained beyond three years.

Source: *The provisions of this §21.31 adopted to be effective July 2, 1998, 23 TexReg 6715; amended to be effective September 5, 2002, 27 TexReg 8203.*

§21.32. Acceptance of Trust Deposits.

(a) Compliance required. A trust company may not deposit trust funds with itself as an investment pursuant to Finance Code, §184.301, unless it first complies with this section and §21.31 of this title (relating to Notice to Engage in Trust Deposits). Trust deposits must be fully insured by deposit insurance issued by the Federal Deposit Insurance Corporation (FDIC), or its successor, or fully secured by a separate fund of pledged securities, by pledged certificates of deposit, or a combination of the foregoing.

(b) Pledged collateral. A separate fund of securities or certificates of deposit that are pledged to secure trust deposits must be maintained in a federal reserve bank, a state or nationally chartered depository institution, or a clearing corporation, as defined by Business & Commerce Code, §8.102, either in this state or elsewhere, and must:

(1) for a fund of securities, contain only bonds, notes, or other evidences of indebtedness which are investment grade, convertible to cash within three business days, at least 80% of which have a maturity date of not later than the 91st day after the date of purchase. For purposes of this subsection, investment grade refers to a security that is rated "Baa" or better by Moody's or "BBB" or better by Standard & Poor's rating services in accordance with the terms of the Uniform Agreement on Classification Of Assets And Appraisal Of Securities by the Federal Financial Institutions Examination Council;

(2) for a fund of securities, the value of the securities must at all times equal or exceed 110% of the deposits held plus accrued and unpaid interest; provided, however, that if the value of the securities is evaluated daily and reduced to writing, the value of the securities must at all times equal or exceed 100% of the deposits held plus accrued and unpaid interest. In any event, the value of the securities must be evaluated at least monthly to ensure that the deposits are fully secured; and

(3) for a certificate of deposit, be fully insured by the FDIC.

(c) Noninsurability by FDIC. If a trust company's trust deposits are not insured by the FDIC, a trust company must provide each client related to an account from which deposits may be accepted with a written notice conspicuously stating that: "Your deposit with this trust company is not insured by the FDIC." This notice must be provided to the client prior to any deposit activity regarding the related account and must be signed by both the client and the trust company. The notice must be in type that is boldfaced, capitalized, underlined or otherwise set out from surrounding written material so as to be conspicuous. Furthermore, all documents issued by a trust company evidencing a deposit transaction, must contain a notice complying with the requirements of this subsection.

(d) Records. A trust company shall maintain all written documentation adequate to demonstrate compliance with this section, which documents must be available at all times to the department for examination and review. For purposes of this subsection, required documentation need not be retained beyond three years.

Source: *The provisions of this §21.32 adopted to be effective July 2, 1998, 23 TexReg 6715; amended to be effective September 5, 2002, 27 TexReg 8203.*

Subchapter D. Trust Company Offices

§21.41. Written Notice and Application for Change of Home Office.

(a) Relocation by notice. If the location that is the home office of a trust company prior to a proposed relocation of the home office is to remain an additional office of the trust company after the relocation, the trust company may relocate its home office by filing a written notice pursuant to Finance Code, §182.202(c). The filed notice must contain all information required by subsection (c) of this section, accompanied by the required filing fee pursuant to §21.2 of this title (relating to Filing and Investigation Fees), and notice of the submission must be published as required by subsection (e) of this section. A trust company filing notice of a home office relocation under this subsection may relocate its home office on the 31st day after the required notice and fee have been received by the banking commissioner, unless the banking commissioner gives notice in writing, prior to the expiration of that time period, that an earlier or later date is authorized or that additional information and additional time for analysis is required. Upon issuance of a notice requiring additional information and additional time for analysis, the trust company may relocate its home office only on written approval of the banking commissioner. Except as otherwise provided in this section, the banking commissioner shall evaluate the notice under the criteria of §21.42(e) of this title (relating to Establishment, Relocation and Closing of an Additional Office).

(b) Relocation by application. If Finance Code, §182.202(c), and subsection (a) of this section do not apply, a trust company desiring to change its home office location must file an application with the banking commissioner pursuant to Finance Code, §182.202(d), setting forth all information required by subsection (d) of this section, accompanied by the required filing fee pursuant to §21.2 of this title, and notice of the submission must be published as required by subsection (e) of this section. The banking commissioner shall issue a written notice no later than 15 days after the date the initial filing is received, as required by §21.4 of this title (relating to Required Information and Abandoned Filings), informing the applicant either that all filing fees have been paid and the application is complete and accepted for filing, or that the application is deficient and specific additional information is required. Except as otherwise provided in this section, the banking commissioner shall evaluate the application under the criteria of §21.42(e) of this title. An applicant under this subsection may not relocate its home office without the prior written approval of the banking commissioner.

(c) Contents of notice. The notice filed under subsection (a) of this section must disclose:

(1) the name of the trust company requesting the home office relocation;

(2) the street address of the trust company's home office before the requested home office relocation;

(3) the street address of the trust company's proposed home office;

(4) the desired effective date of the home office relocation under subsection (a) of this section;

(5) a copy of the resolution adopted by the trust company's board of directors authorizing the proposed home office relocation;

(6) the cost to be incurred in connection with the relocation and a statement of the impact of such cost on the trust company's ability to meet liquidity requirements;

(7) evidence that the trust company has considered applicable federal law, if any;

(8) a description of any actual, proposed, or contemplated financial involvement by an officer, director, manager, managing participant, or principal shareholder or participant of the trust company with respect to its home office relocation; and

(9) such other information as the banking commissioner may require.

(d) Contents of application. The application submitted under subsection (b) of this section must disclose:

(1) the name of the trust company requesting the home office relocation;

(2) the street address of the trust company's home office before the requested home office relocation;

(3) the street address of the trust company's proposed home office;

(4) the desired effective date for the home office relocation;

(5) a copy of the resolution adopted by the trust company's board of directors authorizing the home office relocation;

(6) the cost to be incurred in connection with the relocation and a statement of the impact of such cost on the trust company's ability to meet liquidity requirements;

(7) a written statement signed by the principal executive officer of the trust company or a majority of the trust company's board of directors stating whether the home office relocation will result in an abandonment of all or a part of the community served by the trust company present home office location and, if so, an explanation of how the abandonment is consistent with the original determination of public convenience and advantage for the establishment of the trust company at its existing home office location;

(8) a written statement signed by the principal executive officer of the trust company or a majority of the trust company's board of directors stating whether the home office relocation is anticipated to result in a reduction of trust services presently offered by the trust company at its present location within the 18-month period after the proposed effective date of the relocation and, if so, an explanation of the anticipated reduction in trust and fiduciary services and how the diminution in services is consistent with the original determination of public convenience and advantage for the establishment of the trust company at its existing home office location;

(9) a description of any actual, proposed, or contemplated financial involvement by an officer, director, manager, managing participant, or principal shareholder or participant of the trust company with respect to the home office relocation;

(10) evidence that the trust company has considered applicable federal law, if any; and

(11) such other information as the banking commissioner may require.

(e) Public notice and participation.

(1) Within 14 days of the initial submission of a notice or application under subsection (a) or (b) of this section, the trust company shall publish notice of the submission as required by §21.5 of this title (relating to Public Notice). Notice must be published in the community where the current home office of the trust company is located and in the community where

the proposed home office will be located, and must disclose the locations of the existing and proposed home offices.

(2) For a period of 14 days after publication of notice or such longer period as the banking commissioner may allow for good cause shown, the public may submit written comments or protests. Persons submitting comments are not entitled to further notice of or participation in the proceedings. In the event of a properly filed protest, each protesting party has the rights and responsibilities of a protesting party to a notice of additional office under §21.42 of this title.

(f) Certificate of formation. An amendment to the certificate of formation of the trust company is not required to effect a change in the location of its home office under this section. However, if the certificate of formation is subsequently restated for any reason, the trust company must include the address of its then current home office in the restated certificate of formation.

Source: *The provisions of this §21.41 adopted to be effective July 2, 1998, 23 TexReg 6715; amended to be effective September 5, 2002, 27 TexReg 8203; amended to be effective November 7, 2013, 38 TexReg 7690.*

§21.42. Establishment, Relocation and Closing of an Additional Office.

(a) Establishment or relocation by notice. A trust company may establish or relocate an additional office pursuant to Finance Code, §182.203, by filing a written notice with the banking commissioner containing all information required by subsection (b) of this section, accompanied by the required filing fee pursuant to §21.2 of this title (relating to Filing Fees and Cost Deposits), and notice of the submission must be published as required by subsection (d) of this section. A trust company filing notice of an additional office under this subsection may establish the additional office on the 31st day after the date the required notice and fee are received by the banking commissioner unless the banking commissioner gives notice in writing, prior to the expiration of that time period, that an earlier or later date is authorized or that additional information is required pursuant to subsection (c) of this section.

(b) Contents of notice. The notice filed under subsection (a) of this section must disclose:

(1) the name and home office location of the trust company requesting the additional office;

(2) the street address of the trust company's proposed additional office;

(3) a description of the activities proposed to be conducted at the proposed additional office;

(4) the desired effective date for establishment of the additional office;

(5) a certified copy of the resolution adopted by the trust company's board of directors authorizing the proposed additional office;

(6) the cost to be incurred in connection with the establishment of the additional office and a statement of the impact of such cost on the trust company's ability to meet liquidity requirements;

(7) a description of any actual proposed, or contemplated financial involvement by any officer, director, manager, managing participant, or principal shareholder or participant of the trust company with respect to establishing the additional office;

(8) evidence that the trust company has considered applicable federal law, if any; and

(9) such other information as the banking commissioner may require.

(c) Request for additional information. At any time before the 31st day after the date the notice required by subsection (a) of the section is filed, the banking commissioner may issue written notice to the trust company specifying a later date for establishing or relocating an additional office and requiring the submission of additional information and additional time for analysis. Upon issuance of a notice requiring the submission of additional information and additional time for analysis, the trust company may establish or relocate the additional office only on written approval of the banking commissioner.

(d) Public notice and participation.

(1) Within 14 days of the initial submission of the notice required under subsection (a) of this section, the trust company shall publish notice of the submission as required by §21.5 of this title (relating to Public Notice). Notice must be published in the community where the proposed additional office will be located and must specifically disclose the location of the proposed additional office.

(2) For a period of 14 days after publication of notice or such longer period as the banking commissioner may allow for good cause shown, the public may submit written comments or protests. Persons submitting comments will not be charged fees or costs, but are not entitled to further notice of or participation in the proceedings. Each protesting party has the rights and responsibilities set forth in subsections (f) and (g) of this section.

(e) Criteria for determining significant supervisory or regulatory concern. The banking commissioner may deny permission to establish or relocate an additional office of a trust company if the commissioner has significant supervisory or regulatory concern about the proposed transaction.

(1) In evaluating whether significant supervisory concerns exist regarding a proposed additional office, the banking commissioner shall consider the financial condition of the trust company, the financial effect of the additional office on the trust company, the management abilities of the trust company, and the history and prospects of the trust company and its affiliates regarding fulfillment of responsibilities to regulatory agencies and to the public. A request will ordinarily be denied if the trust company is in less than satisfactory financial condition as of its most recent examination.

(2) In evaluating whether significant regulatory concerns exist regarding a proposed additional office, the banking commissioner will consider the relevant marketplace and the convenience of the public in accessing desired trust services and preferred trustees. The banking commissioner will follow the principles that the marketplace normally is the best regulator of economic activity, and that healthy competition promotes a sound and more efficient trust company system that serves customers well. Accordingly, absent significant supervisory concerns, the general policy of the banking commissioner is to approve applications, requests and notices to establish and relocate additional offices, provided that approval would not otherwise violate applicable provisions of federal or state law (including any requirements for federal banking agency approval).

(3) In evaluating whether the banking commissioner should have significant supervisory or regulatory concerns as set forth in paragraphs (1) and (2) of this subsection, the banking commissioner will consider written material in the record, including the contents of the application, notice or request, comments on file, the department's files as they relate to the current financial condition of the trust company, and other data that the banking commissioner may properly officially notice. Specifically, the banking commissioner shall approve the establishment or relocation of an additional office if the following considerations are met:

(A) the department's files do not indicate significant supervisory concerns as they relate to the current financial condition of the trust company, including but not limited to its capital, asset quality, management, earnings and liquidity;

(B) the costs of establishing or relocating the office, including costs of purchasing or leasing the office site, necessary furnishings, staffing and equipment, do not significantly affect the operations of the trust company as a whole;

(C) the projected earnings appear reasonable and sufficient to support expenses attributable to the establishment and relocation of the office without jeopardizing the safety and soundness of the trust company;

(D) the depth and quality of management of the trust company and of the proposed additional office are sufficient to justify a belief that the trust company will operate in compliance with law;

(E) the trust company has demonstrated a responsiveness to recommendations made in past state and federal regulatory examinations or other regulatory findings and the trust company has generally been operated in substantial compliance with all applicable state and federal laws; and

(F) no areas of general supervisory concern exist as determined by the banking commissioner in the exercise of discretion.

(4) The banking commissioner shall direct the department to assemble, evaluate, and make a recommendation regarding all relevant documentation and data as set forth in this subsection on or before the 30th day after the date the application is accepted for filing.

(5) The banking commissioner shall either approve, conditionally approve, or deny the application, notice, or request on or before the 30th day after the date of the department's recommendation.

(f) Protest.

(1) A protest may be initiated by notifying the department in writing of the intent to protest the establishment of an additional office at the specified location within the time period allowed by subsection (d) of this section, accompanied by the filing fee as set forth in §21.2(c) of this title (relating to Filing and Investigation Fees). If the protest is untimely, the filing fee will be returned to the protesting party. If the protest is timely, the department will notify the applicant of the protest and mail or deliver a complete copy of the non-confidential sections of the application to the protesting party on or before the 14th day after receipt of the protest or the application, whichever occurs later.

(2) The protesting party shall file a detailed protest responding to each substantive statement contained in the notice on or before the 20th day after the date of receipt of the application. The protesting party's response must indicate with regard to each such statement whether it is admitted or denied. The applicant shall file a written reply to the detailed response on or before the 10th day after the date the response is filed. Both the detailed response and the reply thereto must be verified by affidavit and must contain a certificate of service on the opposing party. When applicable, statements in the response and in the reply may be supported by references to data available in sources of which official notice may properly be taken. Comments received by the department and any replies of the applicant to such comments will also be made available to the protesting party.

(3) The banking commissioner may extend any time period set forth in this subsection for good cause shown. Good cause includes, but is not limited to, failure of the department to furnish required documentation, forms, or information within a reasonable time to permit its effective use by the recipient, or failure of a party to timely serve a filed document on an opposing party. The filing date is the date the document is actually received by the department and not the date of mailing. Failure to timely file a required document is considered an abandonment of the application or protest, as applicable. Rule 21a, Texas Rules of Civil Procedure, governs the methods and manner of authorized service and the computation of time periods under this subsection.

(g) Hearing.

(1) The banking commissioner may not be compelled to hold a hearing prior to allowing or not allowing an additional office to be established. In the exercise of discretion, the banking commissioner may consider granting a hearing on a notice of additional office at the request of either the filing trust company or a protesting party. The banking commissioner may order a hearing even if no hearing has been requested.

(2) A party requesting a hearing must indicate with specificity what issues are involved that cannot be determined on the basis of the record compiled pursuant to subsection (e) of this section and why the issues cannot be so determined. The request for hearing and the banking commissioner's decision with regard to granting a hearing will be made a part of the record. If a hearing is not requested or if a request for hearing is denied, the banking commissioner will

consider the notice in the manner set forth in and solely on the basis of the written record established pursuant to subsection (e) of this section.

(3) If a hearing is granted, the administrative law judge shall enter appropriate order(s) and conduct the hearing within 30 days after the date the hearing was granted, or as soon thereafter as is reasonably possible, under Chapter 9 of this title (relating to Rules of Procedure for Contested Case Hearings, Appeals, and Rulemakings) and the Administrative Procedure Act (Texas Government Code, Chapter 2001). Issues will be limited to those on which testimony is absolutely necessary, and the administrative law judge may require testimony to be submitted in written form and prefiled. No evidence will be received on matters that are not in dispute. No issues or evidence will be considered that are not relevant to the standards set forth in subsection (e) of this section or that are not supported by the notice, response, or reply. A proposal for decision, exceptions and replies to such proposal for decision, the final decision of the banking commissioner, and motions for rehearing are governed by Chapter 9 of this title.

(h) Closing an additional office.

(1) Subject to paragraph (2) of this subsection, at least 30 days prior to the date a trust company proposes to close an additional office, the trust company shall file written notice with the banking commissioner disclosing:

(A) the name and home office location of the trust company seeking to close the additional office location;

(B) the street address of the additional office location to be closed;

(C) the effective date of the proposed closing;

(D) evidence of distribution of written notice of closing to all customers and account holders at least 45 days prior to the proposed closing date.

(E) the place and street address of location where records from the closed office will be transferred;

(F) a copy of the resolution adopted by the trust company's board of directors authorizing the proposed closing of the additional location; and

(G) such other information as the banking commissioner may require.

(2) If the trust company must comply with notice requirements of federal banking law applicable to closing a branch office, in lieu of compliance with paragraph (1) of this subsection, the trust company may provide the banking commissioner with a copy of the closing notice filed with the appropriate federal banking regulator simultaneously with its filing.

(3) Once the additional office has been closed, the trust company may not reopen the additional office except upon notice or application for a new additional office in compliance with this section.

Source: *The provisions of this §21.42 adopted to be effective July 2, 1998, 23 TexReg 6715; amended to be effective September 5, 2002, 27 TexReg 8203.*

§21.43. Representative Trust Offices of Federally Chartered or Federally Insured Out-of-State Banks.

(a) A bank authorized by its charter to conduct a trust business that maintains its principal office or a branch in this state in accordance with governing law may freely establish one or more representative trust offices in this state to the extent authorized by its primary regulator and governing law, except that a foreign bank must comply with Finance Code §204.106 in lieu of this section.

(b) An out-of-state bank authorized by its charter to conduct a trust business that has not established or acquired a branch in this state may establish a representative trust office in this state:

(1) if not chartered by a federal banking regulatory agency and not insured by the Federal

Deposit Insurance Corporation, only after complying with §21.44 of this title; or

(2) if chartered by a federal banking regulatory agency or insured by the Federal Deposit Insurance Corporation, after filing a written notice with the banking commissioner disclosing:

(A) the name of the institution and the address of its principal office;

(B) the physical address and the proposed opening date of the proposed office;

(C) a description of proposed activities at the office consistent with the limitations of Finance Code §187.201;

(D) copies of any regulatory notices, filings, or publications required by the trust institution's home state regulator and/or its primary federal regulator regarding the establishment of the office; and

(E) a copy of the institution's registration filed with the secretary of state pursuant to Finance Code §201.102.

(c) An out-of-state bank that has established and is maintaining a representative trust office in this state pursuant to subsection (b) of this section may establish additional representative trust offices in this state without providing notice to the banking commissioner.

Source: *The provisions of this §21.43 adopted to be effective May 5, 2016, 41 TexReg 3101.*

§21.44. Representative Trust Offices of Out-of-State Trust Companies and Uninsured State Banks.

(a) Required notice. An out-of-state trust company or a state-chartered bank, the deposits of which are not insured by the Federal Deposit Insurance Corporation, may establish an initial representative trust office in this state after registration with the banking commissioner in accordance and in compliance with Finance Code §187.202 and this section, provided that the relevant home state regulator is a current party to regulatory information sharing and cooperation agreements with the banking commissioner that satisfy the requirements of Finance Code §181.303 and §187.301. At least 30 days before the proposed opening date of the proposed office, the institution must submit a written notice to the banking commissioner containing:

(1) the name of the institution and the address of its principal office;

(2) the physical address and the proposed opening date of the proposed office;

(3) a description of the proposed activities at the office consistent with the limitations of Finance Code §187.201;

(4) a copy of the institution's chartering document and evidence that the institution is active and in good standing;

(5) a copy of the resolution adopted by the board of the institution authorizing establishment of the proposed office;

(6) a copy of the institution's registration filed with the secretary of state pursuant to Finance Code §201.102;

(7) copies of any home state regulatory notices or filings required in connection with establishing the proposed office in this state;

(8) contact information for the institution's home state regulator;

(9) current financial statements evidencing tangible equity capital, defined as the total of owner's equity, surplus, and undivided profits reduced by the total of intangible assets, in an amount that equals or exceeds the minimum amount of restricted capital required for a state trust company pursuant to Finance Code §182.008; and

(10) the executed agreement required by subsection (b) of this section.

(b) Required agreement. The institution must submit its enforceable written agreement in the form provided by the banking commissioner, duly executed by an authorized officer of the institution, in which the institution agrees to:

(1) maintain tangible equity capital in an amount that equals or exceeds the minimum amount of restricted capital required for a state trust company pursuant to Finance Code §182.008, at all times during the period an office of the institution is maintained in this state;

(2) cooperate with and participate in examination at least once every 12 months at the discretion of the banking commissioner, and to pay the costs of each such examination as provided by §17.22 of this title (relating to Examination and Investigation Fees); and

(3) provide prompt written notice to the banking commissioner:

(A) pursuant to Finance Code §187.306, at least 30 days before the effective date of the event, or, in the case of an emergency transaction, a shorter period before the effective date consistent with applicable state or federal law, of:

(i) a merger or other transaction that would cause a change of control with respect to the institution and require an application to be filed with the home state regulator;

(ii) a transfer of all or substantially all of the trust accounts or trust assets of the institution to another person; or

(iii) the relocation, closing, or other disposition of an office of the institution in this state.

(B) not later than 30 days after the institution receives notice of the imposition of or a proposed enforcement action or condition by the institution's home state regulator.

(c) When the office may open. The institution may commence business at the representative trust office on the 31st day after the date the banking commissioner receives the notice unless the banking commissioner specifies an earlier or later date.

(1) The 30-day period of review may be extended by the banking commissioner on a determination that the written notice raises issues that require additional information or additional time for analysis. If the period of review is extended, the institution may establish the representative trust office only on prior written approval by the banking commissioner.

(2) The banking commissioner may deny approval of the representative trust office if the banking commissioner finds that the institution lacks sufficient financial resources to undertake the proposed expansion without adversely affecting its safety or soundness or that the proposed office would be contrary to the public interests.

(d) Additional offices. An out-of-state trust company or uninsured state-chartered bank that has established and is maintaining a representative trust office in this state pursuant to this section may establish additional representative trust offices in this state without providing notice to the banking commissioner.

Source: The provisions of this §21.44 adopted to be effective May 5, 2016, 41 TexReg 3101.

Subchapter E. Change of Control

§21.51. Application for Acquisition or Change of Control of Trust Company.

(a) General. Without the prior written consent of the banking commissioner, or as otherwise provided by this section, a person or entity may not, directly or indirectly, acquire a legal or beneficial interest in voting securities of a trust company or a corporation or other entity owning voting securities of a trust company if, after the acquisition, the person or entity would control the trust company. Except as otherwise provided in this section, an application must be filed with the banking commissioner for review and consideration of the proposed transaction.

(b) Form of application. The applicant shall submit a fully completed, verified application on a form prepared and prescribed by the banking commissioner and simultaneously tender the required filing fee pursuant to §21.2 of this title (relating to Filing and Investigation Fees). The application must, except to the extent expressly waived in writing by the banking commissioner, disclose the following information:

(1) the identity, biographical data, business background, and experience relating to trust industry matters, and a current statement of financial condition, a statement of changes in net worth and a statement of cash flows of each person by whom, or on whose behalf, the acquisition is to be made and by each person acting in concert with others seeking to acquire voting securities subject to Finance Code, §183.001, and to this section. Financial statements will be considered current if audited and dated within 180 days of the date of the application or will be considered current if unaudited and dated within 90 days of the date of the application. All financial statements must be accompanied by an affidavit of no material change dated as of the date of application;

(2) a completed authorization to release employment, financial, credit, fingerprint information, and criminal history records to the department;

(3) a completed confirmation inquiry form;

(4) the identity of each entity other than a natural person seeking to acquire control or working in concert with others to acquire control of a trust company and a copy of the entity's most recent audited financial statement. Financial statements will be considered current if audited and dated within 180 days of the date of the application or will be considered current if unaudited and dated within 90 days of the date of the application. All financial statements must be accompanied by an affidavit of no material change dated as of the date of application;

(5) a description of all material, pending or adjudicated legal or administrative proceedings in which each acquiring person or entity is or was a party. A material legal proceeding includes a proceeding in which the person or entity has been charged with, cited for, or convicted under a state or federal law relating to trust or other financial institutions, securities or financial instrument reporting, or a felony or crime that directly relates to the duties and responsibilities involved in the operation of a trust company or financial institution under the laws of a state, the United States, or another country. A material legal proceeding also includes a proceeding that resulted in a material unsatisfied judgment, or may result in a judgment, against the acquiring person or entity and such loss contingency must be disclosed in the financial statements of the acquiring person or entity under generally accepted accounting principles, or is otherwise material. A material administrative proceeding includes a proceeding in which the person or entity is or has been subject to a cease and desist, removal, enforcement, or other order, including an order of supervision or conservatorship issued by a state, federal, or foreign regulatory agency;

(6) the terms and conditions of the proposed acquisition or change of control and the manner in which the acquisition or change of control is to be made;

(7) the identity, source, and amount of the funds or other consideration used or to be used in making the acquisition or change of control;

(8) if a portion of the funds or other consideration to be used in making the acquisition has been borrowed or is to be borrowed or otherwise obtained for the purpose of making the acquisition, a complete description of the transaction, the names of the parties to the transaction, and a summary of all arrangements, agreements, or understandings with such parties including terms of repayment;

(9) the applicant's current or proposed business or strategic plan including amendments to a current plan;

(10) plans or proposals to liquidate the trust company, to sell its assets or merge it with another trust company or other entity, or to make other major changes in its business, corporate structure, or management;

(11) plans or proposals to change officers and directors of the trust company and the related trust or financial institution management experience of proposed or current officers and directors;

(12) the terms and conditions of an offer, invitation, agreement, or arrangement under which a voting security will be acquired and any contract affecting such security or its financing after it is acquired;

(13) pro forma financial statements with projections indicating whether the acquired or controlled trust company will be adequately capitalized for a period of not less than two years from the date of acquisition; and

(14) such other information that the banking commissioner requires to be included in the particular application as considered necessary to an informed decision to approve or reject the proposed acquisition. The applicant bears the burden to supply all material information necessary to enable the banking commissioner to make a fully informed decision regarding the application.

(c) Public notice. Not earlier than the 14th day before or later than the 14th day after the date of initial submission of an application filed pursuant to §21.4 of this title (relating to Required Information and Abandoned Filings), the applicant shall publish notice as required by Finance Code, §183.002(d), and §21.5 of this title (relating to Public Notice) in the county where the trust company's home office is located. One publication under this subsection is adequate unless the banking commissioner expressly requires additional notice.

(d) Confidentiality. Information obtained by the banking commissioner under this section is confidential and may not be disclosed by the banking commissioner or an officer or employee of the department, subject only to such disclosure as may be permitted by Finance Code, §183.002(c), or by §3.111 of this title (relating to Confidential Information).

(e) Grandfather clause. A principal shareholder or participant that is considered to control a trust company, under Finance Code, §183.001(b), is exempt from filing an application under this section until the principal shareholder acquires one or more additional shares or participation shares of the trust company.

(f) Capital requirements. A person or entity seeking to acquire control of a trust company subject to this section must bring the trust company into compliance with the minimum capital requirements of Finance Code, §182.008, or such amount as required by the banking commissioner at the time the transaction is consummated.

(g) Exemptions. In addition to the acquisitions specifically exempted pursuant to Finance Code, §183.001(d), the following types of involuntary acquisitions of control do not require prior written approval of the banking commissioner:

(1) the inadvertent acquisition of control of a trust company by a shareholder as a result of a stock redemption or repurchase by the issuer if the potential controlling shareholder or participant of a trust company did not vote or have any direct or indirect input into the issuer's decision to repurchase or redeem the voting securities;

(2) the acquisition and control by a qualified employee stock ownership plan (ESOP) of less than 25% of voting securities of a trust company unless an officer, director, or principal shareholder or participant directly or indirectly controls the voting securities held by the ESOP, in which event an application for acquisition of control must be filed by the officer, director or principal shareholder or participant, if as a result that person would control over 25% of the voting securities;

(3) the acquisition of control of a trust company as a result of a shareholder receiving proportionate voting securities in a trust company arising from the liquidation of a holding company;

(4) the acquisition of additional shares of voting securities of a trust company by virtue of a pro-rata stock dividend or stock split not resulting in increased ownership percentage;

(5) the acquisition of control of a trust company as a result of a gift made in good faith, provided:

(A) the donee is related to the donor within the second degree of consanguinity or affinity;

(B) neither the donor nor donee is under an enforcement order; and

(C) notice of the gift is given to the banking commissioner pursuant to subsection (h) of this section;

(6) the acquisition of control of a trust company as a result of the transfer of voting securities by gift to a limited partnership or other estate planning vehicle, if determined by the banking commissioner to have an equivalent effect, if:

(A) the limited partnership owns no other voting securities other than the securities transferred;

(B) the donor is the sole general partner of the limited partnership who retains sole voting authority over the voting securities;

(C) neither the donor nor donee is under an enforcement order; and

(D) notice of the gift is given to the banking commissioner pursuant to subsection (h) of this section; and

(7) the acquisition of control of a trust company by another entity if:

(A) the transaction is subject to an application to be reviewed by a federal or state regulatory authority that will be the primary regulator of the trust company after the transaction is consummated; and

(B) that regulatory authority has entered into an information sharing agreement with the banking commissioner.

(h) Notices in lieu of filing. In the event that an application is not required because of exemption under Finance Code, §183.001(d), or subsection (g) of this section, but an application is required to be filed with a federal regulatory authority or a regulatory authority of another state, a copy of the application as filed with another agency must be filed with the banking commissioner within seven days of the date of such other filing or filings. A notice in lieu of filing is also required of a person claiming an exemption under Finance Code, §183.001(d), or paragraph (5) or (6) of subsection (g) of this section. This notice must be filed before the securities acquired are voted and must be accompanied by a completed authorization pursuant to subsection (b)(2) of this section. No filing fees are required for notices filed under this section; however, should the banking commissioner determine that an application is required, the appropriate filing fee pursuant to §21.2 of this title is required.

(i) Approval. Automatic approval; conditional approval. If an application filed under this section is not approved by the banking commissioner or is not set for hearing on or before the 60th day after notice is published pursuant to subsection (c) of this section, the transaction may be consummated. The banking commissioner may, before the expiration of the initial 60-day period, give the applicant written notice that the application has been approved, in which case the transaction may be immediately consummated on receipt of the notice. The banking commissioner may also, before the expiration of the initial 60-day period, give an applicant written notice that the application has been approved subject to certain conditions. The applicant shall enter into a written agreement with the banking commissioner concerning the conditions on or before the 30th day after the date of notification of conditional approval. An agreement entered into by the applicant and the banking commissioner concerning conditional approval is enforceable against the applicant and the trust company and is considered for all purposes an agreement under the provisions of Finance Code, §185.002(a). In the event that an applicant who has received conditional approval does not enter into an agreement with the banking commissioner as required by this subsection, the banking commissioner shall set the matter for hearing.

(j) Consummation of an acquisition or change of control transaction. The acquisition or change of control of the voting securities must be consummated as proposed in the application, in the agreement concerning conditional approval as provided in subsection (i) of this section, or as provided in a final order pursuant to subsection (m) of this section. A transaction approved or conditionally approved under this section must be consummated within 12 months after the date of approval by the banking commissioner unless an extension is granted in writing. Until a transaction is consummated, the banking commissioner reserves the right to alter, suspend or withdraw approval should an interim development warrant such action.

(k) Notification by banking commissioner. A notification by the banking commissioner under this section may be by registered or certified mail, return receipt requested, and is complete when the notification is deposited in the United States mail postage prepaid, return receipt requested, addressed to the address furnished in the application.

(l) Abandoned filing. The banking commissioner may determine an application to be abandoned pursuant to §21.4 of this title.

(m) Hearing on application. The banking commissioner shall set an application for hearing on or before the 60th day after notice is published as required by Finance Code, §183.003, and subsection (i) of this section. The notice of hearing must comply with Government Code, §2001.051, and shall state that the purpose of the hearing is to give the applicant an opportunity to show all required qualifications for the banking commissioner's approval of the acquisition or change of control application have been met. The applicant has the burden of showing all such required qualifications by a preponderance of evidence. After the hearing, the banking commissioner shall grant or deny the application based solely upon the evidence presented at the hearing. An applicant may not appeal denial of an application or conditional approval of an application until a final order is issued. If after a hearing has been held, the banking commissioner has entered an order denying the application, and the order has become final, the applicant may appeal the final order as provided by Finance Code, §183.004, and Government Code, Chapter 2001.

Source: *The provisions of this §21.51 adopted to be effective September 3, 1998, 23 TexReg 8832; amended to be effective September 5, 2002, 27 TexReg 8203.*

Subchapter F. Application for Merger, Conversion, Or Sale of Assets

§21.61. Definitions.

(a) Words and terms used in this subchapter that are defined in the Trust Company Act or in §21.1 of this title, have the same meanings as defined therein.

(b) The following words and terms, when used in this subchapter, shall have the following meanings unless the context clearly indicates the contrary.

(1) Annual report--Formal financial statements and accompanying narrative of management issued yearly for the benefit of shareholders and other interested parties.

(2) Chartering agency--A government authority that has chartering jurisdiction over an entity involved in a transaction under this subchapter.

(3) Corporation or domestic corporation--A corporation for profit subject to the provisions of the Texas Business Organizations Code, except a foreign corporation.

(4) Current financial statements--Audited financial statements dated as of a date not more than 180 days prior to the date of submission of an application, or unaudited financial statements dated as of a date not more than 90 days prior to the date of submission of an application.

(5) Fiduciary institution--A bank, savings association, savings bank, credit union, or other financial institution with the power to act as a fiduciary under applicable law.

(6) Low-quality asset--An asset as defined in 12 United States Code, §371c(b)(10), currently an asset that falls in any one or more of the following categories:

(A) an asset classified as “substandard,” “doubtful,” or “loss,” or treated as “other loans especially mentioned” in the most recent report of examination or inspection of an affiliate prepared by either a federal or state supervisory agency;

(B) an asset in a nonaccrual status;

(C) an asset on which principal or interest payments are more than 30 days past due; or

(D) an asset whose terms has been renegotiated or compromised due to the deteriorating financial condition of the obligor.

(7) Material administrative proceeding--A past or pending proceeding by a state, federal, or foreign regulatory agency against the applicant or other person involved in a transaction under this subchapter that resulted in or could result in the issuance of a cease and desist, removal, enforcement action, determination letter or other order, including an order of supervision or conservatorship; excluding, however, a past proceeding that resulted in an order, other than a removal order, that has been satisfied or otherwise terminated more than five years prior to the date the application or notice requesting such information is submitted.

(8) Material legal proceeding--

(A) a past or pending criminal proceeding against the applicant or other person involved in a transaction under this subchapter that resulted or may result in conviction of the applicant or other person of a crime under a state or federal law or the law of a foreign country relating to fiduciaries, banks or other financial institutions, securities, financial instrument reporting, or another crime involving moral turpitude; or

(B) a past or pending proceeding that has or may result in a judgment against the applicant or other person or entity involved in a transaction under this subchapter and the loss contingency must be disclosed in the financial statements of the entity under generally accepted accounting principles, or is otherwise material.

(9) Merger--A transaction that is:

(A) the division of a trust company into two or more new trust companies, fiduciary institutions, or other entities, or into a surviving trust company and one or more new trust companies, fiduciary institutions, or other entities; or

(B) the combination of one or more trust companies with one or more fiduciary institutions or other entities, resulting in:

(i) one or more surviving trust companies, fiduciary institutions, or other entities;

(ii) the creation of one or more new trust companies, fiduciary institutions, or other entities; o

(iii) one or more surviving trust companies, fiduciary institutions, or other entities and the creation of one or more new trust companies, fiduciary institutions, or other entities.

(10) Other entity--An entity, whether or not organized for profit, including a corporation, limited or general partnership, joint venture, joint stock company, cooperative, association, or another legal entity organized pursuant to the laws of this state or another state or country to the extent such laws or the constituent documents of that entity, consistent with such laws, permit that entity to enter into a merger or share exchange subject to this subchapter.

(11) Principal executive officer--An officer primarily responsible for the execution of board policies and operation of a trust company or other entity.

(12) Purchase of assets--The purchase other than in the ordinary course of business of all, substantially all, or a part of the assets of a trust company, fiduciary institution, or other entity, including but not limited to fiduciary rights pertaining to client accounts.

(13) Regulatory restriction--A memorandum of understanding, determination letter, notice of determination, order to cease and desist, or other state or federal administrative enforcement order issued by a state or federal banking regulatory agency, or another limitation imposed on a fiduciary institution or other entity by a state or federal banking regulatory agency that restricts its ability to act without

authorization from the regulatory agency imposing the condition.

(14) Resulting trust company--A trust company that is a surviving or newly created entity in a merger.

(15) Sale of assets--The sale, lease, exchange, or other disposition of substantially all of the assets of a trust company, including but not limited to fiduciary rights pertaining to client accounts, other than in the ordinary course of business.

(16) Share exchange--A transaction by which one or more trust companies, fiduciary institutions, or other entities acquire all of the outstanding shares of one or more classes or series of one or more trust companies under the authority of Finance Code, §182.301, and the Texas Business Organizations Code.

(17) Trust company--A state trust company as defined by Finance Code, §181.002(a).

(18) Verified--Documents submitted by the applicant that have been attested to as true and correct, but not necessarily notarized.

Source: *The provisions of this §21.61 adopted to be effective December 31, 1998, 23 TexReg 13033; amended to be effective September 5, 2002, 27 TexReg 8203; amended to be effective November 7, 2013, 38 TexReg 7690.*

§21.62. General.

Without the prior written consent of the banking commissioner, a trust company may not consummate a merger, conversion, sale of assets, purchase of assets, or share exchange. Except as otherwise provided by Finance Code, Chapter 182, Subchapters D-F, or this subchapter, an application must be filed with the banking commissioner for review and consideration of the proposed transaction.

Source: *The provisions of this §21.62 adopted to be effective December 31, 1998, 23 TexReg 13033; amended to be effective September 5, 2002, 27 TexReg 8203.*

§21.63. Expedited Filings.

(a) An eligible trust company as defined in §21.1(4) of this title (relating to Definitions) may file an expedited filing in lieu of an application required under §21.64 of this title (relating to Application for Merger or Share Exchange) and simultaneously tender the required filing fee pursuant to §21.2 of this title (relating to Filing and Investigation Fees).

(b) An expedited filing consists of a letter application including, except to the extent waived by the banking commissioner, the following items:

(1) a summary of the transaction;

(2) a current pro forma balance sheet and income statement for all parties to the transaction, with adjustments, reflecting the proposed transaction as of the most recent quarter ended immediately prior to the filing of the application, demonstrating that each resulting trust company meets the statutory capital requirement or capital requirement imposed by order or condition of the banking commissioner. The pro forma must include a statement of fiduciary assets as well as corporate assets;

(3) an executed opinion of counsel conforming to the requirements of §21.64(b)(12) of this title;

(4) copies of all other required regulatory notices or filings submitted to other state or federal regulatory agencies concerning the transaction; and

(5) a copy of the public notice published in conformity with §21.64(d) of this title.

(c) The banking commissioner shall notify the applicant on or before a date that is 15 days after receipt of the application if expedited filing treatment is not available under this section for any reason. Such notification must be in writing and must indicate the reason expedited treatment is not available. Notification is effective when mailed by the banking commissioner and is not subject to appeal.

(d) The banking commissioner may deny expedited filing treatment to an eligible trust company if, in the exercise of discretion, the banking commissioner finds that the application involves one or more of the following:

(1) the proposed transaction involves significant policy, supervisory, or legal issues;

(2) approval of the proposed transaction is contingent on additional statutory or regulatory approval by the banking commissioner or another state or federal regulatory agency;

(3) the proposed transaction contemplates a resulting entity that is not an authorized fiduciary institution;

(4) the proposed transaction involves a fiduciary institution or other entity that is not domiciled in Texas;

(5) the proposed transaction would cause the corporate or fiduciary assets of a resulting trust company to increase by more than 100%;

(6) the proposed transaction involves a trust company that has experienced, since the last commercial examination by a state or federal regulatory agency, corporate or fiduciary asset growth, through acquisition or otherwise, greater than 100%; or

(7) a resulting fiduciary institution that is not "well capitalized" as defined in 12 Code of Federal Regulations, §325.103, or that will not meet capital requirements imposed by its principal regulator.

(e) The banking commissioner shall approve or deny an expedited filing on or before a date that is 30 days after the date the expedited filing is accepted for filing pursuant to §21.4 of this title (relating to Required Information and Abandoned Filings). The banking commissioner may, in the exercise of discretion, before the expiration of the period for decision, give the applicant written notice that the banking commissioner will convene a hearing to obtain evidence related to the application, and the decision will thereafter be made in accordance with §21.72 of this title (relating to Approval; Conditional Approval; Denial of Application; Hearings).

(f) The applicant bears the burden to supply all material information necessary to enable the banking commissioner to make a fully informed decision regarding the expedited filing.

Source: *The provisions of this §21.63 adopted to be effective December 31, 1998, 23 TexReg 13033; amended to be effective July 10, 2008, 33 TexReg 5277.*

§21.64. Application for Merger or Share Exchange.

(a) Scope. This section governs an application for merger or share exchange pursuant to Finance Code, §§182.301 et seq. This section does not apply to a merger that results in a trust company becoming another fiduciary institution under another regulatory system pursuant to Finance Code, §182.501, or other applicable law, and such transactions are governed by §21.67 of this title (relating to Notice of Merger, Reorganization, or Conversion of a Trust Company Into Another Fiduciary Institution).

(b) Form of application. The applicant shall submit a fully completed, verified application on a form prescribed by the banking commissioner and simultaneously tender the required filing fee pursuant to §21.2 of this title (relating to Filing and Investigation Fees). The application must, except to the extent waived by the banking commissioner, include the following information:

(1) a summary of the proposed transaction;

(2) a copy of all agreements related to the proposed transaction executed by an authorized representative of each party to the merger or share exchange;

(3) certificate and plan of merger or share exchange in accordance with the Texas Business Organizations Code, which must include the following:

(A) a current draft of the certificate of merger or share exchange, and such number of additional copies equal to the number of surviving, new, or acquired entities, executed and acknowledged by an authorized officer for each party to the merger or share exchange;

(B) the plan of merger or share exchange;

(C) the certificate or restated certificate of formation of each resulting trust company;

(D) the certificate or restated certificate of formation, or other constitutive documents, of each newly created or surviving entity other than a resulting trust company; and

(E) if a party to a merger is an entity required to file documents with the Texas secretary of state before the transaction can be legally consummated, a provision in the certificate of merger conditioning the merger upon the approval of the banking commissioner, containing wording substantially as follows, as applicable: This merger shall become effective upon the final approval and filing of the certificate of merger by the Secretary of State of Texas and with the Banking Commissioner of Texas which shall be on or before _________ (date), which is the 90th day after the date of filing of such certificate of merger with the Secretary of State;

(4) for each party to the merger or share exchange, a certified copy of those portions of the minutes of board meetings and shareholder or participant meetings (or their equivalent) at which action was taken regarding approval of the merger or share exchange, or a certificate of an officer verifying the action taken by the board of directors and the shareholders or participants approving the merger or share exchange, or an explanation of the basis for concluding such action was not required;

(5) for each resulting trust company, an assessment of its future prospects, proposed officers and directors, and proposed offices and other locations;

(6) an assessment of the current regulatory and financial condition of each party to the transaction;

(7) a copy of current financial statements for each entity involved in the proposed transaction, accompanied by an affidavit of no material change dated no earlier than 30 days prior to the date of submission of the application;

(8) a copy of the latest annual report for each fiduciary institution and holding company involved in the proposed transaction;

(9) a copy of that portion of the most recent watch list for each fiduciary institution involved in the proposed transaction that identifies low-quality assets;

(10) a description of the due diligence review conducted by or for each trust company that is a party to the transaction and a summary of findings;

(11) a description of all material legal or administrative proceedings involving any party to the merger or share exchange;

(12) an opinion of legal counsel that conforms with §21.68 of this title (relating to Opinion of Legal Counsel), concluding the following:

(A) each resulting trust company will be solvent and will have adequate capitalization for its business and location;

(B) the merger or share exchange has been duly authorized by the board and shareholders or participants of each participating trust company, fiduciary institution, or other entity, including trust companies in accordance with applicable law;

(C) the merger or share exchange will not cause or result in a material violation of the laws of this state relative to the organization and operation of trust companies;

(D) all liabilities of each trust company that is a party to the merger or share exchange will be discharged or otherwise assumed or retained by a trust company or other fiduciary;

(E) each surviving, new, or acquiring entity that is not authorized to engage in the trust business will not engage in the trust business and has in all respects complied with the laws of this state;

(F) all conditions with respect to the merger or share exchange that have been imposed by the banking commissioner have been satisfied or otherwise resolved or, to the best knowledge of legal counsel, no such conditions have been imposed;[1]

(13) a copy of each filing or application regarding the proposed merger or share exchange that is required to be made with another state or federal regulatory agency, complete with all related attachments, exhibits, and correspondence;

(14) a current pro forma balance sheet and income statement for each party to the transaction, with adjustments, reflecting the proposed merger or share exchange as of the most recent quarter ended immediately prior to the filing of the application. The pro forma must include a statement of fiduciary assets as well as corporate assets;

(15) for each resulting trust company, a copy of the strategic plan that complies with the banking commissioner's Memorandum 1009, including projections of the balance sheet and income statement of each resulting trust company as of the quarter ending one year from the date of the pro forma financial statement required by paragraph (14) of this subsection;

(16) an explanation of compliance with or nonapplicability of provisions of governing law relating to rights of dissenting shareholders or participants to the merger or share exchange;

(17) a copy of all securities offering documents, proxy statements, or other disclosure materials delivered or to be delivered to shareholders or participants of a party concerning the merger or share exchange;

(18) an explanation of the manner and basis of converting or exchanging any of the shares or other evidences of ownership of an entity that is a party to the merger or share exchange into shares, obligations, evidences of ownership, rights to purchase securities, or other securities of one or more of the surviving, acquiring, or new entities, into cash or other property, including shares, obligations, evidences of ownership, rights to purchase securities, or other securities of another person or entity, or into a combination of the foregoing;

(19) for antitrust purposes, an analysis of the anticipated competitive effect of the proposed transaction in the affected markets and a statement of the basis of the analysis of the competitive effects, or if applicable, a copy of the analysis of competitive effects of the proposed transaction addressed in a companion federal regulatory agency application; and

(20) such other information that the banking commissioner, in the exercise of discretion, requires to be included in the particular application as considered necessary to an informed decision to approve or deny the proposed merger or share exchange.[2]

(c) Applicant's duty to disclose. The applicant bears the burden to supply all material information necessary to enable the banking commissioner to make a fully informed decision regarding the application.

(d) Public notice. Not earlier than the 14th day before or later than the 14th day after the date of the initial submission of the application, the applicant shall publish notice in accordance with the requirements of §21.5 of this title (relating to Public Notice) in the specified communities where the home office of the applicant, the target entity, and the resulting trust company are located.[3]

[1] With respect to a proposed merger or share exchange involving a state trust company and a trust institution whose home state is another state, or that is chartered under the laws of a foreign country, the applicant should contact the department to determine additional opinions that may be required.

[2] With respect to a proposed merger or share exchange involving a state trust company and a trust institution whose home state is another state, or that is chartered under the laws of a foreign country, the applicant must provide information regarding applicable host state law and evidence of compliance with such laws, and should contact the department to determine additional information that may be required in an application.

[3] With respect to a proposed merger or share exchange involving a state trust company and a trust institution whose home state is another state, or that is chartered under the laws of a foreign country, the applicant must inform the department of the publication requirements in the host state for a determination pursuant to §21.5(e) of this title whether such requirements satisfy the publication requirements of this subsection.

(e) Approval by the banking commissioner and filings with a chartering agency.

(1) The banking commissioner shall approve a merger or share exchange only if the application indicates substantial compliance with all conditions of Finance Code, §182.302(c).

(2) If any party is required to file with its chartering agency after acceptance for filing pursuant to §21.4(b) of this title (relating to Required Information and Abandoned Filings), an applicant for merger or share exchange shall file the original certificate of merger or share exchange as certified by the chartering agency with the banking commissioner.

(3) After approval of an application under this section by the banking commissioner, the certificate of merger or share exchange previously filed with the chartering agency, if applicable, will be accepted and a certificate of merger or share exchange will be issued by the banking commissioner who shall perform the duties required by Finance Code, §182.303(a). With respect to a transaction that requires filing with the Texas secretary of state, if the banking commissioner does not approve the certificate of merger or share exchange on or before the 90th day after the filing of the certificate of merger with the Texas secretary of state, the applicant must refile the certificate of merger or share exchange with both the Texas secretary of state and with the banking commissioner.

(4) After issuance of the certificate of merger or share exchange by the banking commissioner, the applicant shall file a statement with the chartering authority, if applicable, certifying that any future event upon which the effectiveness of the merger or share exchange was conditioned, has been satisfied and the date upon which the condition was satisfied.

(5) The date of issuance of the certificate of merger or share exchange by the banking commissioner constitutes the date of approval pursuant to Finance Code, §182.303(b), unless the merger or exchange agreement provides for a later effective date which has been approved by the banking commissioner.

Source: *The provisions of this §21.64 adopted to be effective December 31, 1998, 23 TexReg 13033; amended to be effective September 5, 2002, 27 TexReg 8203; amended to be effective November 7, 2013, 38 TexReg 7690.*

§21.67. Notice of Merger, Reorganization, or Conversion of a Trust Company Into Another Fiduciary Institution.

(a) Scope. This section governs notice of the merger, reorganization, or conversion of a trust company into another form of fiduciary institution in a manner that results in extinguishment of the trust company charter, pursuant to Finance Code, §182.501, or other applicable law.

(b) Form of notice. A trust company does not cease to be subject to the jurisdiction of the banking commissioner until the banking commissioner is given written notice of intent to merge, reorganize, or convert into another form of fiduciary institution before the 31st day preceding the date of the proposed transaction and the merger, reorganization, or conversion has otherwise become effective. The notice must, except to the extent waived by the banking commissioner, include the following information:

(1) a summary of the proposed transaction;

(2) a copy of all agreements or other documentation related to the proposed transaction executed by an authorized representative of the applicant and other parties, if any;

(3) a copy of each filing regarding the proposed transaction that is required to be filed with other state or federal regulatory agencies, complete with all related attachments, exhibits, and correspondence;

(4) a certified copy of the relevant portions of the minutes of board meetings and shareholder or participant meetings (or their equivalent) at which action was taken regarding approval of the transaction, or a certificate of an officer verifying the action taken by the board of directors and the shareholders or participants approving the merger, reorganization, or conversion;

(5) Opinion of legal counsel. An opinion of legal counsel that conforms with the requirements of §21.68 of this title (relating to Opinion of Legal Counsel), concluding the following:

(A) the merger, reorganization, or conversion of the trust company has been duly authorized by its board and shareholders or participants in accordance with the Texas Business Corporation Act;

(B) all liabilities of the trust company will be discharged or otherwise retained by the successor fiduciary institution; and

(C) all conditions with respect to the merger, reorganization, or conversion imposed by the banking commissioner have been satisfied or otherwise resolved or, to the best knowledge of legal counsel, no such conditions have been imposed;

(6) a publisher's certificate showing publication of notice as required by subsection (c) of this section; and

(7) an explanation of compliance with the provisions of the Texas Business Corporation Act relating to rights of dissenting shareholders or participants.]

(c) Notices, publication, and certificate of authority.

(1) The applicant shall submit a copy of the published notice of the proposed transaction required by the successor regulatory authority or shall publish notice as required by §21.5 of this title (relating to Public Notice). Submission of such notice, with the publisher's certificate required by subsection (b)(6) of this section, is considered notice of the transaction in accordance with Finance Code, §182.501(c)(2). The banking commissioner may require, upon written notice to the applicant, such other publication requirements at such times and places and in such manner as considered appropriate.

(2) Within 14 days after receipt of the certificate of authority to do business, or such other document issued by the successor regulatory authority that authorizes the consummation of the merger, reorganization, or conversion, the successor fiduciary institution shall provide written notice to the banking commissioner of the effective date and a copy of the certificate of authority or other document.

(d) Filing fees. A filing fee is not required in connection with notice under this section.

Source: *The provisions of this §21.67 adopted to be effective December 31, 1998, 23 TexReg 13033; amended to be effective September 5, 2002, 27 TexReg 8203.*

§21.68. Opinion of Legal Counsel.

(a) An opinion of legal counsel required by this subchapter must be addressed to the banking commissioner and state the opinions expressed, the specific documents reviewed and the matters considered of both law and fact, as legal counsel has considered necessary or appropriate in the exercise of professional judgment for the opinions expressed, and the assumptions, qualifications, limitations, and exceptions made or taken with respect to the opinions expressed. A draft opinion may be submitted with an application under this chapter provided a final, signed opinion is delivered to the banking commissioner prior to final action on the application. Any variation in the final opinion from the draft version must be specifically called to the attention of the banking commissioner.

(b) An opinion letter required under this subchapter will be governed by and interpreted in accordance with the Third Party Legal Opinion Report, Including the Legal Opinion Accord, of the Section of Business Law (American Bar Association, 1991), available in pamphlet form as reprinted from the November 1991 issue of The Business Lawyer (Volume 47, Number 1, Page 167), (the Accord), or a successor document officially promulgated by an appropriate authority.

(c) Unless specifically noted in the opinion, the banking commissioner will assume that the opinions expressed are based upon and subject to the assumptions, qualifications, limitations and exceptions set forth in the Accord, provided the Accord is incorporated by reference. In addition, whether or not stated in the Accord, if specifically noted in the opinion, counsel:

(1) need not express an opinion as to the laws of the United States or a foreign jurisdiction unless such an opinion is specifically requested by the banking commissioner;

(2) may assume that the parties to the transaction have engaged only in activities provided in their respective constitutive documents, and that all surviving parties to the transaction will engage only in activities provided in their respective constitutive documents;

(3) may assume that the transaction will be consummated in accordance with its terms as disclosed in the application; and

(4) may qualify the opinions given as opinions solely for the benefit of the banking commissioner that may not be quoted in whole or in part or otherwise referred to in another document or report, and that may not be furnished to a person or entity other than the banking commissioner and the department without the written consent of counsel, except as may be permitted or required by law, including Finance Code, §§181.301 et seq, and Government Code, Chapter 552.

(d) Legal counsel shall specifically notify the banking commissioner of any substantive deviation from the assumptions, qualifications, limitations and exceptions allowed in this section and the Accord, and any substantive deviation from the opinion requirements of the section of this subchapter that governs a particular application. Deviations may result in a processing delay of the application to the extent additional analysis is required to understand the purpose of the deviation. A substantive deviation from the requirements of this subchapter applicable to legal opinions that is not brought to the attention of the banking commissioner will be considered a material misrepresentation in the application.

(e) Legal counsel rendering an opinion under this subchapter shall be an attorney in good standing admitted to practice before the highest court of a state, territory or district of the United States. However, legal counsel shall be well versed and professionally competent in applicable Texas law, or should seek the advice and opinion of an attorney in good standing admitted to practice before the highest courts in this state if legal counsel may not properly and ethically render opinions regarding applicable Texas law. An opinion of local legal counsel must be disclosed if relied on by legal counsel.

(f) Legal counsel rendering an opinion under this subchapter shall be independent of the applicant, the notice provider, or another person or entity required to submit an opinion of counsel pursuant to this section. Legal counsel is considered independent if able to exercise independent professional judgment and render candid advice, whether in private practice or employed by an applicant.

Source: *The provisions of this §21.68 adopted to be effective December 31, 1998, 23 TexReg 13033; amended to be effective September 5, 2002, 27 TexReg 8203.*

§21.69. Rights of Dissenting Shareholders.

The rights of dissenting shareholders or participants to a transaction under this subchapter may be governed by the Texas Business Organizations Code or other applicable law relating to the rights of dissenters, and applicants shall provide evidence of compliance with or inapplicability of such provisions of law.

Source: *The provisions of this §21.69 adopted to be effective December 31, 1998, 23 TexReg 13033; amended to be effective November 7, 2013, 38 TexReg 7690.*

§21.70. Investigation of Application.

(a) Authority. An application under this subchapter is subject to such investigation as considered necessary, in the banking commissioner's sole discretion, in order to make an informed decision regarding an application.

(b) Costs and fees. An applicant under this subchapter shall pay reasonable costs incurred in the investigation including the cost of a required examination, as provided by §21.2 of this title (relating to Filing and Investigation Fees).

(c) Examinations. The banking commissioner may consider the following factors in determining whether to require an examination of one or more of the entities to the transaction:

(1) a question exists regarding the solvency or potential solvency of the applicant or one or more of the fiduciary institutions or other entities involved in the proposed transaction;

(2) a trust company or other fiduciary institution involved in the transaction has not been examined by a state, federal, or foreign regulatory agency within the 18-month period immediately preceding the date of submission of the application;

(3) a trust company or other fiduciary institution involved in the proposed transaction has numerous substantive violations cited in its last examination report, or has a less than satisfactory corporate or trust regulatory rating;

(4) a question exists regarding the experience, ability, standing, trustworthiness, or integrity of the existing or proposed officers, directors, managers or managing participants of a party involved in the proposed transaction;

(5) a question exists whether a resulting trust company will operate in compliance with the law;

(6) a question exists whether a resulting trust company will be free from improper or unlawful influence or interference from its principal shareholders with respect to operation in compliance with the law;

(7) a question exists whether a resulting trust company will have adequate capitalization;

(8) one or more of the parties to the transaction are under a regulatory restriction; or

(9) such other factors as determined in the sole discretion of the banking commissioner.

Source: *The provisions of this §21.70 adopted to be effective December 31, 1998, 23 TexReg 13033.*

§21.72. Approval; Conditional Approval; Denial of Application; Hearings.

(a) Approval, conditional approval, or denial. Except as otherwise provided by §21.63 of this title (relating to Expedited Filings), the banking commissioner shall approve or deny an application filed under this subchapter on or before a date that is 60 days after the date the application is accepted for filing pursuant to §21.4 of this title (relating to Required Information and Abandoned Filings).

(b) Pre-decision hearing. The banking commissioner may, in the exercise of discretion, before the expiration of the initial period for decision provided by subsection (a) of this section, give the applicant written notice that the banking commissioner will convene a hearing to obtain evidence related to the application. Such notice by the banking commissioner suspends the specified period for approval or denial of an application, and the banking commissioner shall approve or deny the application on or before a date that is 30 days after the date the final proposal for decision resulting from the hearing is provided to the banking commissioner and the applicant.

(c) Acceptance of conditional approval. The banking commissioner may give the applicant written notice that the application has been approved subject to certain conditions. The applicant shall provide the banking commissioner with written confirmation of acceptance of the conditions on or before a date that is 10 days after the date of notification to the applicant of the conditional approval. An agreement between the applicant and the banking commissioner concerning conditional approval is enforceable against the applicant. In the event an applicant who has received conditional approval does not provide the banking commissioner with written confirmation as required by this subsection, consummation of the transaction constitutes confirmation of acceptance of the conditions imposed by the banking commissioner and is considered for all purposes an agreement enforceable against the applicant.

(d) Requests for hearing. An applicant may request a hearing on or before a date that is 30 days after the effective date of notice of denial or conditional approval of an application under this subchapter by the banking commissioner. The request for hearing must be in writing and state with specificity the reasons the applicant alleges that the decision of the banking commissioner is in error. The applicant has the burden of proof for each issue specified in the request for hearing. The request for hearing and the banking commissioner's decision to deny or condition the application will be made a part of the record.

(e) Hearings on denial of applications. Requests for hearing under this subchapter will be forwarded to the administrative law judge who shall enter appropriate orders and conduct the hearing on or before a date that is 60 days after the date the request for hearing was received, or as soon after that as is reasonably possible, under Chapter 9 of this title (relating to Rules of Procedure for Contested Case Hearings, Appeals, and Rulemaking) and Government Code, Chapter 2001. A proposal for decision, exceptions and replies to such proposal for decision, the final decision of the banking commissioner, and motions for rehearing are governed by Chapter 9 of this title. An applicant may not appeal denial of an application or conditional approval of an application until a final order is issued. After a hearing and final order, the applicant may appeal the final order as provided in Finance Code, §§181.202-181.204.

Source: *The provisions of this §21.72 adopted to be effective December 31, 1998, 23 TexReg 13033; amended to be effective September 5, 2002, 27 TexReg 8203.*

§21.73. Consummation of a Transaction.

A transaction under this subchapter must be consummated as proposed in the application, in the agreement concerning conditional approval, or as provided in a final order. An approved transaction under this subchapter must be consummated within 12 months after the date of approval by the banking commissioner unless an extension is granted in writing. Until a transaction is consummated, the banking commissioner may alter, suspend, or withdraw approval should an interim development warrant such action.

Source: *The provisions of this §21.73 adopted to be effective December 31, 1998, 23 TexReg 13033.*

§21.74. Notification.

A notification by the banking commissioner under this subchapter may be by registered or certified mail, return receipt requested, and is complete when the notification is deposited in the United States mail postage prepaid, return receipt requested, mailed to the address furnished in the application. Notification may also be made in person to the applicant, or to the trust company or another person, fiduciary institution, foreign corporation or domestic corporation, or other entity subject to this subchapter, by agent-receipted delivery or by courier-receipted delivery to the address furnished in the application, or by telephonic document transfer to the applicant's telecopier number as furnished in the application. Notice by telephonic document transfer served after 6:00 p.m. local time of recipient is considered as notice served on the following day.

Source: *The provisions of this §21.74 adopted to be effective December 31, 1998, 23 TexReg 13033.*

§21.75. Abandoned Filing.

The banking commissioner may determine an application under this subchapter to be abandoned pursuant to §21.4 of this title (relating to Required Information and Abandoned Filings).

Source: *The provisions of this §21.75 adopted to be effective December 31, 1998, 23 TexReg 13033.*

§21.76. Confidentiality.

Information obtained by the banking commissioner under this subchapter is presumed to be public information unless such information is confidential under Finance Code, §§181.301 et seq, or under exceptions contained in Government Code, Chapter 552. The applicant has the burden to request confidential treatment for specified information, to segregate and mark documents claimed to be confidential, and to specifically reference the provision of law that allows confidential treatment.

Source: *The provisions of this §21.76 adopted to be effective December 31, 1998, 23 TexReg 13033; amended to be effective September 5, 2002, 27 TexReg 8203.*

Subchapter G. Charter Amendments and Certain Changes in Outstanding Stock

§21.91. Acquisition and Retention of Shares as Treasury Stock.

(a) Permitted acquisition of treasury stock. Pursuant to Finance Code, §§182.103, 184.101, and 184.102, a trust company may acquire its own shares to be held as treasury stock, if prior notice of the proposed transaction is filed with the banking commissioner pursuant to subsection (b) of this section and the plan of acquisition has not been disapproved by the banking commissioner pursuant to subsection (d) of this section.

(b) Notice filing. A trust company that desires to effect a treasury stock transaction shall file notice of its intention to enter into a plan of acquisition with the banking commissioner, setting forth or including as exhibits the following:

(1) consistent with subsection (g) of this section, the pro forma effects of the plan of acquisition on the trust company's liquidity and restricted and secondary capital, and disclosure of the basis for the calculations, including:

(A) the price or price range per share at which the shares will be acquired;

(B) the number of shares sought to be acquired, expressed as a maximum; and

(C) the source of funds for the acquisition;

(2) the date by which the plan of acquisition will be completed;

(3) a certified copy of a resolution duly adopted by the board of directors, approving the plan of acquisition; and

(4) a current draft of the securities offering document or other disclosure materials proposed to be delivered to shareholders considering the sale of the trust company's shares to the trust company.

(c) Consummation of plan of acquisition. If a notice of intention to acquire treasury stock filed under this section is not disapproved by the banking commissioner on or before the 30th day after the notice is complete and accepted for filing, the transaction may be consummated in the manner and in accordance with the terms set forth in the plan of acquisition. The banking commissioner may, before the expiration of the 30-day period, impose conditions on the plan of acquisition, including limitations on the number of shares to be acquired, the source of funds for the acquisition, or a condition that the transaction be consummated as of a specified date. A notification by the banking commissioner under this section may be by registered or certified mail, return receipt requested, and is complete when the notification is deposited in the United States mail postage prepaid, return receipt requested, addressed to the address furnished in the notice.

(d) Disapproval. The banking commissioner may disapprove the proposed plan of acquisition if the banking commissioner concludes that the trust company's plan of acquisition:

(1) will result in an acquisition of treasury stock at an aggregate cost in excess of its undivided profits,

(2) may threaten the adequacy of the trust company's liquidity and the requirements of Finance Code, §184.101(b);

(3) may threaten the adequacy of the trust company's equity capital or its restricted capital, or could result in a trust company failing to maintain the minimum required level in restricted capital set forth in Finance Code, §182.103; or

(4) could otherwise place the trust company in an unsafe or unsound condition.

(e) Compliance with securities law.

(1) An issuer's purchase of its own shares is a transaction subject to the antifraud provisions of federal securities law, see 15 United States Code, §78j, 17 Code of Federal Regulations, §240.10b-5, and Spector v. L Q Motor Inns, Inc., 517 F.2d 278 (5th Cir. 1975), cert. denied, 423 U.S. 1055 (1976). Such a transaction is also subject to the antifraud provisions of state securities law, see Texas Civil Statutes, Article 581-33(B). Potential liability of the trust company to the selling shareholder can therefore arise if the trust company withholds or misrepresents material facts that the seller would have considered important in making the decision to sell.

(2) Any transaction consummated under subsection (c) of this section does not constitute a determination by the banking commissioner that the trust company has complied with applicable securities law.

(f) Retention of treasury stock. The banking commissioner may require a trust company to cancel and retire all or part of shares held as treasury stock to the status of authorized and unissued shares if the banking commissioner concludes that holding treasury stock in the amount held by the trust company creates safety and soundness or other regulatory concerns.

(g) Accounting for treasury stock. A trust company shall account for the acquisition and retention of treasury stock in accordance with generally accepted accounting principles under either the cost method or the par value method (see Accounting Research Bulletin Number 43), although use of the cost method may avoid the reduction in restricted capital that would be required under the par value method. The method used for accounting for treasury stock must be clearly reflected in the trust company's accounting records.

(h) Status of treasury stock. Shares held by a trust company as treasury stock may not be voted, directly or indirectly, at any meeting of shareholders, and may not be counted in determining the total number of outstanding shares at any given time.

Source: *The provisions of this §21.91 adopted to be effective December 31, 1998, 23 TexReg 13039; amended to be effective September 5, 2002, 27 TexReg 8203; amended to be effective July 10, 2008, 33 TexReg 5277.*

§21.92. Amendment of Certificate to Effect a Reverse Stock Split.

(a) Definitions. The following words and terms when used in this section shall have the following meanings, unless the context clearly indicates otherwise.

(1) Affiliate--For purposes of this section only, a person that directly or indirectly through one or more intermediaries controls, is controlled by, or is under common control with a trust company seeking to effect a reverse stock split. A person who is not an affiliate of the trust company at the commencement of its reverse stock split will not be considered an affiliate of the trust company prior to the completion of the reverse stock split.

(2) Appraisal report--A report, opinion (other than an opinion of counsel), or appraisal, prepared by an outside party, that is materially related to the reverse stock split, including a report, opinion, or appraisal relating to the consideration or the fairness of the consideration to be offered to shareholders in connection with the reverse stock split or the fairness of such transaction to the trust company or to unaffiliated shareholders.

(3) Reverse stock split--An amendment to the certificate of formation of a trust company that achieves a reduction in the number of issued shares of such trust company by requiring exchange of all issued shares in a particular class for a proportionately smaller number of shares, generally with a proportionately increased par or stated value. The equity capital of the trust company remains substantially the same.

(4) Share--A unit representing ownership of at least part of the proprietary interests of a trust

company, whether or not divided or subdivided by means of classes, series, relative rights, or preferences; and includes a stock or similar security; or a security convertible, with or without consideration, into such a security, or carrying a warrant or right to subscribe to or purchase such a security; or such warrant or right; or another security determined by the banking commissioner to be an equity security as defined by Finance Code, §181.002(a).

(5) Unaffiliated shareholder--A shareholder of a share subject to a reverse stock split who is not an affiliate of the trust company that issued the share.

(b) Procedure. Pursuant to Finance Code, §182.101, to effectuate a reverse stock split in compliance with this section, a trust company shall:

(1) obtain the approval of its shareholders as required by law; and

(2) obtain the approval of the banking commissioner pursuant to subsection (d) of this section, by filing an application setting forth the information and documents required by subsection (c) of this section and the filing fee required by §21.2 of this title (relating to Filing and Investigation Fees).

(c) Application. A trust company proposing a reverse stock split transaction shall file with the banking commissioner a written application seeking approval of the proposed amendment to its certificate of formation, stating the results of the vote of shareholders regarding the proposed reverse stock split and stating the percentage of shares of unaffiliated shareholders that were voted in favor of the proposed reverse stock split, or undertaking to supplement the application after conditional approval is obtained to provide shareholder approval information, setting forth or including as exhibits the following:

(1) the original and one copy of the proposed amendment to the certificate of formation, to be processed in the manner required by Finance Code, §182.101, and a description of the material terms of the proposed reverse stock split, including terms or arrangements relating to any shareholder of the trust company which are not identical to those relating to other shareholders of the same class;

(2) any plan or proposal of the trust company, regarding activities or transactions which are to occur after the reverse stock split which relate to or would result in:

(A) an extraordinary corporate transaction, such as a merger, reorganization, or liquidation, involving the trust company or any of its subsidiaries;

(B) a sale or transfer of a material amount of assets of the trust company or any of its subsidiaries;

(C) a change in the present board of directors or management of the trust company, including a plan or proposal to change the number or term of directors, to fill an existing vacancy on the board or to change a material term of the employment contract of an executive officer;

(D) a material change in the present dividend rate or policy or indebtedness or capitalization of the trust company;

(E) any other material change in the trust company's corporate structure or business;

(3) the corporate purpose or purposes of the trust company for the reverse stock split, and alternative means, if any, considered by the trust company to accomplish such purposes and the reasons for their rejection, and the reason for choosing the structure of a reverse stock split and for undertaking such transaction at this time;

(4) a certified resolution of the board of directors of the trust company approving the proposed amendment to the certificate of formation, accompanied by a statement whether or not the board of directors of the trust company reasonably believes that the reverse stock split is fair or unfair to unaffiliated shareholders that:

(A) identifies each director, if any, that dissented to or abstained from voting on the merits of the reverse stock split, and describes, if known to the trust company after making reasonable inquiry, the reasons for each dissent or abstention; and

(B) states the number and percentage of disinterested directors that voted in favor of the proposed reverse stock split;

(5) whether or not the trust company obtained an appraisal report and, if an appraisal report was obtained, a copy of the appraisal report. To the extent not addressed in the appraisal report, the trust company shall disclose:

(A) the identity, qualifications, and method of selection of the outside party that prepared the appraisal report, any material relationship between the outside party or its affiliates and the trust company or its affiliates which existed during the past two years or is mutually understood to be contemplated, and any compensation received or to be received as a result of such relationship;

(B) a summary of the performance of such appraisal report, including the procedures followed, the findings and recommendations, the bases for and methods of arriving at such findings and recommendations, instructions received from the trust company, and any limitation imposed by the trust company on the scope of the investigation; and

(C) whether such appraisal report will be made available for inspection and copying at the home office of the trust company during its regular business hours by any shareholder of the trust company or such shareholder's representative who has been so designated in writing;

(6) with respect to the class of shares to which the reverse stock split relates, the aggregate amount and percentage of shares beneficially owned by any pension, profit sharing, or similar plan of the trust company, and by each officer, director, principal shareholder, and subsidiary of the trust company;

(7) with respect to any purchases of such shares made by the trust company since the commencement of the trust company's second full fiscal year preceding the date of the application, the amount of such shares purchased, the range of prices paid for such shares, and the average purchase price for each quarterly period of the trust company during such period;

(8) to the extent known to the trust company after reasonable inquiry, any transaction in the class of shares subject to the proposed reverse stock split that was effected during the past 60 days by the trust company or by an officer, director, principal shareholder, or subsidiary of the trust company, including the identity of the person who effected the transaction, the date of the transaction, the amount of shares involved, the price per share, and where and how the transaction was effected;

(9) to the extent known to the trust company after reasonable inquiry, a description and/or a copy of any contract, arrangement, understanding, or relationship (whether or not legally enforceable) in connection with the reverse stock split between the trust company (or an officer, director, principal shareholder, or subsidiary of the trust company) and any person with respect to any shares of the trust company (including a contract, arrangement, understanding, or relationship concerning the transfer or the voting of any such shares, joint ventures, loan, or option arrangements, puts or calls, guaranties of loans, guaranties against loss or the giving or withholding of proxies, consents, or authorizations), naming the persons with whom such contracts, arrangements, understandings, or relationships have been entered into and giving the material provisions thereof, including such information for any of such shares that are pledged or otherwise subject to a contingency, the occurrence of which would give another person the power to direct the voting or disposition of such shares, except that disclosure of standard default and similar provisions contained in loan agreements need not be included;

(10) to the extent known to the trust company after reasonable inquiry, whether or not any officer, director, principal shareholder, or subsidiary of the trust company has made a recommendation in support of or opposed to the reverse stock split and, if so, the reasons for such recommendation;

(11) whether or not appraisal rights are being voluntarily accorded by the trust company to shareholders in connection with the reverse stock split and whether or not any provision has been or will be made to allow unaffiliated shareholders to obtain counsel or appraisal services at the voluntary expense

of the trust company and, if so, a detailed description of such appraisal rights or counsel or appraisal services;

(12) a reasonably itemized statement of all expenses incurred or estimated to be incurred in connection with the reverse stock split, including filing fees, legal, accounting, and appraisal fees, solicitation expenses, and printing costs, and disclosure of the person who has paid or will be responsible for paying such expenses;

(13) the proxy statement furnished to shareholders of the trust company in connection with obtaining shareholder approval for the reverse stock split, or a draft of the proxy statement to be furnished to shareholders in the event approval of the banking commissioner is sought prior to a shareholder vote; and

(14) such other information that the banking commissioner requires to be included in the particular application as considered necessary to an informed decision to approve or reject the proposed amendment effectuating a reverse stock split.

(d) Standards for approval.

(1) The banking commissioner shall process the proposed reverse stock split in accordance with Finance Code, §182.101(d). The banking commissioner shall require that the reverse stock split be for a valid business purpose of the trust company, viewed as an entity distinct from its affiliates, and be accomplished through fair dealing with and a fair price to unaffiliated shareholders. The banking commissioner may impose conditions on approval, including a condition that an independent appraisal report be obtained regarding the value of the unaffiliated shareholders' shares, exclusive of any element of value arising from the accomplishment or expectation of the proposed transaction, and without minority discount. Share value determined by an independent and properly prepared appraisal report that is fully disclosed to trust company shareholders or by the market price of publicly traded shares will be presumed to be a fair value unless extenuating circumstances to the contrary are specifically noted.

(2) In the event approval of the banking commissioner is obtained prior to approval by shareholders, the trust company shall file a statement with the banking commissioner certifying that any future event or condition upon which the approval of the transaction was conditioned has been satisfied and the date that each such condition was satisfied. Upon receipt of such statement, the banking commissioner shall file the approved amendment to the certificate of formation in accordance with Finance Code, §182.101(e).

(3) An issuer's purchase of its own shares is a transaction subject to the antifraud provisions of federal securities law, see 15 United States Code, §78j, 17 Code of Federal Regulations (CFR), §240.10b-5, and Spector v. L Q Motor Inns, Inc., 517 F.2d 278 (5th Cir. 1975), cert. denied, 423 U.S. 1055 (1976). Such a transaction is also subject to the antifraud provisions of state securities law, see Texas Civil Statutes, Article 581-33(B). Potential liability of the trust company to the selling shareholder can therefore arise if the trust company withholds or misrepresents material facts that the seller would have considered important in making the decision to sell. Consequently, a trust company must disclose to the shareholders in writing, prior to or simultaneously with the written notice of the shareholders meeting, all material information necessary to an informed decision regarding the proposed reverse stock split. If the reverse stock split involves publicly traded shares and is subject to 15 CFR, §240.13e-3, the registration statement required by federal law is considered to satisfy this disclosure obligation. Approval of an application under this section by the banking commissioner does not constitute a determination that the trust company has complied with applicable securities law.

(e) Exemptions.

(1) This section does not apply to a reverse stock split that:

(A) will not result in fractional shares;

(B) permits each shareholder to choose to cash in the resulting fractional share by selling it to the trust company or to round up to the next highest whole share by purchasing fractional interests, provided that:

(i) the specified sale and purchase prices are equivalent and reasonable; and

(ii) no fractional share resulting from the reverse stock split is less than 10% of a full share;

(C) is adopted by means of a unanimous written consent of shareholders; or

(D) the banking commissioner expressly exempts after written application as not within the purposes of this section.

(2) An amendment to the certificate of formation that implements a reverse stock split exempt from this section is filed and processed in accordance with Finance Code, §182.101.

(3) The availability of an exemption from the requirements of this section does not relieve a trust company from its obligation to comply with applicable securities law.

Source: *The provisions of this §21.92 adopted to be effective December 31, 1998, 23 TexReg 13039; amended to be effective September 5, 2002, 27 TexReg 8203; amended to be effective November 7, 2013, 38 TexReg 7690.*

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CHAPTER 35. CHECK VERIFICATION ENTITIES

CHAPTER 35. CHECK VERIFICATION ENTITIES

Subchapter A. General Provisions

§35.1. Definitions.

In this subchapter:

(1) Banking Commissioner--The Commissioner of the Texas Department of Banking.

(2) Department--The Texas Department of Banking.

(3) Electronic notification system--The secure e-mail or other secure system established under §11.309, Finance Code, and used by financial institutions to notify check verification entities as required by §523.052, Business & Commerce Code.

(4) Financial institution--A financial institution as defined by §523.052(a)(2), Business & Commerce Code.

(5) Police report--A police report of an offense under Section 32.51, Penal Code.

(6) Sworn statement--The sworn statements referred to in §523.052(b)(2) and §523.052(e)(2)(B), Business & Commerce Code, except when the term is specifically limited to one of the sworn statements.

(7) Written authorization--The written authorization referred to in §523.052(b)(3), Business & Commerce Code.

Source: *The provisions of this §35.1 adopted to be effective January 3, 2008, 32 TexReg 9940; amended to be effective September 9, 2010, 35 TexReg 8102.*

Subchapter B. Registration of Check Verification Entities

§35.11. Who must register with the banking commissioner?

An entity is a check verification entity and must register with the banking commissioner if it:

(1) is a consumer reporting agency as defined in the Fair Credit Reporting Act (15 U.S.C. Section 1681 et seq.);

(2) contracts with businesses in this state to recommend acceptance or rejection of checks or similar sight orders received by the businesses; and

(3) compiles and maintains files on consumers on a nationwide basis regarding the consumers' check-writing history for those businesses with which it contracts.

Source: *The provisions of this §35.11 adopted to be effective January 3, 2008, 32 TexReg 9940.*

§35.12. What is the registration requirement for a check verification entity?

A check verification entity must register with the department and then renew the registration annually thereafter on forms prescribed by the department.

Source: *The provisions of this §35.12 adopted to be effective January 3, 2008, 32 TexReg 9940.*

§35.13. What must a check verification entity do to register in Texas?

(a) A check verification entity must complete and submit the registration form prescribed by the banking commissioner, which at a minimum, must include:

(1) the full legal name, any assumed name, principal business address, mailing address, business telephone number, facsimile number, and website address of the check verification entity;

(2) the full legal name, title, business telephone number, facsimile number, and e-mail address of the following persons associated with the check verification entity:

(A) the person responsible for questions about the registration or renewal process; and

(B) the person responsible for compliance with the requirements of §523.052, Business & Commerce Code.

(3) a statement that:

(A) the registration information is true and correct; and

(B) it has business clients in Texas and compiles and maintains files on consumers on a nationwide basis regarding consumers' check-writing history for those businesses;

(4) such other information as the banking commissioner may require, including information confirming that the registering entity is required to register under §35.11 of this title; and

(5) a certification by an authorized officer that the information therein is true and correct; and

(b) Submit the nonrefundable annual registration fee of $100 with the registration form.

Source: *The provisions of this §35.13 adopted to be effective January 3, 2008, 32 TexReg 9940; amended to be effective September 9, 2010, 35 TexReg 8102.*

§35.14. Is there a fee for registering a check verification entity?

A check verification entity must pay a $100 fee to the department when it initially submits a completed registration form to the department and then annually thereafter when it submits a form to renew its registration.

Source: *The provisions of this §35.14 adopted to be effective January 3, 2008, 32 TexReg 9940.*

§35.15. When does a check verification entity's registration expire?

Regardless of the date on which a registration under this chapter is effective, the registration expires on March 1 of each year.

Source: *The provisions of this §35.15 adopted to be effective January 3, 2008, 32 TexReg 9940.*

§35.16. How does a check verification entity renew its registration?

To renew a registration, a check verification entity must file a completed registration form pursuant to the instructions in §35.13 of this title, on or before February 1 of each year.

Source: *The provisions of this §35.16 adopted to be effective January 3, 2008, 32 TexReg 9940.*

§35.17. What must a check verification entity do when its registration information changes?

A check verification entity must notify the department of any change in the registration information provided to the department not later than the 30th day after the date of the change.

Source: *The provisions of this §35.17 adopted to be effective January 3, 2008, 32 TexReg 9940.*

§35.18. How long will the department take to process my registration?

(a) On or before the 15th day after the date the department receives your registration form, the department will notify you in writing that:

(1) your registration form is incomplete and specify the additional information required before the department will accept your registration for filing; or

(2) your registration is complete and accepted for filing.

(b) On or before the 30th day after the date the department accepts your registration for filing, the banking commissioner will approve or deny your registration and advise you in writing of the decision.

Source: *The provisions of this §35.18 adopted to be effective June 30, 2016, 41 TexReg 4638.*

§35.19. What remedy is available if the department does not comply with the registration processing times?

(a) If the department does not process your registration within the time periods specified in §35.18 of this title, you may file a written complaint with the banking commissioner. The complaint must set out the facts regarding the delay and the specific relief you seek. The department must receive your complaint on or before the 30th day after the date the commissioner approves or denies your registration.

(b) The department division responsible for complying with the applicable time period must submit a written response to the banking commissioner regarding your complaint that includes any facts on which the division relies to show that good cause existed for exceeding the applicable time period.

(c) The banking commissioner will review your written complaint and the division's response. If the commissioner deems it necessary, a hearing may be held to take evidence on the matter.

(d) The banking commissioner will determine, based upon your complaint and the division's response, if the department exceeded the applicable time period and, if so, whether the responsible division established good cause for the delay.

(e) The banking commissioner will notify you of the decision regarding your complaint on or before the 60th day after the date the commissioner receives your written complaint. The commissioner's decision is final and may not be appealed.

(f) If the banking commissioner decides that the department exceeded the applicable time period without good cause, the department will reimburse you all of your registration fees.

(g) A decision in your favor under this section does not affect any decision by the banking commissioner to grant or deny your registration. The decision to grant or deny your registration is based upon applicable substantive law without regard to whether the department timely processed your registration.

Source: *The provisions of this §35.19 adopted to be effective June 30, 2016, 41 TexReg 4638.*

Subchapter C. Responsibilities of the Banking Commissioner

§35.31. What is the banking commissioner required to do with respect to the electronic notification system?

(a) The banking commissioner is required to establish an electronic notification system, through secure email or another secure system, to be used by a financial institution to notify check verification entities as required by §523.052, Business & Commerce Code.

(b) The department will maintain the electronic notification system for financial institutions to use to transmit the required information to check verification entities, but the department:

(1) will not verify the accuracy, validity, or completeness of any information transmitted through the electronic notification system; and

(2) is not furnishing the information to the check verification entities.

Source: *The provisions of this §35.31 adopted to be effective January 3, 2008, 32 TexReg 9940; amended to be effective September 9, 2010, 35 TexReg 8102.*

Subchapter D. Procedure Following a Customer Report of an Offense Under Section 32.51, Penal Code

§35.51. What is an offense under Section 32.51, Penal Code?

Generally, a person commits an offense under §32.51, Penal Code, if the person, with the intent to harm or defraud another, obtains, possesses, transfers, or uses:

(1) identifying information of another person without the other person's consent; or

(2) without legal authorization, information concerning a deceased person that would be identifying information of that person were that person alive.

Source: *The provisions of this §35.51 adopted to be effective January 3, 2008, 32 TexReg 9940.*

§35.52. What must a financial institution or check verification entity do when a person reports to it that the person was the victim of an offense under Section 32.51, Penal Code?

(a) When a customer reports to a financial institution that they have been the victim of an offense under §32.51, Penal Code, the financial institution is encouraged to provide the customer with a sworn statement form under §523.052(b)(2), Business & Commerce Code, and a written authorization form under §523.052(b)(3).

(b) When a person reports to a check verification entity that they have been the victim of an offense under §32.51, Penal Code, the check verification entity is encouraged to provide the person with a sworn statement form under §523.052(e)(2)(B), Business & Commerce Code.

(c) If a person agrees to receive the documents described in subsection (a) or (b) of this section in a particular electronic format or on the Internet, a financial institution or check verification entity may provide the documents to the person electronically or by providing the person with the URL address of the webpage where the forms are located:

(1) on the website of the financial institution or check verification entity; or

(2) on the department's website.

Source: *The provisions of this §35.52 adopted to be effective January 3, 2008, 32 TexReg 9940; amended to be effective September 9, 2010, 35 TexReg 8102.*

§35.53. Will the department provide model forms for the sworn statement and written authorization required by Section 523.052(b)(2) and (3), Business & Commerce Code?

(a) The department has provided a model form combining the sworn statement under §523.052(b)(2), Business & Commerce Code, and the written authorization under §523.052(b)(3) for use by financial institutions.

(b) The department has provided a model form sworn statement under §523.052(e)(2)(B), Business & Commerce Code, for use by check verification entities.

(c) A financial institution or check verification entity may use and accept:

(1) the model forms provided by the department; and

(2) other forms that contain spaces for persons to provide the information required by §523.052, Business & Commerce Code, and this Chapter.

(d) The model forms in subsection (a) and (b) of this section are available on the department's website. The department encourages financial institutions, check verification entities, and other financial institution regulators to make the model forms, or the forms they use, available on their websites.

(e) A financial institution may use and accept a form that combines the sworn statement and the written authorization into a single form.

Source: *The provisions of this §35.53 adopted to be effective January 3, 2008, 32 TexReg 9940; amended to be effective September 9, 2010, 35 TexReg 8102.*

§35.54. What information must appear on the sworn statement required by Section 523.052(b)(2), Business & Commerce Code, for use when a person contacts a financial institution with the intent to send information through the electronic notification system?

The sworn statement form required by §523.052(b)(2), Business & Commerce Code, must include:

(1) a notice, at the top of the first page, that provides that:

(A) the customer must file a police report regarding an offense under §32.51, Penal Code; and

(B) the customer must return the completed sworn statement with either:

(i) the incident or case number of the police report; or

(ii) a copy of the police report.

(2) blanks for the customer to provide:

(A) customer's name, address, phone number, date of birth;

(B) the number and the issuing governmental entity's name for the customer's:

(i) driver's license or state issued identification card; or

(ii) if the customer does not have a driver's license or state issued identification card, other government-issued identification.

(C) the account number of any account compromised by the alleged offense and closed in response to the alleged offense;

(D) routing number for the financial institution where the account was closed;

(E) numbers or the range of numbers of any checks that have been lost, stolen, or compromised, if any;

(F) the incident or case number of the police report; and

(G) a signature before a notary public.

Source: *The provisions of this §35.54 adopted to be effective January 3, 2008, 32 TexReg 9940; amended to be effective September 9, 2010, 35 TexReg 8102.*

§35.55. What information must appear on the written authorization required by Section 523.052(b)(3), Business & Commerce Code?

The written authorization form provided to a customer by a financial institution must contain:

(1) a signature bar for the customer's signature; and

(2) a provision in uppercase, bold-faced type that is substantially similar to this provision and in at least 12-point font:

THE STATE OF TEXAS HAS ESTABLISHED AN ELECTRONIC NOTIFICATION SYSTEM TO DELIVER INFORMATION TO CHECK VERIFICATION ENTITIES REGARDING VICTIMS OF OFFENSES UNDER SECTION 32.51, PENAL CODE, REGARDING FRAUDULENT USE OR POSSESSION OF IDENTIFYING INFORMATION OF A PERSON. THE CHECK VERIFICATION ENTITIES USE INFORMATION RECEIVED TO ASSIST BUSINESSES IN DECIDING WHETHER TO ACCEPT CHECKS AND OTHER PAYMENT DEVICES PRESENTED TO THEM. BY SUBMITTING THIS FORM, YOU ARE AUTHORIZING ______________________ (NAME OF FINANCIAL INSTITUTION) TO SUBMIT THE INFORMATION YOU PROVIDED ON THE SWORN STATEMENT TO THE ELECTRONIC NOTIFICATION SYSTEM.

Source: *The provisions of this §35.55 adopted to be effective January 3, 2008, 32 TexReg 9940; amended to be effective September 9, 2010, 35 TexReg 8102.*

§35.56. What information must appear on the sworn statement required by Section 523.052(e)(2)(B), Business & Commerce Code, for use with a person who contacts a check verification entity directly?

The sworn statement required by §523.052(e)(2)(B), Business & Commerce Code, must include:

(1) the information required by §35.54 of this title; and

(2) a statement that the person has requested that their financial institution close any account that has been compromised by the alleged offense.

Source: *The provisions of this §35.56 adopted to be effective January 3, 2008, 32 TexReg 9940; amended to be effective September 9, 2010, 35 TexReg 8102.*

§35.57. When must a financial institution submit customer information through the electronic notification system?

A financial institution must submit the information required by §523.052(d), Business & Commerce Code, to the electronic notification system not later than the second business day after the date the customer:

(1) notifies the financial institution that the customer was a victim of an offense under §32.51, Penal Code;

(2) requests the financial institution close an account that has been compromised by the alleged offense; and

(3) presents to the home office, if in Texas, or to any branch of the financial institution in Texas:

(A) an incident or case number of the police report or a copy of the police report of an offense under §32.51, Penal Code;

(B) the sworn statement required by §523.052(b)(2), Business & Commerce Code; and

(C) the written authorization required by §523.052(b)(3), Business & Commerce Code.

Source: *The provisions of this §35.57 adopted to be effective January 3, 2008, 32 TexReg 9940; amended to be effective September 9, 2010, 35 TexReg 8102.*

§35.58. May a financial institution or check verification entity accept a case or offense number issued by a police department instead of a copy of the police report?

Instead of a copy of the police report regarding an offense under §32.51, Penal Code, a person may provide a financial institution or check verification entity the case or offense number issued by the police department.

Source: *The provisions of this §35.58 adopted to be effective January 3, 2008, 32 TexReg 9940.*

§35.59. What procedures must a check verification entity maintain to prevent recommending approval of a check or similar sight order after receipt of a notification of an offense under Section 32.51, Penal Code?

A check verification entity must process a notification received through the electronic notification system or pursuant to §523.052(e)(2), Business & Commerce Code, in the same manner as it processes information received from its usual sources, including information received from its business customers.

Source: *The provisions of this §35.59 adopted to be effective January 3, 2008, 32 TexReg 9940; amended to be effective September 9, 2010, 35 TexReg 8102.*

Subchapter E. Procedures When Incorrect Information is Reported to the Check Verification Entity

§35.71. What must a financial institution do when it receives notice from a customer or a check verification entity that it sent incorrect information through the electronic notification system?

A financial institution that determines or is informed that information it furnished to check verification entities through the electronic notification system is not complete or accurate must correct that information promptly in accordance with 15 U.S.C. §§1681 et seq. and other applicable law. The electronic notification system is available to the financial institution to provide the registered check verification entities with complete and accurate information.

Source: *The provisions of this §35.71 adopted to be effective January 3, 2008, 32 TexReg 9940.*

§35.72. What must a check verification entity do when it receives notice directly from a person pursuant to Section 523.052(e)(2), Business & Commerce Code, or from a financial institution through the electronic notification system that information the check verification entity received was erroneous?

Subject to other applicable state or federal law, a check verification entity that is notified that information it received through the electronic notification system is not complete or accurate must process the notice in the same manner as it processes such notices received from its usual sources, including information received from its business customers.

Source: *The provisions of this §35.72 adopted to be effective January 3, 2008, 32 TexReg 9940; amended to be effective September 9, 2010, 35 TexReg 8102.*

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TEXAS ADMINISTRATIVE CODE
TITLE 7. BANKING AND SECURITIES

PART VIII. JOINT FINANCIAL REGULATORY AGENCIES

CHAPTER 151. HOME EQUITY LENDING PROCEDURES

CHAPTER 151. HOME EQUITY LENDING PROCEDURES

§151.1. Application for Interpretation. (a) The Finance Commission and Credit Union Commission may on their own motion issue interpretations of Section 50(a)(5) - (7), (e) - (p), and (t), Article XVI of the Texas Constitution.

(b) An interested person may submit a request for an interpretation of Section 50(a)(5) - (7), (e) - (p), and (t), Article XVI of the Texas Constitution. All requests must:

(1) be directed to the general counsel for the Office of Consumer Credit Commissioner who will promptly distribute it to the general counsels for the Department of Banking, the Department of Savings and Mortgage Lending, and the Credit Union Department;

(2) contain an explicit statement that an interpretation approved by the Finance Commission and Credit Union Commission is desired;

(3) contain the reference to the specific applicable section, subsection and paragraph of the Texas Constitution of which the interpretation is requested;

(4) state with sufficient particularity the factual and legal context to which the application of the provision is vague or ambiguous; and

(5) indicate the requestor's opinion of how the legal issue should be resolved, the basis for that opinion, an analysis of any relevant court decisions, and all prior interpretations to which the request relates.

Source: *The provisions of this §151.1 adopted to be effective January 7, 2004, 29 TexReg 83; amended to be effective November 13, 2008, 33 TexReg 9073.*

§151.2. Review of Request. (a) The request for interpretation shall be evaluated to determine:

(1) whether the requestor has complied with the requirements of §151.1(b);

(2) the significance and general application of the interpretation; and

(3) the ambiguity of the constitutional provision.

(b) Reasons for a denial of a request for interpretation will be stated in writing.

Source: *The provisions of this §151.2 adopted to be effective January 7, 2004, 29 TexReg 83.*

§151.3. Initiation of Interpretation Procedure. (a) If an interpretation is initiated, the requestor shall be notified in writing.

(b) To ensure that clear and concise formal interpretations are made, it may be necessary to rephrase the original interpretation request. A requestor will be notified in writing if a request is rephrased and a copy of the rephrased request shall be provided to the requestor.

(c) Copies of the request for interpretation will be sent to parties requesting advance notice for their input.

(d) The parties requesting advance notice may provide their input indicating an opinion of how the legal issue should be resolved, the basis for that opinion, an analysis of any relevant court decisions and all prior interpretations to which the request relates.

(e) The input of the parties requesting advance notice will be considered.

Source: *The provisions of this §151.3 adopted to be effective January 7, 2004, 29 TexReg 83; amended to be effective November 13, 2008, 33 TexReg 9073.*

§151.4. Notice of Proposed Interpretation. If the Finance Commission and the Credit Union Commission propose an interpretation, notice of the proposed interpretation will be published in the *Texas Register*. The notice of the proposed interpretation shall contain:

(1) A brief explanation of the proposed interpretation;

(2) The text of the proposed interpretation, except any portion omitted under Section 2002.014, Government Code, prepared in a manner to indicate any words to be added or deleted from the current text;

(3) A reference to the section of the constitution interpreted; and

(4) A statement of whether the interpretation is inconsistent with any other interpretations and an explanation of the justification for any inconsistency.

Source: *The provisions of this §151.4 adopted to be effective January 7, 2004, 29 TexReg 83.*

§151.5. Public Comment. Any person may submit comments, briefs or proposals pertaining to the proposed interpretation not later than 30 days following the publication of the proposed interpretation in the *Texas Register*. The Finance Commission and Credit Union Commission will allow the opportunity for public comment and public hearing as required by Section 2001.029, Government Code.

Source: *The provisions of this §151.5 adopted to be effective January 7, 2004, 29 TexReg 83.*

§151.6. Action on Proposed Interpretation. The Finance Commission and the Credit Union Commission may adopt or decline to adopt the proposed interpretation or remand the proposed interpretation for modification, revision, or additional comment. This action will be conducted at a public meeting.

Source: *The provisions of this §151.6 adopted to be effective January 7, 2004, 29 TexReg 83.*

§151.7. Adoption of Interpretation. The interpretation as finally adopted by the Finance Commission and Credit Union Commission, will include:

(1) a reasoned justification for the interpretation as adopted consisting solely of:

(A) a summary of comments received from parties interested in the interpretation that shows the names of interested parties or associations offering comment on the interpretation and whether they were for or against its adoption;

(B) a summary of the factual basis for the interpretation as adopted which demonstrates a rational connection between the factual basis for the interpretation and the interpretation as adopted; and

(C) the reasons why the Finance Commission and Credit Union Commission disagree with party submissions and proposals;

(2) a concise restatement of the particular constitutional provisions under which the interpretation is adopted and of how the Finance Commission and Credit Union Commission interpret the provisions as authorizing or requiring the interpretation; and

(3) a certification that the interpretation, as adopted, has been reviewed by legal counsel and found to be a valid exercise of the Finance Commission's and Credit Union Commission's legal authority.

Source: *The provisions of this §151.7 adopted to be effective January 7, 2004, 29 TexReg 83; amended to be effective November 13, 2008, 33 TexReg 9073.*

§151.8. Savings Clause and Severability. The Finance Commission and Credit Union Commission intend that each provision of any interpretation adopted under Chapters 151, 152, and 153 of this title is consistent with Chapter 2001, Government Code. The provisions of any interpretation adopted under Chapters 151, 152, and 153 of this title are severable. If any provision of any interpretation adopted under Chapters 151, 152, and 153 of this title is determined to be inconsistent with Chapter 2001, Government Code or otherwise invalid, all valid provisions are severable from the invalid part.

Source: *The provisions of this §151.8 adopted to be effective January 7, 2004, 29 TexReg 83; amended to be effective November 13, 2008, 33 TexReg 9073.*

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CHAPTER 152. REPAIR, RENOVATION, AND NEW CONSTRUCTION ON HOMESTEAD PROPERTY

CHAPTER 152. REPAIR, RENOVATION, AND NEW CONSTRUCTION ON HOMESTEAD PROPERTY

§152.1. Definitions. Any reference to Section 50 in this interpretation refers to Article XVI, Texas Constitution, Section 50. Words and terms have these meanings when used in this chapter, unless the context indicates otherwise:

(1) Contract--A contract for work and material, that complies with the Texas Constitution and the Texas Property Code, used to:

(A) construct new improvements;

(B) repair or renovate existing improvements; or

(C) both subparagraphs (A) and (B) of this paragraph.

(2) Existing improvements--A pre-existing addition to a homestead that is physically attached to the homestead.

(3) New improvements--An addition physically attached to a homestead:

(A) that does not exist on the homestead prior to the commencement of the use of work and material to physically attach the new improvements to the homestead under Section 50(a)(5); and

(B) the construction of which will not involve:

(i) work on existing improvements

(ii) the use of material on existing improvements; or

(iii) physically attaching material to existing improvements.

(4) Material--Material used in constructing new improvements or repairing or renovating existing improvements. Material alone is not improvements. Material used to construct new improvements becomes a part of the new improvements once physically attached to the new improvements. Likewise, material used to repair or renovate existing improvements becomes a part of the existing improvements once physically attached to the existing improvements.

(5) Owner--A person who has the right to possess, use, and convey, individually or with the joinder of another person, all or part of the homestead.

(6) Physically attach--To permanently attach, affix, add to, or fasten onto.

(7) Repair or Renovate--Work and material used to:

(A) replace material physically attached to existing improvements whether or not the new material is similar to or the same as the material being replaced (examples include replacing flooring, roofing, built-in appliances, siding, windows, or other material that is attached to existing improvements);

(B) physically attach material to existing improvements where there is no previously attached material being replaced that is the same as or similar to the material being attached (examples include attaching to existing improvements a new room, a built-in cabinet, or a second story); and

(C) mend, remedy or upgrade all or a portion of existing improvements without adding or replacing material to the existing improvements (examples include restoring wood flooring or woodwork of an existing improvement where the work does not include physically attaching material to the existing improvements, and removing flooring to expose flooring underneath).

(8) Title company--A title insurance company or an agent of a title insurance company.

Source: *The provisions of this §152.1 adopted to be effective July 7, 2005, 30 TexReg 3863.*

§152.3. Requirements for Construction of New Improvements: Section 50(a)(5). (a) Except as provided in §152.5(c) of this chapter, Section 50(a)(5)(A) - (D) does not apply to the construction of new improvements on a homestead.

(b) A valid lien, under Section 50(a)(5), may be created on a homestead if the debt for the work and material used for new improvements is contracted for in writing. Once the lien is created, the homestead is not protected by Section 50 from forced sale for the payment of the debt.

Source: *The provisions of this §152.3 adopted to be effective July 7, 2005, 30 TexReg 3863.*

§152.5. Requirements for Work and Material Used to Repair or Renovate: Section 50(a)(5)(A) - (D). (a) Section 50(a)(5)(A) - (D) applies only to contracts and applications for work and material used to repair or renovate existing improvements.

(b) If debt is incurred for work and material used to repair or renovate existing improvements and the requirements of Section 50(a)(5)(A) - (D) have been met, a lien is established on the homestead of a family, or of a single adult person, and it is not protected by Section 50 from forced sale for the payment of the debt.

(c) If the application and contract are for both work and material used to repair or renovate existing improvements and for work and material used in constructing new improvements, the entire transaction is considered a contract to repair and renovate existing improvements and compliance with the constitutional requirements of Section 50(a)(5)(A) - (D) is required to establish a lien on the homestead.

Source: *The provisions of this §152.5 adopted to be effective July 7, 2005, 30 TexReg 3863.*

§152.7. Consent of Spouses in the Case of Family Homestead: Section 50(a)(5)(A). (a) In the case of a family homestead, both spouses must consent in writing to the contract for repair or renovation of existing improvements, regardless of whether the spouse has a community property interest or other ownership interest in the homestead.

(b) In addition to the consent of both spouses of a family homestead, the lender or contractor, at its option, may also require all other owners and their spouses to consent to the contract.

Source: *The provisions of this §152.7 adopted to be effective July 7, 2005, 30 TexReg 3863.*

§152.9. Five Day Waiting Period for a Contract Before Executing Work and Materials for Repairs or Renovation: Section 50(a)(5)(C) . The contract for work and materials may not be executed before the fifth calendar day after the owner makes written application for any extension of credit for the work and materials except as provided in §152.13. To count the five days, the day after the application for extension of credit is made is day one. If the fifth calendar day falls on a Sunday or federal legal public holiday, then the contract for work and materials may not be executed until the next calendar day that is not a Sunday or federal legal public holiday.

Source: *The provisions of this §152.9 adopted to be effective March 3, 2005, 30 TexReg 1065.*

§152.11. Three Day Right to Rescind Contract for Work and Materials for Repairs or Renovation: Section 50(a)(5)(C). The owner and owner's spouse may rescind the contract for work and materials within three calendar days after execution by all parties of the contract for work and materials. To count the three days, the day after the contract is executed is day one. The rescission period ends at midnight of the third calendar day following the execution of the contract. If the third calendar day falls on a Sunday or federal legal public holiday, then the right of rescission is extended to midnight of the next calendar day that is not a Sunday or federal legal public holiday.

Source: *The provisions of this §152.11 adopted to be effective March 3, 2005, 30 TexReg 1065.*

§152.13. Health or Safety Reasons for Waiving the Five Day Waiting Period and the Three Day Right to Rescind: Section 50(a)(5)(B) and (C). (a) If the owner wants to waive the 5-day waiting period in §50(a)(5)(B) or the 3-day right of rescission in §50(a)(5)(C), the owner must sign a statement that, at a minimum:

(1) describes how the conditions of the homestead property require immediate repair;

(2) describes how the conditions of the homestead property materially affect the health and safety of the owner or the person residing in the homestead; and

(3) states that the owner is waiving the 5-day waiting period under §50(a)(5)(B), the 3-day period to rescind the contract for work and materials under §50(a)(5)(C), or both;

(b) Printed forms for this purpose are prohibited.

Source: *The provisions of this §152.13 adopted to be effective March 3, 2005, 30 TexReg 1065.*

§152.15. Place for Execution of Contract for Work and Material: Section 50(a)(5)(D). (a) The persons granting or acknowledging the encumberance of their homestead interest must execute the contract for work and material used to repair or renovate existing improvements at the permanent physical address of:

(1) the office or branch office of a third-party lender making an extension of credit for the work and material;

(2) an attorney at law; or

(3) a title company.

(b) Execution of the contract may not occur at a mobile office located at:

(1) the homestead; or

(2) any other place not permitted by subsection (a) of this section.

Source: *The provisions of this §152.15 adopted to be effective July 7, 2005, 30 TexReg 3863.*

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CHAPTER 153. HOME EQUITY LENDING

CHAPTER 153. HOME EQUITY LENDING

§153.1. Definitions. Any reference to Section 50 in this interpretation refers to Article XVI, Texas Constitution, unless otherwise noted. These words and terms have the following meanings when used in this chapter, unless the context indicates otherwise:

(1) Balloon--an installment that is more than an amount equal to twice the average of all installments scheduled before that installment.

(2) Business Day--All calendar days except Sundays and these federal legal public holidays: New Year's Day, the Birthday of Martin Luther King, Jr., Washington's Birthday, Memorial Day, Independence Day, Labor Day, Columbus Day, Veterans Day, Thanksgiving Day, and Christmas Day.

(3) Closed or closing--the date when each owner and the spouse of each owner signs the equity loan agreement or the act of signing the equity loan agreement by each owner and the spouse of each owner.

(4) Consumer Disclosure--The written

notice contained in Section 50(g) that must be provided to the owner at least 12 days before the date the extension of credit is made.

(5) Cross-default provision--a provision in a loan agreement that puts the borrower in default if the borrower defaults on another obligation.

(6) Date the extension of credit is made--the date on which the closing of the equity loan occurs.

(7) Equity loan--An extension of credit as defined and authorized under the provisions of Section 50(a)(6).

(8) Equity loan agreement--the documents evidencing the agreement between the parties of an equity loan.

(9) Fair Market Value--the fair market value of the homestead as determined on the date that the loan is closed.

(10) Force-placed insurance--insurance purchased by the lender on the homestead when required insurance on the homestead is not maintained in accordance with the equity loan agreement.

(11) Interest--As used in Section 50(a)(6)(E), “interest” means the amount determined by multiplying the loan principal by the interest rate over a period of time.

(12) Lockout provision--a provision in a loan agreement that prohibits a borrower from paying the loan early.

(13) Owner--A person who has the right to possess, use, and convey, individually or with the joinder of another person, all or part of the homestead.

(14) Preclosing Disclosure--The written itemized disclosure required by Section 50(a)(6)(M)(ii).

(15) Three percent limitation--the limitation on fees in Section 50(a)(6)(E).

Source: *The provisions of this §153.1 adopted to be effective January 8, 2004, 29 TexReg 84; amended to be effective January 1, 2015, 39 TexReg 10407.*

§153.2. Voluntary Lien: Section 50(a)(6)(A). An equity loan must be secured by a voluntary lien on the homestead created under a written agreement with the consent of each owner and each owner's spouse.

(1) The consent of each owner and each owner's spouse must be obtained, regardless of whether any owner's spouse has a community property interest or other interest in the homestead.

(2) An owner or an owner's spouse who is not a maker of the note may consent to the lien by signing a written consent to the mortgage instrument. The consent may be included in the mortgage instrument or a separate document.

(3) The lender, at its option, may require each owner and each owner's spouse to consent to the equity loan. This option is in addition to the consent required for the lien.

Source: *The provisions of this §153.2 adopted to be effective January 8, 2004, 29 TexReg 84.*

§153.3. Limitation on Equity Loan Amount: Section 50(a)(6)(B). An equity loan must be of a principal amount that when added to the aggregate total of the outstanding principal balances of all other indebtedness secured by valid encumbrances of record against the homestead does not exceed 80 percent of the fair market value of the homestead on the date the extension of credit is made. For example, on a property with a fair market value of $100,000, the maximum amount of debt against the property permitted by Section 50(a)(6)(B) is $80,000. Assuming existing debt of $30,000, the maximum amount of the equity loan debt is $50,000.

(1) The principal amount of an equity loan is the sum of:

(A) the amount of the cash advanced; and

(B) the charges at the inception of an equity loan to the extent these charges are financed in the principal amount of the loan.

(2) The principal balance of all outstanding debt secured by the homestead on the date the extension of credit is made determines the maximum principal amount of an equity loan.

(3) The principal amount of an equity loan does not include interest accrued after the date the extension of credit is made (other than any interest capitalized and added to the principal balance on the

date the extension of credit is made), or other amounts advanced by the lender after closing as a result of default, including for example, ad valorem taxes, hazard insurance premiums, and authorized collection costs, including reasonable attorney's fees.

(4) On a closed-end multiple advance equity loan, the principal balance also includes contractually obligated future advances not yet disbursed.

Source: *The provisions of this §153.3 adopted to be effective January 8, 2004, 29 TexReg 84.*

§153.4. Nonrecourse: Section 50(a)(6)(C). An equity loan must be without recourse for personal liability against each owner and the spouse of each owner, unless the owner or spouse obtained the extension of credit by actual fraud.

(1) If an owner or the spouse of an owner cosigns an equity loan agreement or consents to a security interest, the equity loan must not give the lender personal liability against an owner or an owner's spouse.

(2) A lender is prohibited from pursuing a deficiency except when the owner or owner's spouse has committed actual fraud in obtaining an equity loan.

(3) To determine whether a lender may pursue personal liability, the borrower or owner must have committed "actual fraud." To obtain personal liability under this section, the deceptive conduct must constitute the legal standard of "actual fraud." Texas case law distinguishes "actual fraud" from "constructive fraud." "Actual fraud" encompasses dishonesty of purpose or intentional breaches of duty that are designed to injure another or to gain an undue and unconscientious advantage.

Source: *The provisions of this §153.4 adopted to be effective January 8, 2004, 29 TexReg 84.*

§153.5. Three percent fee limitation: Section 50(a)(6)(E). An equity loan must not require the owner or the owner's spouse to pay, in addition to any interest, fees to any person that are necessary to originate, evaluate, maintain, record, insure, or service the extension of credit that exceed, in the aggregate, three percent of the original principal amount of the extension of credit.

(1) Optional Charges. Charges paid by an owner or an owner's spouse at their sole discretion are not fees subject to the three percent fee limitation. Charges that are not imposed or required by the lender, but that are optional, are not fees subject to the three percent limitation. The use of the word "require" in Section 50(a)(6)(E) means that optional charges are not fees subject to the three percent limitation.

(2) Optional Insurance. Insurance coverage premiums paid by an owner or an owner's spouse that are at their sole discretion are not fees subject to the three percent limitation. Examples of these charges may include credit life and credit accident and health insurance that are voluntarily purchased by the owner or the owner's spouse.

(3) Charges that are Interest. Charges an owner or an owner's spouse is required to pay that constitute interest under §153.1(11) of this title (relating to Definitions) are not fees subject to the three percent limitation.

(A) Per diem interest is interest and is not subject to the three percent limitation.

(B) Legitimate discount points are interest and are not subject to the three percent limitation. Discount points are legitimate if the discount points truly correspond to a reduced interest rate and are not necessary to originate, evaluate, maintain, record, insure, or service the loan. A lender may rely on an established system of verifiable procedures to evidence that the discount points it offers are legitimate. This system may include documentation of options that the owner is offered in the course of negotiation, including a contract rate without discount points and a lower contract rate based on discount points.

(4) Charges that are not Interest. Charges an owner or an owner's spouse is required to pay that are not interest under §153.1(11) of this title are fees subject to the three percent limitation.

(5) Charges Absorbed by Lender. Charges a lender absorbs, and does not charge an owner or an owner's spouse that the owner or owner's spouse might otherwise be required to pay are unrestricted and not fees subject to the three percent limitation.

(6) Charges to Originate. Charges an owner or an owner's spouse is required to pay to originate an equity loan that are not interest under §153.1(11) of this title are fees subject to the three percent limitation.

(7) Charges Paid to Third Parties. Charges

an owner or an owner's spouse is required to pay to third parties for separate and additional consideration for activities relating to originating a loan are fees subject to the three percent limitation. Charges those third parties absorb, and do not charge an owner or an owner's spouse that the owner or owner's spouse might otherwise be required to pay are unrestricted and not fees subject to the three percent limitation. Examples of these charges include attorneys' fees for document preparation and mortgage brokers' fees to the extent authorized by applicable law.

(8) Charges to Evaluate. Charges an owner or an owner's spouse is required to pay to evaluate the credit decision for an equity loan, that are not interest under §153.1(11) of this title, are fees subject to the three percent limitation. Examples of these charges include fees collected to cover the expenses of a credit report, survey, flood zone determination, tax certificate, title report, inspection, or appraisal.

(9) Charges to Maintain. Charges paid by an owner or an owner's spouse to maintain an equity loan that are not interest under §153.1(11) of this title are fees subject to the three percent limitation if the charges are paid at the inception of the loan, or if the charges are customarily paid at the inception of an equity loan but are deferred for later payment after closing.

(10) Charges to Record. Charges an owner or an owner's spouse is required to pay for the purpose of recording equity loan documents in the official public record by public officials are fees subject to the three percent limitation.

(11) Charges to Insure an Equity Loan. Premiums an owner or an owner's spouse is required to pay to insure an equity loan are fees subject to the three percent limitation. Examples of these charges include title insurance and mortgage insurance protection.

(12) Charges to Service. Charges paid by an owner or an owner's spouse for a party to service an equity loan that are not interest under §153.1(11) of this title are fees subject to the three percent limitation if the charges are paid at the inception of the loan, or if the charges are customarily paid at the inception of an equity loan but are deferred for later payment after closing.

(13) Secondary Mortgage Loans. A lender making an equity loan that is a secondary mortgage loan under Chapter 342 of the Texas Finance Code may charge only those fees permitted in TEX. FIN. CODE, §§342.307, 342.308, and 342.502. A lender must comply with the provisions of Chapter 342 of the Texas Finance Code and the constitutional restrictions on fees in connection with a secondary mortgage loan made under Chapter 342 of the Texas Finance Code.

(14) Escrow Funds. A lender may provide escrow services for an equity loan. Because funds tendered by an owner or an owner's spouse into an escrow account remain the property of the owner or the owner's spouse those funds are not fees subject to the three percent limitation. Examples of escrow funds include account funds collected to pay taxes, insurance premiums, maintenance fees, or homeowner's association assessments. A lender must not contract for a right of offset against escrow funds pursuant to Section 50(a)(6)(H).

(15) Subsequent Events. The three percent limitation pertains to fees paid or contracted for by an owner or owner's spouse at the inception or at the closing of an equity loan. On the date the equity loan is closed an owner or an owner's spouse may agree to perform certain promises during the term of the equity loan. Failure to perform an obligation of an equity loan may trigger the assessment of costs to the owner or owner's spouse. The assessment of costs is a subsequent event triggered by the failure of the owner's or owner's spouse to perform under the equity loan agreement and is not a fee subject to the three percent limitation. Examples of subsequent event costs include contractually permitted charges for force-placed homeowner's insurance costs, returned check fees, debt collection costs, late fees, and costs associated with foreclosure.

(16) Property Insurance Premiums. Premiums an owner or an owner's spouse is required to pay to purchase homeowner's insurance coverage are not fees subject to the three percent limitation. Examples of property insurance premiums include fire and extended coverage insurance and flood insurance. Failure to maintain this insurance is generally a default provision of the equity loan agreement and not a condition of the extension of credit. The lender may collect and escrow premiums for this insurance and include the premium in the periodic payment amount or principal amount. If the lender sells insurance to the owner, the lender must comply with applicable law concerning the sale of insurance in connection with a mortgage loan.

Source: *The provisions of this §153.5 adopted to be effective January 8, 2004, 29 TexReg 84; amended to be effective January 1, 2015, 39 TexReg 10407.*

§153.7. Prohibition on Prepayment Penalties: Section 50(a)(6)(G). An equity loan may be paid in advance without penalty or other charge.

(1) A lender may not charge a penalty to a borrower for paying all or a portion of an equity loan early.

(2) A lockout provision is not permitted in an equity loan agreement because it is considered a prepayment penalty.

Source: *The provisions of this §153.7 adopted to be effective January 8, 2004, 29 TexReg 84.*

§153.8. Security of the Equity Loan: Section 50(a)(6)(H). An equity loan must not be secured by any additional real or personal property other than the homestead. The definition of "homestead" is located at Section 51 of Article XVI, Texas Constitution, and Chapter 41 of the Texas Property Code.

(1) A lender and an owner or an owner's spouse may enter into an agreement whereby a lender may acquire an interest in items incidental to the homestead. An equity loan secured by the following items is not considered to be secured by additional real or personal property:

(A) escrow reserves for the payment of taxes and insurance;

(B) an undivided interest in a condominium unit, a planned unit development, or the right to the use and enjoyment of certain property owned by an association;

(C) insurance proceeds related to the homestead; or

(D) condemnation proceeds;

(E) fixtures; or

(F) easements necessary or beneficial to the use of the homestead, including access easements for ingress and egress.

(2) A guaranty or surety of an equity loan is not permitted. A guaranty or surety is considered additional property for purposes of Section 50(a)(6)(H). Prohibiting a guaranty or surety is consistent with the prohibition against personal liability in Section 50(a)(6)(C). An equity loan with a guaranty or surety would create indirect liability against the owner. The constitutional home equity lending provisions clearly provide that the homestead is the only allowable collateral for an equity loan. The constitutional home equity provisions prohibit the lender from contracting for recourse of any kind against the owner or owner's spouse, except for provisions providing for recourse against the owner or spouse when the extension of credit is obtained by actual fraud.

(3) A contractual right of offset in an equity loan agreement is prohibited.

(4) A contractual cross-collateralization clause in an equity loan agreement is prohibited.

(5) Any equity loan on an urban homestead that is secured by more than ten acres is secured by additional real property in violation of Section (50)(a)(H).

Source: *The provisions of this §153.8 adopted to be effective January 8, 2004, 29 TexReg 84.*

§153.9. Acceleration: Section 50(a)(6)(J). An equity loan may not be accelerated because of a decrease in the market value of the homestead or because of the owner's default under other indebtedness not secured by a prior valid encumbrance against the homestead.

(1) An equity loan agreement may contain a provision that allows the lender to accelerate the loan because of a default under the covenants of the loan agreement. Examples of these provisions include a promise to maintain the property or not remove improvements to the property that indirectly affects the market value of the homestead.

(2) A contractual cross-default clause is permitted only if the lien associated with the equity loan agreement is subordinate to the lien that is referenced by the cross default clause .

Source: *The provisions of this §153.9 adopted to be effective January 8, 2004, 29 TexReg 84.*

§153.10. Number of Loans: Section 50(a)(6)(K). An equity loan must be the only debt secured by the homestead at the time the extension of credit is made unless the other debt was made for a purpose described by Section 50(a)(1)-(a)(5) or (a)(8).

(1) Number of Equity Loans. An owner may have only one equity loan at a time, regardless of the

aggregate total outstanding debt against the homestead.

(2) Loss of Homestead Designation. If under Texas law the property ceases to be the homestead of the owner, then the lender, for purposes of Section 50(a)(6)(K), may treat what was previously a home equity mortgage as a non-homestead mortgage.

Source: *The provisions of this §153.10 adopted to be effective January 8, 2004, 29 TexReg 84.*

§153.11. Repayment Schedule: Section 50(a)(6)(L)(i). Unless an equity loan is a home equity line of credit under Section 50(t), the loan must be scheduled to be repaid in substantially equal successive periodic installments, not more often than every 14 days and not less often than monthly, beginning no later than two months from the date the extension of credit is made, each of which equals or exceeds the amount of accrued interest as of the date of the scheduled installment.

(1) The two month time period contained in Section 50(a)(6)(L)(i) begins on the date of closing.

(2) For purposes of Section 50(a)(6)(L)(i), a month is the period from a date in a month to the corresponding date in the succeeding month. For example, if a home equity loan closes on March 1, the first installment must be due no later than May 1. If the succeeding month does not have a corresponding date, the period ends on the last day of the succeeding month. For example, if a home equity loan closes on July 31, the first installment must be due no later than September 30.

(3) For a closed-end equity loan to have substantially equal successive periodic installments, some amount of principal must be reduced with each installment. This requirement prohibits balloon payments.

(4) Section 50(a)(6)(L)(i) does not preclude a lender's recovery of payments as necessary for other amounts such as taxes, adverse liens, insurance premiums, collection costs, and similar items.

Source: *The provisions of this §153.11 adopted to be effective January 8, 2004, 29 TexReg 84; amended to be effective November 13, 2008, 33 TexReg 9074.*

§153.12. Closing Date: Section 50(a)(6)(M)(i). An equity loan may not be closed before the 12th calendar day after the later of the date that the owner submits an application for the loan to the lender or the date that the lender provides the owner a copy of the required consumer disclosure. One copy of the required consumer disclosure may be provided to married owners. For purposes of determining the earliest permitted closing date, the next succeeding calendar day after the later of the date that the owner submits an application for the loan to the lender or the date that the lender provides the owner a copy of the required consumer disclosure is the first day of the 12-day waiting period. The equity loan may be closed at any time on or after the 12th calendar day after the later of the date that the owner submits an application for the loan to the lender or the date that the lender provides the owner a copy of the required consumer disclosure.

(1) Submission of a loan application to an agent acting on behalf of the lender is submission to the lender.

(2) A loan application may be given orally or electronically.

Source: *The provisions of this §153.12 adopted to be effective January 8, 2004, 29 TexReg 84; amended to be effective November 13, 2008, 33 TexReg 9074.*

§153.13. Preclosing Disclosures: Section 50(a)(6)(M)(ii). An equity loan may not be closed before one business day after the date that the owner of the homestead receives a copy of the loan application, if not previously provided, and a final itemized disclosure of the actual fees, points, interest, costs, and charges that will be charged at closing. If a bona fide emergency or another good cause exists and the lender obtains the written consent of the owner, the lender may provide the preclosing disclosure to the owner or the lender may modify the previously provided preclosing disclosure on the date of closing.

(1) For purposes of this section, the "preclosing disclosure" consists of a copy of the loan application, if not previously provided, and a final itemized disclosure of the actual fees, points, interest, costs, and charges that will be charged at closing.

(2) The copy of the loan application submitted to the owner in satisfaction of the preclosing disclosure requirement must be the most current version at the time the document is delivered. The lender is not obligated to provide another copy of the loan application if the only difference from the version previously provided to the owner is formatting. The lender is not obligated to give another copy of the loan application if the

information contained on the more recent application is the same as that contained on the application of which the owner has a copy.

(3) A lender may satisfy the disclosure requirement of providing a final itemized disclosure of the actual fees, points, interest, costs, and charges that will be charged at closing by delivery to the borrower of a properly completed Department of Housing and Urban Development (HUD) disclosure Form HUD-1 or HUD-1A.

(4) Bona fide emergency.

(A) An owner may consent to receive the preclosing disclosure or a modification of the preclosing disclosure on the date of closing in the case of a bona fide emergency occurring before the date of the extension of credit. An equity loan secured by a homestead in an area designated by Federal Emergency Management Agency (FEMA) as a disaster area is an example of a bona fide emergency if the homestead was damaged during FEMA's declared incident period.

(B) To document a bona fide emergency modification, the lender should obtain a written statement from the owner that:

(i) describes the emergency;

(ii) specifically states that the owner consents to receive the preclosing disclosure or a modification of the preclosing disclosure on the date of closing;

(iii) bears the signature of all of the owners entitled to receive the preclosing disclosure; and

(iv) affirms the owner has received notice of the owner's right to receive a final itemized disclosure containing all actual fees, points, costs, and charges one day prior to closing.

(5) Good cause. An owner may consent to receive the preclosing disclosure or a modification of the preclosing disclosure on the date of closing if another good cause exists.

(A) Good cause to modify the preclosing disclosure or to receive a subsequent disclosure modifying the preclosing disclosure on the date of closing may only be established by the owner.

(i) The term "good cause" as used in this section means a legitimate or justifiable reason, such as financial impact or an adverse consequence.

(ii) At the owner's election, a good cause to modify the preclosing disclosure may be established if:

(I) the modification does not create a material adverse financial consequence to the owner; or

(II) a delay in the closing would create an adverse consequence to the owner.

(iii) The term "de minimis" as used in this section means a very small or insignificant amount.

(B) At the owner's election, a de minimis good cause standard may be presumed if:

(i) the total actual disclosed fees, costs, points, and charges on the date of closing do not exceed in the aggregate more than the greater of $100 or 0.125 percent of the principal amount of the loan (e.g. 0.125 percent on a $80,000 principal loan amount equals $100) from the initial preclosing disclosure; and

(ii) no itemized fee, cost, point, or charge exceeds more than the greater of $100 or 0.125 percent of the principal amount of the loan than the amount disclosed in the initial preclosing disclosure.

(C) To document a good cause modification of the disclosure, the lender should obtain a written statement from the owner that:

(i) describes the good cause;

(ii) specifically states that the owner consents to receive the preclosing disclosure on the date of closing;

(iii) bears the signature of all of the owners entitled to receive the preclosing disclosure; and

(iv) affirms the owner has received notice of the owner's right to receive a final itemized disclosure containing all fees, costs, points, or charges one day prior to closing.

(6) An equity loan may be closed at any

time during normal business hours on the next business day following the calendar day on which the owner receives the preclosing disclosure or any calendar day thereafter.

(7) The owner maintains the right of rescission under Section 50(a)(6)(Q)(viii) even if the owner exercises an emergency or good cause modification of the preclosing disclosure.

Source: *The provisions of this §153.13 adopted to be effective June 29, 2006, 31 TexReg 5080; amended to be effective November 9, 2006, 31 TexReg 9022; amended to be effective November 13, 2008, 33 TexReg 9074.*

§153.14. One Year Prohibition: Section 50(a)(6)(M)(iii). An equity loan may not be closed before the first anniversary of the closing date of any other equity loan secured by the same homestead property.

(1) Section 50(a)(6)(M)(iii) prohibits an owner who has obtained an equity loan from:

(A) refinancing the equity loan before one year has elapsed since the loan's closing date; or

(B) obtaining a new equity loan on the same homestead property before one year has elapsed since the previous equity loan's closing date, regardless of whether the previous equity loan has been paid in full.

(2) Section 50(a)(6)(M)(iii) does not prohibit modification of an equity loan before one year has elapsed since the loan's closing date. A modification of a home equity loan occurs when one or more terms of an existing equity loan is modified, but the note is not satisfied and replaced. A home equity loan and a subsequent modification will be considered a single transaction. The home equity requirements of Section 50(a)(6) will be applied to the original loan and the subsequent modification as a single transaction.

(A) A modification of an equity loan must be agreed to in writing by the borrower and lender, unless otherwise required by law. An example of a modification that is not required to be in writing is the modification required under the Soldiers' and Sailors' Civil Relief Act.

(B) The advance of additional funds to a borrower is not permitted by modification of an equity loan.

(C) A modification of an equity loan may not provide for new terms that would not have been permitted by applicable law at the date of closing of the extension of credit.

(D) The 3% fee cap required by Section 50(a)(6)(E) applies to the original home equity loan and any subsequent modification as a single transaction.

Source: *The provisions of this §153.14 adopted to be effective January 8, 2004, 29 TexReg 84; amended to be effective November 13, 2008, 33 TexReg 9074.*

§153.15. Location of Closing: Section 50(a)(6)(N). An equity loan may be closed only at an office of the lender, an attorney at law, or a title company. The lender is anyone authorized under Section 50(a)(6)(P) that advances funds directly to the owner or is identified as the payee on the note.

(1) An equity loan must be closed at the permanent physical address of the office or branch office of the lender, attorney, or title company. The closing office must be a permanent physical address so that the closing occurs at an authorized physical location other than the homestead.

(2) Any power of attorney allowing an attorney-in-fact to execute closing documents on behalf of the owner or the owners' spouse must be signed by the owner or the owner's spouse at an office of the lender, an attorney at law, or a title company. A lender may rely on an established system of verifiable procedures to evidence compliance with this paragraph. For example, this system may include one or more of the following:

(A) a written statement in the power of attorney acknowledging the date and place at which the power of attorney was executed;

(B) an affidavit or written certification of a person who was present when the power of attorney was executed, acknowledging the date and place at which the power of attorney was executed; or

(C) a certificate of acknowledgement signed by a notary public under Chapter 121, Civil Practice and Remedies Code, acknowledging the date and place at which the power of attorney was executed.

(3) The consent required under Section 50(a)(6)(A) must be signed by the owner and the owner's spouse, or an attorney-in-fact described by

paragraph (2) of this subsection, at an office of the lender, an attorney at law, or a title company.

Source: *The provisions of this §153.15 adopted to be effective January 8, 2004, 29 TexReg 84; amended to be effective January 1, 2015, 39 TexReg 10407.*

§153.16. Rate of Interest: Section 50(a)(6)(O). A lender may contract for and receive any fixed or variable rate of interest authorized under statute.

(1) An equity loan that provides for interest must comply with constitutional and applicable law. Interest rates on certain first mortgages are not limited on loans subject to the federal Depository Institutions Deregulation and Monetary Control Act of 1980 and the Alternative Mortgage Transaction Parity Act. Chapter 342 of the Texas Finance Code provides for a maximum rate on certain secondary mortgage loans. Chapter 124 of the Texas Finance Code and federal law provide for maximum rates on certain mortgage loans made by credit unions. These statutes operate in conjunction with Section 50(a) and other constitutional sections.

(2) An equity loan must amortize and contribute to amortization of principal.

(3) The lender may contract to vary the scheduled installment amount when the interest rate adjusts on a variable rate equity loan. A variable-rate loan is a mortgage in which the lender, by contract, can adjust the mortgage's interest rate after closing in accordance with an external index.

(4) The scheduled installment amounts of a variable rate equity loan must be:

(A) substantially equal between each interest rate adjustment; and

(B) sufficient to cover at least the amount of interest scheduled to accrue between each payment date and a portion of the principal.

(5) An equity loan agreement may contain an adjustable rate of interest that provides a maximum fixed rate of interest pursuant to a schedule of steps or tiered rates or provides a lower initial interest rate through the use of a discounted rate at the beginning of the loan.

Source: *The provisions of this §153.16 adopted to be effective January 8, 2004, 29 TexReg 84.*

§153.17. Authorized Lenders: Section 50(a)(6)(P). An equity loan must be made by one of the following that has not been found by a federal regulatory agency to have engaged in the practice of refusing to make loans because the applicants for the loans reside or the property proposed to secure the loans is located in a certain area: a bank, savings and loan association, savings bank, or credit union doing business under the laws of this state or the United States; a federally chartered lending instrumentality or a person approved as a mortgagee by the United States government to make federally insured loans; a person licensed to make regulated loans, as provided by statute of this state; a person who sold the homestead property to the current owner and who provided all or part of the financing for the purchase; a person who is related to the homestead owner within the second degree of affinity and consanguinity; or a person regulated by this state as a mortgage broker.

(1) An authorized lender under Chapter 341, Texas Finance Code, must meet both constitutional and statutory qualifications to make an equity loan.

(2) A HUD-approved mortgagee is a person approved as a mortgagee by the United States government to make federally insured loans. Approved correspondents to a HUD-approved mortgagee are not authorized lenders of equity loans unless qualifying under another section of (a)(6)(P).

(3) A non-depository lender or broker that makes, negotiates, arranges, or transacts a secondary mortgage loan that is governed by Chapter 342, Texas Finance Code, must comply with the licensing provisions of Chapter 342, Texas Finance Code.

(4) A lender who does not meet the definition of Section 50(a)(6)(P)(i), (ii), (iv), (v), or (vi), must obtain a regulated loan license under Chapter 342 of the Texas Finance Code to meet the provisions of subsection (iii).

Source: *The provisions of this §153.17 adopted to be effective January 8, 2004, 29 TexReg 84.*

§153.18. Limitation on Application of Proceeds: Section 50(a)(6)(Q)(i). An equity loan must be made on the condition that the owner of the homestead is not required to apply the proceeds of the extension of credit to repay another debt except debt secured by the homestead or debt to another lender.

(1) The lender may not require an owner to repay a debt owed to the lender, unless it is a debt secured by the homestead. The lender may require debt secured by the homestead or debt to another lender or creditor be paid out of the proceeds of an equity loan.

(2) An owner may apply for an equity loan for any purpose. An owner is not precluded from voluntarily using the proceeds of an equity loan to pay on a debt owed to the lender making the equity loan.

Source: *The provisions of this §153.18 adopted to be effective June 29, 2006, 31 TexReg 5080.*

§153.20. No Blanks in Any Instrument: Section 50(a)(6)(Q)(iii). A home equity loan must be made on the condition that the owner of the homestead not sign any instrument in which blanks are left to be filled in.

(1) This Section of the Constitution prohibits the owner of the homestead from signing any instrument in which blanks are "left to be filled in". This Section is intended to prohibit a person other than the owner from completing one or more blanks in an instrument after the owner has signed the instrument and delivered it to the lender, thereby altering a party's obligation created in the instrument. Not all documents or records executed in connection with an equity loan are instruments, and not all blanks contained in an instrument are "blanks that are left to be filled in" as contemplated by this Section.

(2) As used in this Section, the term instrument means a document or record that creates or alters a legal obligation of a party. A disclosure required under state or federal law is not an instrument if the disclosure does not create or alter the obligation of a party.

(3) If at the time the owner signs an instrument, a blank is completed or box checked which indicates the owner's election to select one of multiple options offered (such as an election to select a fixed rate instead of an adjustable rate) and the owner therefore by implication has excluded the non-selected options, the instrument does not contain "blanks left to be filled in" when the non-selected option is left blank.

Source: *The provisions of this §153.20 adopted to be effective June 29, 2006, 31 TexReg 5080.*

§153.22. Copies of Documents: Section 50(a)(6)(Q)(v). At closing, the lender must provide the owner with a copy of the final loan application and all executed documents that are signed by the owner at closing in connection with the equity loan. One copy of these documents may be provided to married owners. This requirement does not obligate the lender to give the owner copies of documents that were signed by the owner prior to or after closing.

Source: *The provisions of this §153.22 adopted to be effective January 8, 2004, 29 TexReg 84; amended to be effective July 10, 2008, 33 TexReg 5295.*

§153.24. Release of Lien: Section 50(a)(6)(Q)(vii). The lender must cancel and return the note to the owner and give the owner a release of lien or a copy of an endorsement and assignment of the lien to another lender refinancing the loan within a reasonable time after termination and full payment of the loan. The lender or holder, at its option, may provide the owner a release of lien or an endorsement and assignment of the lien to another lender refinancing the loan.

(1) The lender will perform these services and provide the documents required in 50(a)(6)(Q)(vii) without charge.

(2) This section does not require the lender to record or pay for the recordation of the release of lien.

(3) Thirty days is a reasonable time for the lender to perform the duties required under this section.

(4) An affidavit of lost or imaged note, or equivalent, may be returned to the owner in lieu of the original note, if the original note has been lost or imaged.

Source: *The provisions of this §153.24 adopted to be effective January 8, 2004, 29 TexReg 84.*

§153.25. Right of Rescission: Section 50(a)(6)(Q)(viii). The owner of the homestead and any spouse of the owner may, within three days after the extension of credit is made, rescind the extension of credit without penalty or charge.

(1) This provision gives the owner's spouse, who may not be in record title or have community property ownership, the right to rescind the transaction.

(2) The owner and owner's spouse may rescind the extension of credit within three calendar days. If the third calendar day falls on a Sunday or federal legal public holiday then the right of rescission is extended to the next calendar day that is not a Sunday or federal legal public holiday.

(3) A lender must comply with the provisions of the Truth-in-Lending Act permitting the borrower three business days to rescind a mortgage loan in applicable transactions. Lender compliance with the right of rescission procedures in the Truth-in-Lending Act and Regulation Z, satisfies the requirements of this section if the notices required by Truth-in-Lending and Regulation Z are given to each owner and to each owner's spouse.

Source: *The provisions of this §153.25 adopted to be effective January 8, 2004, 29 TexReg 84.*

§153.41. Refinance of a Debt Secured by a Homestead: Section 50(e). A refinance of debt secured by a homestead and described by any subsection under Subsections (a)(1)-(a)(5) of Section 50 of the Texas Constitution that includes the advance of additional funds may not be secured by a valid lien against the homestead unless: (1) the refinance of the debt is an extension of credit described by Subsection (a)(6) or (a)(7) of Section 50 of the Texas Constitution; or (2) the advance of all the additional funds is for reasonable costs necessary to refinance such debt or for a purpose described by Subsection (a)(2), (a)(3), or (a)(5) of Section 50 of the Texas Constitution.

(1) Reasonableness and necessity of costs relate to the type and amount of the costs.

(2) In a secondary mortgage loan, reasonable costs are those costs which are lawful in light of the governing or applicable law that authorizes the assessment of particular costs. In the context of other mortgage loans, reasonable costs are those costs which are lawful in light of other governing or applicable law.

(3) Reasonable and necessary costs to refinance may include reserves or impounds (escrow trust accounts) for taxes and insurance, if the reserves comply with applicable law.

Source: *The provisions of this §153.41 adopted to be effective January 8, 2004, 29 TexReg 84.*

§153.51. Consumer Disclosure: Section 50(g). An equity loan may not be closed before the 12th day after the lender provides the owner with the consumer disclosure on a separate instrument.

(1) If a lender mails the consumer disclosure to the owner, the lender shall allow a reasonable period of time for delivery. A period of three calendar days, not including Sundays and federal legal public holidays, constitutes a rebuttable presumption for sufficient mailing and delivery.

(2) Certain provisions of the consumer disclosure do not contain the exact identical language concerning requirements of the equity loan that have been used to create the substantive requirements of the loan. The consumer notice is only a summary of the owner's rights, which are governed by the substantive terms of the constitution. The substantive requirements prevail regarding a lender's responsibilities in an equity loan transaction. A lender may supplement the consumer disclosure to clarify any discrepancies or inconsistencies.

(3) A lender may rely on an established system of verifiable procedures to evidence compliance with this section.

(4) A lender whose discussions with the borrower are conducted primarily in Spanish for a closed-end loan may rely on the translation of the consumer notice developed under the requirements of Texas Finance Code, §341.502. Such notice shall be made available to the public through publication on the Finance Commission's webpage.

(5) If the owner has executed a power of attorney described by §153.15(2) of this title (relating to Location of Closing: Section 50(a)(6)(N)), then the lender may provide the consumer disclosure to the attorney-in-fact instead of providing it to the owner.

Source: *The provisions of this §153.51 adopted to be effective January 8, 2004, 29 TexReg 84; amended to be effective November 13, 2008, 33 TexReg 9074; amended to be effective January 1, 2015, 39 TexReg 10407.*

§153.82. Owner Requests for HELOC Advance: Section 50(t)(1). A home equity line of credit (HELOC) is a form of an open-end account that may be debited from time to time, under which credit may be extended from time to time and under which the owner requests advances, repays money, and reborrows money. Any owner who is also a named borrower on the HELOC may request an advance. A HELOC agreement may contain provisions that restrict which borrowers may request an advance or require all borrowers to consent to the request.

Source: *The provisions of this §153.82 adopted to be effective March 11, 2004, 29 TexReg 2306.*

§153.84. Restrictions on Devices and Methods to Obtain a HELOC Advance: Section 50(t)(3). A HELOC is a form of an open-end account that may be debited from time to time, under which credit may be extended from time to time and under which an owner is prohibited from using a credit card, debit card, or similar device, or preprinted check unsolicited by the borrower to obtain a HELOC advance.

(1) A lender may offer one or more non-prohibited devices or methods for use by the owner to request an advance. Permissible methods include contacting the lender directly for an advance, telephonic fund transfers, and electronic fund transfers. Examples of devices that are not prohibited include prearranged drafts, preprinted checks requested by the borrower, or written transfer instructions. Regardless of the permissible method or device used to obtain a HELOC advance, the amount of the advance must comply with:

(A) the advance requirements in Section 50(t)(2);

(B) the loan to value limits in Section 50(t)(5); and

(C) the debit or advance limits in Section 50(t)(6).

(2) A borrower may from time to time specifically request preprinted checks for use in obtaining a HELOC advance but may not request the lender to periodically send preprinted checks to the borrower. A borrower may use a check reorder form, which may be included with preprinted checks, as a means of requesting a specific number of preprinted checks.

(3) An owner may, but is not required to, make in-person contact with the lender to request preprinted checks or to obtain a HELOC advance.

Source: *The provisions of this §153.84 adopted to be effective March 11, 2004, 29 TexReg 2306; amended to be effective July 10, 2008, 33 TexReg 5295.*

§153.85. Time the Extension of Credit is Established: Section 50(t)(4). (a) A HELOC is a form of an open-end account that may be debited from time to time, under which credit may be extended from time to time and under which fees described in Section 50(a)(6)(E) are charged and collected only at the time the extension of credit is established and no fee is charged or collected in connection with any debit or advance.

(b) For the purpose of this section, the time the extension of credit is established for a HELOC refers to the date of closing.

Source: *The provisions of this §153.85 adopted to be effective March 11, 2004, 29 TexReg 2306.*

§153.86. Maximum Principal Amount Extended under a HELOC: Section 50(t)(5). A HELOC is a form of an open-end account that may be debited from time to time, under which credit may be extended from time to time and under which the maximum principal amount that may be extended under the account, when added to the aggregated total of the outstanding principal balances of all indebtedness secured by the homestead on the date the extension of credit is established, cannot exceed 80 percent of the fair market value of the homestead on the date the extension of credit is made.

(1) At the time the initial or subsequent advance is made, the principal amount of the advance must comply with Section 50(t)(5). The following amounts when added together must be equal to or less than 80 percent of the fair market value:

(A) the amount of the advance;

(B) the amount of the principal balance of the HELOC at the time of the advance; and

(C) the principal balance outstanding of all other debts secured by the homestead on the date of the closing of the HELOC.

(2) An advance under Section 50(t)(5) must meet the requirements of Section 50(t)(2).

(3) The maximum principal balance of the HELOC that may be outstanding at any time must be determined on the date of closing and will not change through the term of the HELOC.

(4) For purposes of calculating the limits and thresholds under Section 50(t)(5) and (6), the outstanding principal balance of all other debts secured by the homestead is the principal balance outstanding of all other debts secured by the homestead on the date of the closing of the HELOC.

Source: The provisions of this §153.86 adopted to be effective March 11, 2004, 29 TexReg 2306.

§153.87. Maximum Principal Amount of Additional Advances under a HELOC: Section 50(t)(6). A HELOC is a form of an open-end account that may be debited from time to time, under which credit may be extended from time to time and under which no additional debits or advances can be made if the total principal amount outstanding exceeds an amount equal to 50 percent of the fair market value of the homestead as determined on the date the account is established.

(1) A subsequent advance may be made only when the outstanding principal amount of the HELOC is 50 percent or less of the fair market value.

(2) A subsequent advance is prohibited if the outstanding principal amount of the HELOC exceeds 50 percent of the fair market value.

(3) If the outstanding principal amount exceeds 50 percent of the fair market value and then is repaid to an amount equal to or below the 50 percent of the fair market value, subsequent advances are permitted subject to the requirements of Section 50(t)(2) and (5).

Source: The provisions of this §153.87 adopted to be effective March 11, 2004, 29 TexReg 2306.

§153.88. Repayment Terms of a HELOC: Section 50(t)(8). (a) A HELOC is a form of an open-end account that may be debited from time to time, under which credit may be extended from time to time and under which repayment is to be made in regular periodic installments, not more often than every 14 days and not less often than monthly, beginning not later than two months from the date the extension of credit is established, and during the period during which the owner may request advances, each installment equals or exceeds the amount of accrued interest; and after the period during which the owner may request advances, installments are substantially equal.

(b) Repayment of a HELOC is not required to begin until two months after the initial advance. For example, if an advance is not made at the time of closing, the repayment period is not required to begin until after the first advance. If there is no outstanding balance, then a payment is not required.

(c) Nothing in this section prohibits a borrower from voluntarily making payments on a schedule that is more frequent or earlier than is required by a lender.

Source: The provisions of this §153.88 adopted to be effective March 11, 2004, 29 TexReg 2306.

§153.91. Adequate Notice of Failure to Comply. (a) A borrower notifies a lender or holder of its alleged failure to comply with an obligation by taking reasonable steps to notify the lender or holder of the alleged failure to comply. The notification must include a reasonable:

(1) identification of the borrower;

(2) identification of the loan; and

(3) description of the alleged failure to comply.

(b) A borrower is not required to cite in the notification the section of the Constitution that the lender or holder allegedly violated.

Source: The provisions of this §153.91 adopted to be effective November 11, 2004, 29 TexReg 10257.

§153.92. Counting the 60-Day Cure Period. (a) For purposes of Section 50(a)(6)(Q)(x), the day after the lender or holder receives the borrower's notification is day one of the 60-day period. All calendar days thereafter are counted up to day 60. If day 60 is a Sunday or federal legal public holiday, the period is extended to include the next day that is not a Sunday or federal legal public holiday.

(b) If the borrower provides the lender or holder inadequate notice, the 60-day period does not begin to run.

Source: The provisions of this §153.92 adopted to be effective November 11, 2004, 29 TexReg 10257.

§153.93. Methods of Notification. (a) At closing, the lender or holder may make a reasonably conspicuous designation in writing of the location where the borrower may deliver a written or oral notice of a violation under 50(a)(6)(Q)(x). The designation may include a mailing address, physical address, and telephone number. In addition, the lender or holder may designate an email address or other point of contact for delivery of a notice.

(b) If the lender or holder chooses to change the designated delivery location as provided in subsection (a) of this section, the address change does not become effective until the lender or holder sends conspicuous written notice of the address change to the borrower.

(c) The borrower may always deliver written notice to the registered agent of the lender or holder even if the lender or holder has named a delivery location.

(d) If the lender or holder does not designate a location where the borrower may deliver a notice of violation, the borrower may deliver the notice to any physical address or mailing address of the lender or holder.

(e) Delivery of the notice by borrower to lender or holder's designated delivery location or registered agent by certified mail return receipt or other carrier delivery receipt, signed by the lender or holder, constitutes a rebuttable presumption of receipt by the lender or holder.

(f) If the borrower opts for a location or method of delivery other than set out in subsection (e), the borrower has the burden of proving that the location and method of delivery were reasonably calculated to put the lender or holder on notice of the default.

Source: *The provisions of this §153.93 adopted to be effective March 3, 2005, 30 TexReg 1068.*

§153.94. Methods of Curing a Violation Under Section 50(a)(6)(Q)(x)(a) - (e). (a) The lender or holder may correct a failure to comply under Section 50(a)(6)(Q)(x)(a) - (e), on or before the 60th day after the lender or holder receives the notice from an owner, if the lender or holder delivers required documents, notices, acknowledgements, or pays funds by:

(1) placing in the mail, placing with other delivery carrier, or delivering in person the required documents, notices, acknowledgements, or funds;

(2) crediting the amount to borrower's account; or

(3) using any other delivery method that the borrower agrees to in writing after the lender or holder receives the notice.

(b) The lender or holder has the burden of proving compliance with this section.

Source: *The provisions of this §153.94 adopted to be effective November 11, 2004, 29 TexReg 10257.*

§153.95. Cure a Violation Under Section 50(a)(6)(Q)(x). (a) If the lender or holder timely corrects a violation of Section 50(a)(6) as provided in Section 50(a)(6)(Q)(x), then the violation does not invalidate the lien.

(b) A lender or holder who complies with Section 50(a)(6)(Q)(x) to cure a violation before receiving notice of the violation from the borrower receives the same protection as if the lender had timely cured after receiving notice.

(c) A borrower's refusal to cooperate fully with an offer that complies with Section 50(a)(6)(Q)(x) to modify or refinance an equity loan does not invalidate the lender's protection for correcting a failure to comply.

Source: *The provisions of this §153.95 adopted to be effective November 11, 2004, 29 TexReg 10257; amended to be effective November 13, 2008, 33 TexReg 9074.*

§153.96. Correcting Failures Under Section 50(a)(6)(Q)(x)(f). (a) To correct a failure to comply under Section 50(a)(6)(Q)(x)(f), on or before the 60th day after the lender or holder receives the notice from the borrower the lender or holder may:

(1) refund or credit the $1,000 to the account of the borrower; and

(2) make an offer to modify or an offer to refinance the extension of credit on the terms provided in Section 50(a)(6)(Q)(x)(f) by placing the offer in the mail, other delivery carrier, or delivering the offer in person to the owner.

(b) To correct a failure to comply under Section 50(a)(6)(Q)(x)(f):

(1) the lender or holder has the option to either refund or credit $1,000; and

(2) the lender or holder and borrower may:

(A) modify the equity loan without completing the requirements of a refinance; or

(B) refinance with an extension of credit that complies with Section 50(a)(6).

(c) The lender or holder has the burden of proving compliance with this section.

(d) After the borrower accepts an offer to modify or refinance, the lender must make a good faith attempt to modify or refinance within a reasonable time not to exceed 90 days.

Source: *The provisions of this §153.96 adopted to be effective November 11, 2004, 29 TexReg 10257.*

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CHAPTER 155 PAYOFF STATEMENTS

Subchapter A. Registration

CHAPTER 155 PAYOFF STATEMENTS

Subchapter A. Registration

§155.1. Definitions. "Home loans" has the same meaning as that found in Texas Finance Code Chapter §343.001.

Source: The provisions of this §155.1 adopted to be effective January 8, 2012, 36 TexReg 9300.

§155.2. Payoff Statement Form. (a) Requests made pursuant to this Chapter shall be in writing and submitted to a mortgage servicer by mail, electronic mail or facsimile. If the mortgage servicer has designated a specific physical address; electronic mail address; and/or a specific representative to receive requests made pursuant to this Chapter, then requests shall be submitted in accordance with such designation. Requests for a payoff statement made pursuant to this Chapter shall, at a minimum, include the following:

(1) Name of the mortgagor;

(2) Physical address of the underlying collateral of the loan, or a legal description of the property; and

(3) Proposed closing date of the loan.

(b) Upon receipt of a valid request made under Section (a) of this Chapter, a mortgage servicer shall provide, in writing, by mail or electronic mail, the payoff statement information for the home loan specified in the request which must be provided on the prescribed payoff statement form, Figure 7 TAC §155.2(c)(6), or in a substantially similar format which contains all elements not indicated as optional on the prescribed payoff statement form. The statement must include the following information:

(1) The proposed closing date for the sale or other transaction, as provided in the request made pursuant to this Chapter;

(2) The payoff amount that is valid through the proposed closing date; and

(3) Sufficient information to identify the loan for which the payoff information is provided.

(c) If applicable, the payoff statement may contain:

(1) Adjustable rate mortgage information;

(2) Per diem amount;

(3) Late harge information;

(4) Escrow disbursement information;

(5) A statement regarding which party is responsible for the release of lien; and

(6) Other information necessary to provide a clear and concise payoff statement.

Figure 7 TAC §155.2(c)(6)

PAYOFF STATEMENT FORM

Name of Mortgage Servicer
Name of Representative
Street or E-mail Address
City, State, Zip Code

REQUEST DATE:

SENT BY: ☐ Mail ☐ E-mail ☐ Facsimile

MORTGAGOR: {Primary Borrower} NEXT PAYMENT DUE DATE:

COLLATERAL: {Property Address or Legal Description} Loan Type: {optional}

THIS STATEMENT REFLECTS THE TOTAL AMOUNT DUE UNDER THE TERMS OF THE NOTE/SECURITY INSTRUMENT THROUGH THE CLOSING DATE WHICH IS {INSERT CLOSING DATE}. If this obligation is not paid in full by this date, then you should obtain from us an updated payoff amount before closing.

Total Principal, Interest, and other amounts due under the Note/Security Instrument:

Unpaid Principal Balance:	$ {INSERT AMOUNT}
Interest through {insert good through date}	$ {INSERT AMOUNT}
Less Reductions in amount due	$ {INSERT AMOUNT}
{INSERT DESCRIPTION}	$ {INSERT AMOUNT}
{INSERT DESCRIPTION}	$ {INSERT AMOUNT}
{INSERT DESCRIPTION}	$ {INSERT AMOUNT}
{INSERT DESCRIPTION}	$ {INSERT AMOUNT}
TOTAL AMOUNT DUE:	$ {INSERT AMOUNT}

Beneficiary Name:
Beneficiary/Receiving Bank:
Beneficiary Bank ABA:
Beneficiary Bank Account:
Special Information to Beneficiary:
{Inc. ODI Text Information required}

{Attention}
{Name of Company}
{Street Address}
{City, State, Zip Code}

LEGAL NOTICES

TEXAS FINANCE CODE § 343.106 REQUIRES PAYOFF STATEMENT CONTAIN CLOSING DATE AND DATE THROUGH WHICH PAYOFF AMOUNT IS VALID. THESE REQUIREMENTS CANNOT BE DELETED FROM PAYOFF STATEMENT.

TEXAS FINANCE CODE § 343.106 REQUIRES THE IMPLEMENTING RULE TO ALLOW MORTGAGE SERVICERS AT LEAST SEVEN (7) BUSINESS DAYS FROM THE DATE OF RECEIPT OF PAYOFF REQUEST TO RESPOND TO A REQUEST MADE UNDER THE STATUTE.

ANY AMOUNT HELD IN ESCROW AT CLOSING WILL BE SETTLED IN ACCORDANCE WITH APPLICABLE FEDERAL LAW.

OPTIONAL SECTIONS		
{This is an Adjustable Rate Mortgage. Under the terms of this loan the next Change Date for the interest rate charged is {Insert Next Rate Change Date}. We will only issue a payoff good through the next Change Date. If the closing date is past the next Change Date an updated Payoff Statement from us will be required.}		
{If loan has quotable per diem interest, then "Funds received after {insert good through date} will be subject to an additional ${Insert Per Diem Amount} of interest per day."} FUNDS MUST BE RECEIVED BY {INSERT POSTING CUT OFF TIME} FOR SAME-DAY PROCESSING. PAYOFFS ARE NOT POSTED ON WEEKENDS OR HOLIDAYS. INTEREST WILL BE ADDED TO THE ACCOUNT FOR THESE DAYS.		
NOTE: This Note/Security Instrument is due for payment on {Insert Next Due Date}. If payment is not received within {Insert number of days} of the current payment due date, a late charge of ${insert amount} will be assessed. Please add that amount to the payoff total.		
Escrow Disbursement Amounts & Dates:		
{Insert Description}	${Insert Amount Held}	{Insert Next Disbursement Date}
{Insert Description}	${Insert Amount Held}	{Insert Next Disbursement Date}
{Insert Description}	${Insert Amount Held}	{Insert Next Disbursement Date}
Release of Lien Processing:		
{Provide the Servicer's practice regarding releases (i.e. The Servicer will prepare the release of lien; the title company must prepare the release of lien. The release is mailed to the county, borrower, or Title Company for recording)}		

Source: The provisions of this §155.2 adopted to be effective January 8, 2012, 36 TexReg 9300.

§155.3. Time of Delivery of Payoff Statement. A mortgage servicer shall deliver a payoff statement required under§155.2 to the title company by the eighth business day after the date the request is received unless federal law requires a shorter response time.

Source: The provisions of this §155.3 adopted to be effective January 8, 2012, 36 TexReg 9300.

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SUBJECT INDEX TO SELECTED LEGAL OPINIONS

The Department of Banking selected the opinions included in this resource manual based on an assessment of usefulness for general guidance. Formerly included opinions that do not appear in this manual were omitted for the same reason. Lack of continuing usefulness primarily relates to changes in current law.

The Department edited the included opinions to clearly indicate location of existing law and to reference subsequent events that impact the statements made without rendering the statements obsolete. The Department attempted to capture the meaning of each opinion as it relates to current state law while preserving the original text to the maximum extent possible. Copies of the original opinion are available if more exacting research is required.

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NUMERICAL LIST OF SELECTED LEGAL OPINIONS

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TEXAS DEPARTMENT OF BANKING
SELECTED LEGAL OPINIONS

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Opinion No. 86-1

A bank director's secured guaranty given in connection with a third party debt does not cause the debt to be attributed to the director for legal lending limit purposes if the bank is relying on the primary obligor's creditworthiness for repayment of loan.

April 9, 1986
Hubert Bell, Jr., Assistant General Counsel

Your letter of April 2, 1986, concerning a legal lending limit matter, has been referred to me for response. In your letter you state the following:

> We have a request from a customer for a $300,000 loan which is to be secured by the Collateral Assignment of a first lien real estate note, which note happens to have been executed by one of our Directors, [*****]. [*****]'s holding company also owns 100% of the stock of this bank.
>
> The proceeds of this loan will go directly to our borrower, who is a very credit-worthy individual with a very liquid financial statement in excess of $1,000,000 and no debts.
>
> We would very much like to make this loan; however, the question that we pose to you for a ruling is whether or not the amount borrowed would in any way affect the legal loan limit of [*****].

Although the proposed loan transaction you present is to be secured by the assignment of a first lien real estate note, the situation is analogous to one in which a guaranty is given by a third party as added security for a loan. In my opinion, Department lending limit rule 12.2 [*now 7 TAC §12.9*] under the definition of "Liability of Guarantors and Accommodation Parties," would apply to the loan transaction you proposed. Since you state that the primary obligor is "a very credit-worthy individual" and therefore I presume the bank is relying upon this individual (rather than [*****]) for repayment of the loan, I suggest that the bank follow the certification requirement contained in the above referenced section of [*7 TAC §12.9*]. You also state that the loan proceeds will be received by the borrower, thereby negating any possibility that [*****] will receive a "direct benefit" from the loan.

Based on the facts presented, the proposed $300,000 loan would not be attributable to [*****] for lending limit purposes. However, since there is a possibility that at some point, in the event of default, the bank may be looking to [*****] for repayment of the loan, I also refer you to Chapter 5, Article 9 of the Texas Banking Code [*now Finance Code §33.109*] for compliance with this statutory provision.

Opinion No. 86-2

The amount subject to legal lending limits after exclusion of the exception for indebtedness fully secured by a segregated deposit account depends on whether the security agreement is "all inclusive."

May 14, 1986
Hubert Bell, Jr., Assistant General Counsel

Your letter of May 8, 1986, concerning a legal loan limit matter has been referred to me for response.

Your letter requested an interpretation of the legal loan limit exception involving indebtedness fully secured by a segregated deposit account. If your bank utilizes an "all inclusive" security agreement the pledged deposit account would be subtracted from the aggregate debt relationship. An example would be as follows:

$100,000	Secured by a $125,000 segregated deposit account
50,000	Unsecured
10,000	Secured by vehicle
$160,000	
(125,000)	Less segregated deposit account
$35,000	Amount applicable to legal loan limit

If your bank does not use the aforementioned security agreement, the segregated deposit would only be "netted" against that loan in which it is securing. An example using the same number above would be as follows:

$100,000	Secured by a $125,000 segregated deposit account
50,000	Unsecured
10,000	Secured by vehicle
$160,000	
(100,000)	Less loan secured by a segregated deposit account
$60,000	Amount applicable to legal limit

Opinion No. 87-1

Collateral assignment of note given by individual is aggregated to the individual for legal lending limit purposes if the note serves as any part of the necessary security (Debt of B to A, taken by bank as collateral for loan to A, can cause the A loan to be attributed to B, if the collateral is necessary for loan to A).

July 16, 1987
Hubert Bell, Jr., Assistant General Counsel

The following is in response to your letter of July 8, 1987, requesting an interpretation of the lending limit statute. In your letter, you set forth the following:

> "[Person A] has applied for a loan of $150,000.00 and has offer[ed] as security a note that he carries for [Person B] on a farm that [Person A] sold to [Person B] several years ago. The proceeds of the $150,000.00 loan will be used to pay off an unsecured loan owed to a Dallas bank by [Person A].
>
> "It so happens that [Person B] is also a borrower of our bank. He has two loans, one on a dwelling and the other on cattle located in this area and not on the farm purchased from [Person A].
>
> "The question is whether or not the $150,000.00 loan to [Person A] would have to be added to the two loans previously made to [Person B] in order to arrive at a loan limit for [Person B]? ([Person B] would be over the loan limit if the total loans were combined, not [Person A])."

If [Person B's] note serves as necessary security, in total or for any part, of the loan to [Person A], then in my opinion, a lending limit violation would be created. If, instead, [Person B's] note was only additional or supplemental security for the loan and the credit file clearly and unquestionably so evidenced such fact, then I think the additional collateral could be viewed in the same manner as an accommodation guaranty. (Accommodation guaranties are discussed in Department of Banking Rule 12.2 [*now 7 TAC §12.9(g)*]). As in the case of an accommodation guaranty, a bank official would need to certify to these facts. The credit file should contain said certification and the file indisputably show that the loan would have been made even in the absence of obtaining the "additional" collateral. Otherwise, the loans would be combined for lending limit purposes.

Opinion No. 87-2

A participation interest sold in a standby letter of credit is exempt from legal lending limits.

July 20, 1987
Hubert Bell, Jr., Assistant General Counsel

Your letter of July 2, 1987, concerning the applicability of the lending limit statute to a standby letter of credit has been referred to me for response. In the case you present, a written participation is in place that is at least equivalent in amount to any overline created by the standby letter.

It is my understanding that the participations referenced in your letter are all without recourse against [*****] Bank. I am aware of no prohibition that would prevent a bank from selling a participation interest in a standby letter of credit in the same manner it would sell a participation interest in an ordinary loan. In my opinion, a written enforceable participation agreement wherein an interest in a standby letter of credit is sold would have the effect of excluding the amount of such participation from a bank's lending limit.

Opinion No. 87-3

An overdraft can cause the total extensions of credit to exceed legal lending limits.

December 15, 1987
Hubert Bell, Jr., Assistant General Counsel

Your letter of November 20, 1987, concerning a lending limit question has been referred to me for response. Your questions surround the following facts or hypothesis:

> Charlie Borrower, dba Charlie Borrower Motor Company has a loan as Charlie Borrower Motor Company, he has a loan as Charlie and Jane Borrower and also a small personal loan.
>
> Charlie Borrower, dba Charlie Borrower Motor Company has an overdraft which causes loan limit of Charlie Borrower Motor Company to exceed the loan limit of the bank in Charlie Borrower Motor Company account.

I assume that Charlie Borrower Motor Company is a sole proprietorship, or if it's a corporation then I assume it represents Charlie Borrower's expected source of repayment of the loans involved.

First, pursuant to Department of Banking Rule 12.2 [*now 7 TAC §12.3(a)(1)*], unless an overdraft is an "intra-day" or "daylight" overdraft, it is considered as a loan or extension of credit for lending limit purposes. Intra-day or daylight overdrafts are excluded from this definition. Thus, no overline is created by overdrafts of this nature.

Based on the previously stated assumptions, the three loans to the Borrowers would be combined for lending limit purposes. Thus, in response to your specific question, yes, they would be "tied" to "make one line."

If the overdraft caused the total extensions of credit to Borrower to exceed the bank's lending limit the infraction could be brought into conformance by the borrower reducing the line to an amount within the bank's lending limit. The bank could also participate the excess to another institution. Although the violation would be addressed by such action, the question of potential director liability would remain. I understand one of your questions to be whether all three loans must be fully repaid before the potential liability is extinguished.

The general answer to this question is not necessarily [sic]; the specific answer, however, depends on a number of factors that must be considered, including the following:

1. The bank's past record with regards to lending limit violations;

2. Whether the facts surrounding the transaction reveal that the lending violation occurred in a knowing, intentional or blatant manner with disregard to applicable laws;

3. The inter-relationship between the different lines of credit, i.e. inter-dependent or inter-related business ventures;

4. The established repayment schedule of all loans in question and the actual payment history; and

5. The existence, or lack thereof, of a particular business reason for the established repayment schedules and/or the underlying purpose of any efforts to have the Borrowers change or deviate from said schedule.

Opinion No. 88-1

Loans to a trust are not aggregated to the trustee for legal lending limit purposes.

April 6, 1988
Hubert Bell, Jr., Assistant General Counsel

Your letter of March 1, 1988, concerning Article 342-507 of the Texas Banking Code [*now Finance Code §34.201*] has been referred to me for response.

Based on our conversation, I understand that the trust instrument expressly provides that the trustee is not personally liable for obligations incurred by the trust. I further understand that the business activities engaged in by the trust and the other business ventures engaged in by the trustee, in his personal capacity, are not related, nor are the entities in any way financially interdependent.

In my opinion, loans to the trust will not be combined with the trustee's other independent borrowings from the bank when the trustee is acting in his fiduciary capacity.

Opinion No. 88-2

Use of a surrogate borrower will not evade attribution to the actual borrower for legal lending limit purposes.

April 29, 1988
Hubert Bell, Jr., Assistant General Counsel

This is in response to your request for an interpretation of the Department's lending limit regulations. Please excuse the delay in my response.

I will not restate the facts set forth in your letter. However, in summary, the question presented is whether a loan made to a joint venture for the purchase of an office building will be attributed to another bank customer who subsequently purchased the building from the joint venture.

Ordinarily, one would not expect lending limit rules to result in any form of restraint on the alienation of property, nor should they have such effect. It appears that the bank was aware [*****], its customer, would be the ultimate purchaser and user of the office complex purchased by the joint venture. He would also represent the source of repayment of the loan. Further it appears that the transaction between the bank and the joint venture was structured with this result in mind. Thus, the transaction has the appearance of circumvention; although, based on our discussions, I don't think this was the bank's intent. Direct financing of the complex by the bank for [*****] would have resulted in a lending limit violation. The joint venture purchased the complex which was financed by the bank and on the same, or the next, day the building was sold to [*****]. Also, [*****] makes his payments on the complex directly to the bank. These facts make it appear that the joint venture was acting as a surrogate.

Based on the facts of this particular transaction as I understand them, it is my opinion, at this time, that [*****] received the direct benefit, as well as represented the primary source of repayment, of the bank's loan to the joint venture, and thus the loan would be attributed to him. This opinion is subject to modification if there are other facts that may shed a different light on the transaction and its economic substance, or if my understanding of the facts is inaccurate. Otherwise, the bank should seek the least onerous means by which to correct the violation.

Opinion No. 89-1

Loans secured by letters of credit are not aggregated to the issuer of the letters of credit for legal lending limit purposes.

June 26, 1989
Cynthia N. Milne, Assistant General Counsel

Your letter of May 2, 1989, has been referred to me for response. You have asked whether loans to customers made on the basis of Letters of Credit to the customer from third parties constitute loans for the purposes of Article 342-507 of the Texas Banking Code [*now Finance Code §34.201*].

Pursuant to our telephone conversation of June 13, 1989, it is my understanding that the customer is obligated in all circumstances to repay any funds proffered to him by the Bank. The Letters of Credit from the third parties are considered by the Bank as collateral only. Additionally, the customer must perform an obligation to the third party in order to cause the third party to honor its Letter of Credit. The third party issuer of the Letter of Credit is in no way obligated to repay the funds to the Bank. On these facts, the transaction would qualify as a loan or extension of credit to the customer pursuant to 342-507(a)(1) [*now Texas Finance Code §31.002(a)(34)*] and the Regulations thereto, 7 TAC 12.2 [*now 7 TAC §12.3*], and would be considered against the Bank's lending limits.

Opinion No. 89-2

To qualify for the legal lending limit exception, a segregated deposit account securing a loan must be in the lending bank.

October 17, 1989
Cynthia N. Milne, Assistant Attorney General

By letter of September 1, 1989, you requested a legal opinion regarding the above referenced examination. By telephone conversation with you, I understand that you are seeking the opinion only in regard to the legal lending limit violation discussed in No. 3 of your letter to the Commissioner dated July 21, 1989.

The issue is whether a deposit of less than $100,000 with banks who are FDIC insured constitutes an acceptable security to offset a loan above the originating bank's legal lending limit. The controlling statutory provision is Article 342-507(b)(11) of the Texas Banking Code [*now Finance Code §34.201(a)(10)*], which allows the bank to make loans to an individual above the legal lending limit if the indebtedness is fully secured by a segregated deposit account <u>in the lending bank</u>. [*Finance Code §34.201(a)(10)*] does not provide for a segregated deposit in another bank, which is what [*****] Bank chose to do in this instance. It is a principal of statutory interpretation that the intent of the legislature will be constructed from the law as written. *Young v. Del Mar Homes, Inc.*, 608 S.W. 804, 807 (Tex. Civ. App. – Houston [14th Dist.] 1980, writ ref'd n.r.e.). The Department is therefore confined to the language of the statute and is not authorized to extend its interpretation to include segregated deposits at other banks.[1]

In support of [*****] Bank's action, you cite Article 342-507(b)(10) of the Texas Banking Code [*now Finance Code §34.201(a)(8). Text of current Finance Code §34.201(a)(8) is substituted:*]:

[1] *The Finance Commission has specific authority to create additional exceptions but has not adopted an exception applicable to this situation. Finance Code §34.201(b)(2).*

the portion of an indebtedness that this state, an agency or political subdivision of this state, the United States, or an instrumentality of the United States has unconditionally agreed to repay, purchase, insure, or guarantee

[*Finance Code §34.201(a)(8)*] contemplates direct indebtedness of the United States secured by U.S. Treasury notes or other obligations guaranteed by the United States or its agencies or instrumentalities, e.g., the 90% guarantee available for Small Business Administration loans. FDIC insurance does not constitute a direct indebtedness of the United States. Rather, it is an insurance program, which is funded by the insured banks. See 12 USC §1817. An additional consideration must be made from a safety and soundness viewpoint. There is no guarantee that the deposit at another bank is or will remain the only deposit of the borrower, so that the total deposit might exceed FDIC insurance to the detriment of [*****] Bank.

Opinion No. 89-3
Value behind drafts must be verified to qualify for "bill of lading" exception to legal lending limits.

October 27, 1989
Ann Graham, General Counsel

By letter dated September 20, 1989, you have asked whether certain transactions you describe will qualify for the exception to the legal lending limit provided by Article 342-507 [*now Finance Code §34.201(a)(3); current text substituted*] for

(3) indebtedness secured by a bill of lading, warehouse receipt, or similar document transferring or securing title to readily marketable goods, except that:
(A) the goods must be insured if it is customary to insure those goods; and
(B) the aggregate indebtedness of a person under this subdivision may not exceed an amount equal to 50 percent of the lesser of the bank's capital and certified surplus or the bank's total equity capital " [*also see 7 TAC §12.5(b)*]

Your question is whether it is sufficient to verify the funds at the bank where the draft is to be paid and maintain a copy of the draft and shipper orders. The answer is no. The bank must also be able to establish that the drafts are drawn against actually existing values (meaning that the value of the goods supports the draft) and secured by a lien upon the goods in transit. You should also be advised that verification of available funds at the other bank at a given point in time is no assurance of final payment to your bank. Even transactions of this type which do meet all the technical requirements for exemption are not without risk and should be monitored carefully by your bank and by the bank examiners for safety and soundness purposes.

Opinion No. 91-1
Loans to law firm clients are attributed to the general partners of the law firm that guaranteed the loans for legal lending limit purposes.

January 25, 1991
Cynthia N. Milne, Assistant General Counsel

Thank you for your letter of January 8, 1991 concerning possible attribution of loans to a Director or his law partner and loans to the firm's clients. I will rely on the facts as set forth in your letter, except to note that you have identified the Director as [*****].

The law firm acts as guarantor of the loans made by the Bank to the clients. The loans will be paid back by the client only if a sufficient recovery is made by the firm on the client's personal injury claim. The Bank is therefore not relying on the credit worthiness of the primary obligor for repayment of the loan, as required by Rule 12.2 [*7 TAC §12.9(g)*]. Consequently, we look to the tests set forth in Rule 12.4 [*7 TAC §12.9(a)*] to determine if the loans to either of the partners should be combined with the client loans for purposes of the lending limit calculation. Since the earnings of the law firm will be used for repayment of loans to the general partners and potentially for the repayment of the client loans, the source of repayment test is met and the loans would be combined for lending limit calculations.

Please note that this reply is based on the facts as set forth above and in your letter of January 8, 1991, and any change in those facts could result in a different response.

Opinion No. 91-2
Interim construction loans, subject to FmHA purchase obligations, are not subject to legal lending limits.

April 19, 1991
Larry A. Chilton, Departmental Examiner

This letter is in response to your inquiry as to the application of Article 342-507(b)(8) of the Texas Banking Code [*Finance Code §34.201(a)(8)*] to interim construction loans made by your bank, from time to time, which are subject to purchase obligations of the Farmers Home Administration (FmHA). Our review of this matter has been limited to sample correspondence from a standard form used by FmHA, as well as telephone discussions with FmHA regional office staff.

Based upon this review, it appears that FmHA is obligated to purchase from the bank and provide permanent financing for approved loans subject to certain conditions. Such conditions, however, are not unlike those contained in loan guaranty documents used in FmHA, FHA, SBA, and other similar government programs.

Consequently, such interim construction loans subject to all requirements of FmHA may be excluded from the limitation of [*Finance Code §34.201(a)*]. Nevertheless, the bank's documentation and handling of such loans will be reviewed during the course of examinations to ensure that all conditions imposed by FmHA are being fully satisfied. Furthermore, notwithstanding the exclusion from the statutory lending limitation, undue concentrations in such lending should be avoided.

Opinion No. 91-3
Loan's discounted purchase price, not face amount, is the measurement of the loan amount for legal lending limit purposes.

August 27, 1991
Ann Graham, General Counsel

By letter dated August 20, 1991, you have inquired about the application of the legal lending limit prescribed by Texas Banking Code Article 342-507 [*now Finance Code §34.201*] to the situation in which the bank purchases a loan with a face value greater than the bank's lending limit for a discounted purchase price less than the bank's lending limit. In that circumstance, our examiners would look to the amount actually expended by the bank to acquire the loan. If the discounted purchase price is within the bank's lending limit, there will be no violation.

As always, however, the bank must not neglect a thorough credit analysis. Loans which do not violate the lending limit may nonetheless be criticized if they represent imprudent credit decisions or poor documentation.

Opinion No. 92-1
A bank can pledge assets to secure deposits of a bankruptcy trustee.

November 2, 1992
Ann Graham, General Counsel

By letter dated September 2, 1992, you have requested an opinion from the Texas Department of Banking on the issue of whether Texas state-chartered banks are permitted to pledge assets to secure deposits of bankruptcy estate funds by a trustee in bankruptcy. The answer to this question depends upon an interpretation of Texas Banking Code Article 342-603 [*now Finance Code §34.304, current text substituted*] which provides that:

> *(a) A state bank may not create a lien on its assets or secure the repayment of a deposit except as authorized or required by this section, rules adopted under this subtitle, or other law.*

(b) A state bank may pledge its assets to secure a deposit of this state, an agency or political subdivision of this state, the United States, or an instrumentality of the United States.

(c) This section does not prohibit the pledge of assets to secure the repayment of money borrowed or the purchase of excess deposit insurance from a private insurance company.

(d) An act, deed, conveyance, pledge, or contract in violation of this section is void.

We have determined that, while state-chartered banks are generally prohibited from pledging assets to secure private deposits, [*Finance Code §34.304*] does not prohibit a Texas state-chartered bank from pledging assets to secured deposits of bankruptcy estate funds by a trustee in bankruptcy. In reaching this determination, we have given particular attention and weight to the role of the bankruptcy trustee as an officer of the court and not a private person. *Matter of Topco, Inc.*, 894 F. 2d 727 (5th Cir. 1990), reh'g denied 902 F. 2d 955; *Matter of Evangeline Refining Co.*, 890 F. 2d 1312 (5th Cir. 1989). We also note that national banks are permitted to pledge assets to secure deposits of bankruptcy estate funds by a bankruptcy trustee. See the OCC opinion letter dated August 16, 1988 from Mary Wheat, Senior Attorney, OCC Midwestern District, to John C. Cozad.

Opinion No. 93-1

A state bank may provide archive management services to other community banks, directly or through a subsidiary.

January 11, 1993
Ann Graham, General Counsel

By letter dated January 5, 1993, you have asked whether state-chartered banks may offer archive management as a service to community banks. Archive management includes off premises storage of records and documents for the participating banks and their customers. The service also includes backup copies (microfiche or optical disk) for disaster recovery purposes, document destruction at predetermined dates and timely document retrieval. It is our understanding that you intend to offer this service through a subsidiary of the bank because of profitability accounting and liability concerns.

The Banking Department is of the opinion that the archive management service described is within the incidental powers provided by Texas Banking Code Article 342-301 [*now Finance Code §32.001(b)(1)*]. This opinion is limited to the parties and the facts set forth in this letter. Any change could result in a different legal conclusion.

Opinion No. 94-15

Corporate loans may be attributed to guaranteeing shareholders for legal lending limit purposes, and partnership loans will usually be attributed to partners.

May 10, 1994
Brian R. Herrick, Assistant General Counsel

I have reviewed your letter, dated April 15, 1994, wherein you requested a legal lending limit opinion regarding the aggregation rules under Article 342-507 of the Texas Banking Code [*now Finance Code §34.201*], TEX. REV. CIV. STAT. ANN arts. 342-101 et seq. (the "Banking Code") [*now Finance Code, Title 3, Subtitle A*], and have determined that the loans to the corporation would be aggregated with the loans to its principal shareholders, for the reasons set forth below. The loan to the partnership also would be attributed to and aggregated with other loans to the individual partners.

The facts, as you have described them to me are as follows. The Bank has a $700,000 outstanding interim construction loan commitment to [*****] Properties, Inc. (the "Corporation"). The Corporation is owned equally by [Person A] and [Person B]. The funds will be used to construct an office building, which will be leased to [*****], Inc.(the "Lessee"). The Bank also has committed to lend the Corporation funds for a permanent loan with a ten-year term with respect to the same building. The Bank maintains financial information on the Lessee and has relied principally on the Lessee's financial stability and strength in making its credit decision. The Bank has taken as collateral an assignment of the ten-year lease between the Corporation and Lessee. Both [Person A] and [Person B] have personally guaranteed repayment of the Corporation's debt. I have assumed that neither [Person A] nor [Person B] owns or has an interest in the Lessee, directly or indirectly.

[Person A], who owns 50% of the stock of the Corporation, has approached the Bank with a request for a $250,000 loan to a general partnership, [*****] (the "Partnership"), in which he owns a 50% interest. The Partnership operates a wholesale nursery business. Because of the nature of the loan to the Partnership, however, the Bank will be relying primarily on the financial strength and creditworthiness of [Person A]. [Person B] owns no interest in the Partnership.

As you are aware, the total loans and extensions of credit outstanding at any one time by a state bank to a person may not exceed 25% of the bank's capital and certified surplus. The term "loans and extensions of credit" is defined in Article 342-507(a)(1) [*now Finance Code §31.002(a)(34)*] as "advances of funds to a person that are made on the basis of an obligation of the person to repay the funds or that are repayable from specific property pledged by or on behalf of the person . . ." [Person A], the Corporation, and the Partnership would all be persons, as that term is used in [*Finance Code §31.002(a)(34)*].

Under 7 TAC §12.4 [*now 7 TAC §12.9(a)*], loans to one person may be combined with loans to other persons for purposes of [*Finance Code §34.201*] when:

> (1) the proceeds of the loans . . . are to be used for the direct benefit of the other person ...; or
> (2) the expected source of repayment for each loan ... is the same ....

The specific provision dealing with loans to a corporation and its owner or subsidiary, 7 TAC §12.4(c) [*now 7 TAC §12.9(e)*], defines a subsidiary as a corporation more than 50% of which is owned directly or indirectly by any person. Therefore, a corporation can be a subsidiary of an individual if the individual owns or controls more than 50% of the voting stock of the corporation. Under those circumstances, loans to a person and its subsidiary corporations may be combined for legal lending limit purposes, but need not be combined unless they meet one of the two tests outlined above.

In this instance, [Person A] owns 50% of the voting stock of the Corporation. Thus, the Corporation is not a subsidiary of [Person A] and the Corporation's loans will not be attributed to and combined with loans to [Person A] under [*7 TAC §12.9*].

The guarantee of the Corporation's debt by [Persons A & B], however, presents a different question. Pursuant to 7 TAC §12.2 [now *7 TAC §12.9(g)*], the term "loans and extensions of credit," as used in [*Finance Code §34.201*], does not include liability as a guarantor, provided the bank is relying primarily on the creditworthiness of the primary obligor. Although, in your letter, you do not directly address the reliance issue, I was left with the impression that the guarantees were required because the Corporation has no assets other than the building and the individual investors would have had no personal liability because of the corporate structure of the business. It appears as though the Bank has placed a significant amount of reliance on the guarantees in its decision to make the loan to the Corporation. Therefore, in view of the Bank's reliance on the guarantees inferred from your letter, the liability of [Persons A & B] as guarantors will be treated as "loans or extensions of credit" to them for purposes of [*Finance Code §34.201*].

The aggregation and attribution rules for loans to a partnership, for purposes of legal lending limit, are addressed in 7 TAC §12.4(d) [*now 7 TAC §12.9(f)*]. A loan to the Partnership would be attributed to and aggregated with loans to [Person A], because, under the laws of the State of Texas, [Person A] would be personally liable for the debts and obligations of the Partnership.

Assuming both loans are totally funded, the total amount of loans outstanding [Person A], for legal lending limit purposes, would be $950,000, and the total outstanding to [Person B] for legal lending limit purposes would be $700,000.

This opinion is limited strictly to the facts and circumstances set forth herein and in your letter, dated April 15, 1994. Any change in those facts or circumstances, or the parties involved, may yield a different opinion.

Opinion No. 94-17

A state bank may use an assumed name under certain circumstances.

July 12, 1994
Everette D. Jobe, General Counsel

By letter dated June 10, 1994, as a supplement to your letter dated April 22, 1994, you requested our views regarding the use of the assumed name "[*****] Mortgage" by the Bank to identify its mortgage banking business at a location other than the Bank's domicile or an approved branch facility. You previously stated that no Bank lending or depository services would be available at the offices of [*****] Mortgage, and your recent letter clarified that the services offered at the offices of [*****] Mortgage would be limited to and comply in all respects with the requirements of 7 TAC §3.93 (repealed), our rule regarding loan production offices. You state that the statements regarding lending practices at the proposed facility contained in your letter dated May 13, 1994 were based on erroneous information.

By telephone conversation on July 12th, you clarified how the assumed name would be used. The assumed name will be used on signage, brochures and other advertising as a marketing tool and to discourage Bank customers from attempting to deposit funds at the [*****] Mortgage facility. All loan documentation, including the application, will refer solely to the Bank and not to [*****] Mortgage.

Based on your representations, in our view the Bank may use the assumed name "[*****] Mortgage" for the facility as proposed. As you noted, prior notice of intent to establish a loan production office is required under 7 TAC §3.93 [*now 7 TAC §3.91*], although our position is that the 60 day waiting period may be waived upon request if we have no regulatory concerns.

A loan production office must be operated in compliance with [*7 TAC §3.91*], and the Bank may expect the Department to verify compliance by appropriate examination procedures. As to the use of an assumed name, the Bank is expected to comply with TEX. BUS. & COM. CODE §§36.01 et seq., the Assumed Business and Professional Name Act.

Opinion No. 94-19

Although a state bank generally can sell loan participations to a buyer other than a banking organization, such sales raise material safety and soundness concerns.

May 26, 1994
Everette D. Jobe, General Counsel

You ask whether a state bank can sell loan participations to a buyer other than a banking organization. In general, the answer is yes. However, while no law or regulation prohibits the sale of a loan participation to an individual or company which is not a financial institution, the Department discourages such sales based on safety and soundness concerns.

A loan participation may be considered a security under state and federal law. A bank therefore must assure itself that an exemption is available from securities law registration requirements, and be aware of its obligation to provide full and fair disclosure of all information material to an investment decision. These "security" considerations lead to two problems.

First, individuals and private companies may tend to place undue reliance upon the decision of the bank to grant the loan and conclude that the investment is a quality, collectible credit, even in the face of disclosures and contractual stipulations providing that the bank makes no guarantee as to the credit quality or collectibility of the loan. A loss could result in an image problem for the bank in the community.

Second, the bank would have to disclose potentially sensitive financial information on the borrower that otherwise may not be available to the individual or company. The bank could have liability exposure to the borrower if information disclosed to the individual or company buying the participation is used by the buyer as a basis to harm the borrower, e.g., denial of goods or services from the buyer to the borrower that are essential for the borrower's business.

The preceding discussion is not intended to be exhaustive but serves only as a reminder of the significant business risks inherent in a transaction of the type you describe. The Department strongly encourages you to sell loan participations only to those companies that are in the business of lending as part of their normal business operations.

Opinion No. 94-43

Acquisition loans for a controlling interest, made to employee ownership plans but not to individual borrowers, must be aggregated for legal lending limit purposes.

September 26, 1994
Everette D. Jobe, General Counsel

By letter dated August 23rd, you requested our views regarding application of legal lending limit analysis to certain loans secured by and purchases of stock in [*****] Loan & Building Association (the "Association"), in connection with the conversion of the Association from a mutual to a stock association. This letter will confirm our telephone conversations in which we resolved your concerns prior to the anticipated closing on September 23, 1994.

You stated that the [*****] State Bank (the "Bank") had committed to loan $1,270,000 to the Association's Employee Stock Option Plan ("ESOP") and Recognition and Retention Plan Trust ("RRPT") for the purchase of Association stock. The Bank also anticipated loan applications from individuals in the community for the purpose of purchasing Association stock. By telephone, you further stated that the Bank will be looking to individual borrowers for repayment of any stock loans, although the stock will be held by the Bank as collateral, and all borrowers of stock loans will collectively own less than 50 percent of the Association, thereby avoiding the aggregation rule of 12 TAC §12.4(b) [*now 7 TAC §12.9(c)(1)(B)*], and are not otherwise related as described in 7 TAC §12.4(c) and (d) [*now 7 TAC §12.9(e) and (f)*].

Finally, you indicated that [*****], Inc., the Bank's parent bank holding company, intended to purchase up to 40,000 shares of Association stock for its own account at a price of $10.00 per share. However, in our view, the outright purchase of Association stock by the Bank's holding company should not be considered part of the legal lending limit analysis unless the bank holding company is also borrowing from the Bank to acquire the funds for investment.

We conclude that loans to the ESOP and RRPT, as Association employee compensation devices, should be aggregated, but that loans to the ESOP, the RRPT, and individual borrowers should not be aggregated for legal lending limit purposes unless the total amount of stock owned by these borrowers after the transaction will comprise over 50% of the Association's outstanding stock, which you have represented is not the case.

For purposes of this opinion, we assume as you have represented that individual borrowers of loans to acquire Association stock will not be related to each other in such a manner to invite aggregation of their loans pursuant to [*7 TAC §12.9(e) and (f)*].

Opinion No. 94-60

Loans guaranteed by the Export-Import Bank under its *Medium-Term Export Guarantee Program* are exempt from legal lending limits.

January 5, 1995
Brian R. Herrick, Assistant General Counsel

In accordance with your request, I have reviewed the materials you provided regarding loans guaranteed by the Export-Import Bank of the United States (the "Eximbank") under its medium-term export guarantee program and researched the issue as to whether such loans would be excepted from the legal lending limit restrictions under subsection (b)(8) of TEX. REV. CIV. STAT. ANN. art. 342-507 [*now Finance Code §34.201(a)(8)*]. We have come to the conclusion that the exception would apply. Therefore, any loan guaranteed under that program would not be subject to the single borrower lending restrictions of [*Finance Code §34.201(a)*].

The total loans and extensions of credit outstanding at any one time by a state bank to a person may not exceed 25% of the bank's capital and certified surplus.[1] The term "loans and extensions of credit" is defined in article 342-507(a)(1) [*now Finance Code §31.002(a)(34)*] as "advances of funds to a person that are made on the basis of an obligation of the person to repay the funds or that are repayable from specific property pledged by or on behalf of the person." Clearly, the exporter borrowing the funds is considered a person for purposes of [*Finance Code §31.002(a)(34)*]. Therefore, absent a specific exclusion, loans from a state-chartered bank to an exporter guaranteed by the Eximbank would be subject to the legal lending limit set forth in [*Finance Code §34.201(a)*].

As you are aware, certain classes of loans or obligations are excluded from the limitation on total loans and extensions of credit to a single borrower. Pursuant to [*Finance Code §34.201(a)(8)*], the legal lending limit does not apply to any portion of any indebtedness "unconditionally guaranteed" as to payment of both principal and interest by the United States government, or an agency or instrumentality thereof.[2] In this case, the loans will be directly guaranteed by the Eximbank.

The Eximbank is an independent corporate agency of the United States empowered to provide guarantees, insurance, and extensions of credit to aid in the financing of imports and exports. 12 USC §635(b)(1)(A). Contractual liabilities of the Eximbank incurred pursuant to the authority of its governing statute, 12 USC §635, constitute full faith and credit obligations of the United States. 42 Op. Att'y Gen. 327 (1966).

As I understand it, the medium-term guarantee program provides a 100% guarantee of principal and interest on loans from banks to exporters for export financing purposes. The written guarantee agreement between the Eximbank and the lending bank specifically details the bank's obligations and responsibilities, which must be fulfilled in order to ensure payment under the guarantee. The existence of such conditions under a guarantee arrangement does not necessarily mean the guarantee would be treated as conditional for purposes of [*Finance Code §34.201(a)(8), also see 7 TAC §12.6(f)*]. Guarantee programs of this type generally require that the lender institute certain prudent and customary practices in the making, servicing, and collecting of the loan for the guarantee to be effective. Even with conditions such as these, the guarantee is often viewed as being unconditional for legal lending limit purposes. A guarantee has been interpreted by the Department to be "unconditional" if the protection afforded the bank under the terms of the guarantee is not substantially impaired or diminished in the case of a loss resulting from factors beyond the bank's control. Protection against loss is not considered to be materially diminished or impaired due to procedural requirements in the guarantee agreement within the bank's control, such as a requirement that notification of default be given within a specific period of time after its occurrence, or a requirement of good faith or diligence on the part of the bank in making, servicing, or collecting the loan. This is consistent with the position taken by the Office of the Comptroller of the Currency regarding this issue as it affects national banks. See 12 CFR §32.6(e)(4).

We will treat loans guaranteed by the Eximbank under its medium-term export guarantee program as being unconditionally guaranteed for purposes of [*Finance Code §34.201(a)(8)*], because the protection afforded the bank under the guarantee is consistent with our interpretation of an unconditional guarantee under [*Finance Code §34.201(a)(8), also see 7 TAC §12.6(f)*]. Thus, the portion of a bank's loans to an exporter guaranteed by the Eximbank under the medium-term export guarantee program would not be limited by [*Finance Code §34.201(a)*]. That is not to say these would be appropriate investments for every bank. Safety and soundness concerns that may result from such an investment, e.g., unsafe concentrations of credit, should be examined before any investment is made in an amount approaching the limits set forth in [*Finance Code §34.201(a)*], even if all or a portion of the investment is not subject to those limitations.

This opinion is limited to the facts and circumstances set forth in your letter, dated July 21, 1994, and any facts or assumptions set forth herein. Any change in those facts, circumstances, assumptions, or the parties to the transaction may result in a different opinion.

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[1] *Effective September 1, 2001, this limitation is stated as "25% of the lesser of bank's capital and certified surplus or total equity." Act of May 22, 2001, 77th Leg., H.B. 2155, §12.*

[2] *Id. Effective September 1, 2001, §34.201(a)(8) provides an exemption for "the portion of an indebtedness that this state, an agency or political subdivision of this state, the United States, or an instrumentality of the United States has unconditionally agreed to repay, purchase, insure, or guarantee".*

Opinion No. 94-64

A properly structured loan arising from the discount of negotiable and non-negotiable installment consumer paper is considered to be comprised of separate loans to the underlying consumers for legal lending limit purposes.

October 25, 1994
Brian R. Herrick, Assistant General Counsel

Pursuant to your letter, I have reviewed your request for an opinion regarding the applicability of the legal lending limit statute, TEX. REV. CIV. STAT. ANN. art. 342-507 [*now Finance Code §34.201*], to certain loans proposed to be made by your client, a state-chartered bank (the "Bank"). I have come to the conclusion that although the loan purchase transaction is subject to [*Finance Code §34.201*], if properly structured, it could be excepted under TEX. REV. CIV. STAT. art. 342-507(b)(12) [*now Finance Code §34.201(a)(11); also see 7 TAC §12.6(h)*].

Facts

A. Existing Debt. The Bank has an existing loan to a company (the "Company"), which operates a resort hotel and conference center. This existing loan is secured by a first lien on the Company's assets and is guaranteed by the Company's three owners. The Company has made application to the Bank for financing in three other transactions.

B. Interim Construction Loan. The Company has requested financing from the Bank for an interim construction loan, which would be used to construct a 12-unit condominium project in which the Company contemplates selling time-share units. This loan would be secured by a first lien on the building and all improvements, furniture, and fixtures of the units. Collateral securing the existing debt would be cross-pledged to further secure this proposed credit.

C. Discount of Installment Consumer Paper. In connection with the development of the condominium project, the Company also has inquired whether the Bank would purchase the individual time-share contract-for-deed notes. Before it obligates itself to purchase the notes, the Bank will review each note to ensure that (i) each maker meets the Bank's credit criteria, (ii) a cash down payment of 20 percent has been made against the purchase price, and (iii) the note does not exceed a five to seven year amortization. The Bank also will require that the notes be endorsed with full recourse against the Company. The Bank anticipates requiring a cross-pledge of existing collateral from the Company to secure the Company's recourse obligation on the purchase of the contract-for-deed notes. In addition, the Company will deposit funds with the Bank as a reserve to repurchase loans in default.

D. Guidance Line of Credit. The Company also has requested the Bank extend it a "guidance" line of credit to provide funding for contract-for-deed notes that do not meet the above purchase criteria and, therefore, could not be purchased by the Bank. This line of credit would be secured by collateral assignments of the original contract-for-deed notes and accompanying security agreements, together with the cross-pledge of all existing collateral.

Application and Interpretation of Laws and Regulations

The total loans and extensions of credit outstanding at any one time by a state bank to a person may not exceed 25 percent of the bank's capital and certified surplus. [*Finance Code §34.201(a)*]. The term "loans and extensions of credit" is defined in article 342-507(a)(1) [*now Finance Code §31.002(a)(34)*] as "advances of funds to a person that are made on the basis of an obligation of the person to repay the funds or that are repayable from specific property pledged by or on behalf of the person." Obviously, the Company, whether operated as a corporation, partnership, or joint venture, would be considered a person for purposes of [*Finance Code §31.002(a)(34)*]. The recourse obligation of the Company would be "an obligation . . . to repay the funds" advanced in connection with the purchase. Therefore, absent a specific exclusion, an extension of credit from the Bank to the Company resulting from the purchase by the Bank of the contract-for-deed notes would be subject to the legal lending limit set forth in [*Finance Code §34.201(a)*].

Certain classes of loans or extensions of credit, however, are excluded from the limitation on total loans and extensions of credit to a single borrower. Pursuant to [*Finance Code §34.201(a)(11), current text substituted*], the legal lending limit does not apply to any portion of any:

> *(11) loans and extensions of credit arising from the purchase of negotiable or nonnegotiable installment consumer paper that carries a full recourse endorsement or unconditional guarantee by the person transferring the paper if:*
>
> *(A) the bank's files or the knowledge of its officers of the financial condition of each maker of the consumer paper is reasonably adequate; and*
>
> *(B) an officer of the bank designated for that purpose by the board certifies in writing that the bank is relying primarily on the responsibility of each maker for payment of the loans or extensions of credit and not on a full or partial recourse endorsement or guarantee by the transferor; ....*

Any loan or extension or credit that satisfies the above-stated criteria will not be considered a loan to the transferor for purposes of determining compliance with a bank's legal lending limit. This exception is further explained in rules promulgated by the Banking Department. See 7 TEX. ADMIN. CODE 12.5 [*now 7 TAC §12.6(h)*].

The term "installment consumer paper" is defined as including paper relating to "residences . . . and similar consumer items". [*7 TAC §12.6(h)(3)*]. This has been interpreted by the Department as covering purchase money mortgage loans, home improvement loans, and home construction loans, if to the ultimate owner and not to a builder-developer. I am of the opinion that the term "residences" would include paper relating to a contract-for-deed note for the purchase of a time-share unit in a condominium.

Under the Department of Banking's rules, a loan or extension of credit "arising from the discount of negotiable or non-negotiable installment consumer paper and which carries a full recourse endorsement . . . will be treated as a loan or extension of credit to the person transferring the paper and will be subject to the general lending limitation of 25 percent . . . unless the provisions of [*Finance Code §34.201(a)(11); also see 7 TAC §12.6(h)*] are met." [*7 TAC §12.6(h)*] provides that loans and extensions of credit that meet the requirements of [Finance Code §34.201(a)(11)] are treated as loans or extensions of credit to the maker of the paper even though the bank has recourse against the seller. In order to meet the requirements of [*Finance Code §34.201(a)(11)*], "the bank's files or the knowledge of its officers of the financial condition of each maker of the consumer paper must be reasonably adequate . . . [and a designated] officer of the bank . . . must certify in writing" that the bank's reliance on the maker for repayment is primary. Consequently, in order for a bank to rely on [*Finance Code §34.201(a)(11)*], the bank must make an independent decision as to the creditworthiness of the maker of each loan. The certification and the information required under [*Finance Code §34.201(a)(11)*] and [*7 TAC §12.6(h)*] concerning the financial wherewithal of the maker "must be in such form as is appropriate for the class and quantity of the paper involved." Id.

In your letter, you indicated the Bank will satisfy the conditions set forth in [*7 TAC §12.6(h)*]. Furthermore, you have represented that the Bank's application and underwriting process, the Bank's files, and the knowledge of the Bank's officers of the financial condition of each maker will be reasonably adequate to meet these requirements. The Bank's board of directors will designate an officer for purposes of making the required certification, and that officer will certify that the Bank is relying primarily on the responsibility of each maker for repayment of the loans and not on the recourse obligation of the transferor. Based upon these representations, I am of the opinion that [*Finance Code §34.201(a)(11)*] is applicable to the transactions involving the purchase of the contract-for-deed notes.

Additionally, the existence of the cross-collateralization provisions contemplated by the Bank as additional protection in the event the primary obligor (i.e., the maker of the paper) defaults would not, in and of itself, require aggregation or trigger the attribution rules under [*Finance Code §34.201(c)*] or 7 TAC §§12.1 et seq. [*specifically, 7 TAC §12.9*].

You also have requested that I confirm that the Bank's in-house commitment to purchase up to a specified amount of the contract-for-deed notes would not be considered an "obligation to advance funds" as that phrase is defined in 7 TAC §12.2 [*now 7 TAC §12.3(a)(2)*]. It is my understanding that this commitment is purely internal and not the subject of any written agreement or commitment between the Bank and the Company. The Bank will not be obligated, under any circumstances, to purchase notes from the Company up to this amount. In fact, there will be no binding commitment to advance funds to the Company at a future date for such purposes. Based on the foregoing information, I am of the opinion that this in-house commitment would not be viewed as a "binding commitment to advance funds" such that it would come within the definition of the phrase "obligation to advance funds" as that phrase is defined in [*7 TAC §12.3(a)(2)*].

You have not asked whether the legal lending limit would apply to the interim construction loan or the "guidance" line of credit the Bank intends on extending to the Company. In my opinion, both the interim construction loan and the "guidance" line of credit would be aggregated with the Company's existing credits for purposes of legal lending limit analysis.

This opinion is limited to the facts and circumstances set forth in your letter, dated September 28, 1994, and any facts or assumptions set forth herein. Any change in those facts, circumstances, assumptions, or the parties to the transaction may result in a different opinion.

Opinion No. 94-75

If the source of repayment is the same for all borrowers, 100% of the balance of the note due will be attributed to each borrower for legal lending limit purposes.

February 14, 1995
Brian R. Herrick, Assistant General Counsel

Pursuant to your request, we have reviewed the loan documents submitted with your request and have analyzed the facts of the transaction, as outlined in your letter, and we have come to the conclusion that the amount of the loan to be attributed to [Person A] for legal lending limit purposes would be the entire principal balance of the Note (hereinafter defined).

Facts

The facts of the transaction, as presented by you and set forth in the documents you provided, are as follows. On January 21, 1994, [*****] Bank (the "Bank") loaned [Person A], [Person B], and [*****] Ranches (a partnership composed of [Person C] and [Person D]) the sum of $1,972,500 to purchase 2,005 acres of real property located along Highway [*****] in [*****] County, Texas. Under the terms of the purchase agreement among the borrowers, the borrowers hold title to the property as tenants in common. [Person A] holds an undivided 75% interest in the real property. You have represented that, at the time the loan was made, the Bank had agreed to limit the liability of [Person A] under the Real Estate Lien Note (the "Note") to a percentage of the outstanding balance equal to his ownership interest in the land, i.e., 75%. The Bank's attorney, however, mistakenly drew up the Note to provide that each of the makers was jointly and severally liable for the entire balance of the Note. [Person A] also executed a guaranty agreement whereby he personally guaranteed $1,578,000 or 80%, of the outstanding principal balance of the Note, plus any and all accrued interest.

In October, 1994, when the error in the Note was discovered, the Bank and borrowers entered into an agreement amending the terms of the Note to limit liability of the borrowers under the Note to an amount equal to their respective ownership interests in the property. Although we do not believe it affects the outcome of our analysis, we have assumed the agreement to amend the note accomplished its purported effect.

Issue

The question is whether, for legal lending limit purposes, 75%, 80%, or 100% of the principal balance of the Note should be attributed to [Person A].

Discussion

Under the terms of the Note, as originally written, the entire balance of the Note would be attributed to [Person A] for legal lending limit purposes. Article 342-507(a)(1) of the Texas Banking Code [*now Finance Code §31.002(a)(34)*] includes within the definition of the phrase "loans and extensions of credit" all advances of funds to a person, direct or indirect, "that are made on the basis of an obligation of the person to repay the funds." The facts of the transaction, however, make it clear that the Bank did not intend that [Person A] be obligated for the entire principal balance of the Note. Therefore, assuming the amendment of the Note is effective, [Person A's] direct obligation on the Note would be 75% of its face amount.

The question still remains whether, for legal lending limit purposes, the amount to be attributed to [Person A] will be (i) 75% of the outstanding principal balance (his direct obligation under the terms of the Note, as amended), (ii) the lesser of $1,578,000 or the outstanding principal amount of the Note, which is the obligation of [Person A] under his personal guaranty, or (iii) the entire outstanding principal balance of the Note. Under the Department of Banking's rules, the phrase "loans and extensions of credit," as defined in [*Finance Code §31.002(a)(34)*], does "not include the liability of a . . . guarantor who does not receive any direct benefit from the loan or extension of credit." See 7 TEX. ADMIN. CODE §12.2 [*now 7 TAC §12.9(g)*]. Clearly, [Person A] has directly benefitted from this loan. Therefore, the amount of the loan guaranteed by [Person A] should be attributed to him for legal lending limit purposes. Consequently, for legal lending limit purposes, at the very least, $1,578,000 of the outstanding principal balance of the Note will be attributed to [Person A].

Pursuant to 7 TEX. ADMIN. CODE §12.4(a)(2) [*now 7 TAC §12.9(d)*], a loan or extension of credit to one person will be attributed to other persons for purposes of Article 342-507 [*now Finance Code §34.201*] when the expected source of repayment for each loan or extension of credit is the same for each person. In this instance, the expected source of repayment is the cash flow from the development and sale of the collateral. That source of repayment is the same for all three borrowers. As a result, the source of repayment test set forth in [*7 TAC §12.9(d)*] has been met. Therefore, the amount to be attributed to each of the borrowers, for purposes of [*Finance Code §34.201(a)*], is $1,972,500, which is the entire principal balance of the Note.

We have not addressed the question as to whether facts surrounding the loan in question would trigger the attribution rule of 7 TEX. ADMIN CODE §12.4(a)(1) [*now 7 TAC §12.9(b)*] under the direct benefit test. It is not necessary to discuss that issue, because the source of repayment test has been met. You should keep in mind, however, that an argument for attribution could be made under [*7 TAC §12.9(b)*], as well.

This opinion is limited to the facts and circumstances set forth in your letter, dated November 2, 1994, and facsimile transmission, dated February 1, 1995, and any facts or assumptions set forth herein. Any change in those facts, circumstances, assumptions, or the parties to the transaction may result in a different opinion.

Opinion No. 94-79

A state bank may finance trade receivables but, as structured, the receivables are subject to aggregation for legal lending limit purposes.

February 2, 1995
Brian R. Herrick, Assistant General Counsel

Pursuant to your request for an opinion as to whether it is permissible for a state-chartered bank to purchase trade receivables at a discount, we have reviewed your letter, dated November 2, 1994, and the authorities cited therein, as well as others, and have come to the conclusion that the activity in question is permissible. In our opinion, however, the substance of the transaction you described is not the purchase of trade receivables, but the financing of those receivables by the bank. In any event, the bank may purchase discounted receivables subject to the restrictions outlined herein below and any other constraints in accordance with applicable law.

Facts

The transaction about which you have inquired involves the purchase of the receivables of a commercial business (the "Company") at a discount with full recourse on the seller. The bank would purchase certain of the Company's receivables, which represent amounts owed the Company by its own customers. The bank would bill the obligor directly for each receivable and collect and retain the amount paid by the obligor. In the event an obligor were to default in the payment of all or a portion of the receivable, the bank would have the right to require that the Company repurchase the receivable. In addition, if the Company were to default in someway in its arrangement with the bank, then the bank could require that the Company repurchase all of the receivables. The bank would require that the Company establish a reserve to secure the Company's repurchase obligations. The reserve would be established via a segregated account at the bank. The balance maintained in the reserve account would be at least ten percent of the aggregate balance of outstanding receivables.

The bank will provide data processing services (e.g., tracking payments, calculating and posting accruals, maintaining billing histories, etc.), credit and receivable forms, and billing services for current accounts (i.e., accounts receivable that have not been repurchased by the Company) presumably in exchange for a fee. The bank will contract with [*****], Inc., to provide the billing and information services. The bank will pass on the fee charged by [*****], Inc., for its services to the Company. The bank will not attempt to collect delinquent receivables from the obligor.

Application and Interpretation of Laws and Regulations

The powers of a state-chartered bank are set forth in article 342-302 of the Texas Banking Code, TEX. REV. CIV. STAT. ANN. arts. 342-101 et seq. [*now Finance Code §32.001*]. Article 342-302(a) [*now Finance Code §32.001(b)(1)*] provides, *inter alia*, that a bank may "lend money with or without security at interest . . . and to buy, sell and discount . . . evidences of indebtedness." In addition, article 342-302(e) [*now Finance Code §32.001(b)(1)*] empowers a bank "[t]o purchase, invest in, and sell . . . evidences of indebtedness, and to lend money and to charge and collect interest thereon in advance or otherwise." [*Finance Code §32.001(b)(1)*] also provides that a bank has all incidental powers necessary to exercise its specific powers.

We agree that a bank could purchase receivables at a discount and the receivables in question would be permissible investments for a state-chartered bank. Furthermore, the Finance Commission previously authorized the purchase of open accounts in 7 TAC §11.81. We do not believe, however, that the transaction you described involves the purchase of the receivables. It seems clear that the bank would merely be providing the Company with a line of credit with which to fund its receivables. No true purchase of the receivables appears to be intended or effected.

The bank would treat the relationship as if it were a line of credit, the expected source of repayment of which would be the money generated from the receivables. The bank would book the "purchase" as a demand note and apply receivable payments towards repayment of advances under the line of credit. In the event a particular receivable were to go into default, no attempt would be made by the bank to collect the note. On the contrary, the bank would return the receivable to the Company and charge the Company's reserve account for the full face amount of the receivable, less any principal payments, plus applicable finance charges.

Another aspect of this proposal that leads us to conclude it is not a purchase of receivables is the fee arrangement with respect to bookkeeping and data processing services performed in connection with the transaction. If the bank is truly purchasing the receivables, why then would the Company be responsible for reimbursing the bank for expenses related to processing, billing, and tracking, and related expenses, all of which ordinarily would be paid by the owner of the receivables? Moreover, the bank does not engage in any collection activities whatsoever. It simply returns the defaulted receivable to the Company in exchange for the full amount of the outstanding principal.

The billing and accounting services provided by the bank pursuant to its arrangement with the Company would be viewed by the Department as incidental to its lending arrangement with the Company. Consequently, those services would be permissible as an exercise of incidental powers by the bank pursuant to [*Finance Code §32.001*].

As I am sure you are aware, there is a potential usury problem associated with these transactions that may arise if for usury purposes "interest" paid by the Company is aggregated with finance charges assessed the underlying obligor. That potential problem should be examined and researched very carefully by the bank. The bank should consult with its counsel as to what would be most prudent with respect to further research of those issues. Perhaps, you should consider contacting someone with the Office of Consumer Credit Commissioner and solicit their opinion on this issue.

Although you have not asked for an opinion as to whether the individual receivables would be aggregated for legal lending limit purposes, our initial reaction is that they would. Because the transaction amounts to a financing of the receivables by the bank rather than an outright purchase, the transaction would give rise to an extension of credit under article 342-507 [*now Finance Code §34.201*]. Even if the bank were to successfully argue that the transaction amounted to an outright sale of the receivables to the bank by the Company, the Company's repurchase obligation (among other aspects of the transaction), most likely, would require that all of the receivables be aggregated for purposes of legal lending limit analysis. That is not to say, however, that no exception to the general rule of [*Finance Code §34.201(a)*] would apply. If this issue concerns you, or you would like us to give further consideration to this aspect of the transaction, please make an additional request, in writing.

In summary, the transaction you described appears to be permissible, although we do not agree with your characterization of the transaction as a purchase of the receivables by the bank. In addition, the services provided by the bank incidental to the financing of the receivables, would be viewed by the Department as an exercise of the bank's incidental powers under [*Finance Code §32.001(b)(1)*], and, hence, would be permissible. The Department expresses no opinion as to whether this would be an appropriate avenue of business for any particular bank. A bank embarking on a loan or purchase arrangement of this type should make certain that its officers have adequate experience and expertise in matters of this type. Other safety and soundness concerns that may result from such loans or investments, e.g., unsafe concentrations of credit or usury, should be examined before the bank pursues a program of this type.

This opinion is limited to the facts and circumstances set forth in your letter dated November 2, 1994, and any facts or assumptions set forth herein, any change in those facts, circumstances, assumptions, or the parties to the transaction, may result in a different opinion.

Opinion No. 95-8

The amount of outstanding certified checks on behalf of an entity constitutes a loan to the entity for legal lending limit purposes.

September 18, 1995
Everette D. Jobe, General Counsel

This letter is written in response to your letters dated December 14, 1994, February 27, 1995, and March 6, 1995, and a letter from your attorney dated April 19, 1995, regarding the proposed Immediately Available Funds Procedure Agreement ("Agreement") among [*****] State Bank ("Bank"), [*****] Mortgage Corp. ("Mortgage Company"), and a third party title company ("Title Company"). Please accept my apology for the lengthy delay in responding to your letter.

The Agreement provides a mechanism for satisfying Mortgage Company's obligation to deliver "good funds" to the title insurance agent conducting a real estate mortgage loan closing on behalf of Mortgage Company, pursuant to Article 9.39A, Texas Insurance Code, by providing for telephone "certification" of Mortgage Company's check by the Bank. The Agreement provides for procedures to verify the check as well as amounts on deposit at the Bank and available to satisfy the check. The Bank primarily sought our views because Mortgage Company is a related party to the Bank. [Person A] is chairman of the board of the Bank and [Person B] is vice chairman. [Person B] is also president of Mortgage Company and both [Person B] and [Person A] have direct or indirect ownership interests in Mortgage Company. The Bank has not provided information regarding the extent of common ownership between the Bank and Mortgage Company; however, based on our conclusions, that information may be unnecessary.

The Bank clearly has the power to certify checks drawn upon it, including by a specified telephone procedure. However, we conclude that the amount of outstanding certified checks on behalf of Mortgage Company is a loan or extension of credit by the Bank to Mortgage Company and is subject either to legal lending limit analysis under the Texas Banking Act, §5.201 [*now Finance Code §34.201*], or transaction limits with affiliates under 12 USC §371c, commonly called "23A" (see Texas Banking Act, §5.201(a)(13) [*now Finance Code §34.201(a)(13)*]), unless funds sufficient to satisfy the checks are withdrawn from the account and transferred to the Bank immediately upon certification.

This opinion is limited to the facts as you presented them to us, and any change in facts may compel a different conclusion.

Opinion No. 95-11

A jointly administered loan program between a bank and mortgage company is not a "warehouse facility" for the mortgage company and loans are therefore not aggregated for legal lending limit purposes.

September 18, 1995
Everette D. Jobe, General Counsel

This letter is written in response to your letter to John Vaught dated January 12, 1995.

You inquired whether the "Construction to Permanent Loan" program [*****] Bank (the "Bank") administers jointly with [*****] Mortgage Company ("Mortgage") could be deemed a warehouse facility for Mortgage. We conclude not. Through a single application process, an applicant applies for construction financing through the Bank and a permanent loan through Mortgage. The Bank and Mortgage each evaluate the application under separate lending guidelines, and each funds its portion of the program based on an independent evaluation of the borrower's creditworthiness. The primary linkage between the Bank and Mortgage is that both loans must be approved or neither is approved, and contractual provisions simplify cooperation between the Bank and Mortgage regarding the process of closing into permanent financing. Under these circumstances, the Department considers the Bank's borrower to be the consumer and not Mortgage. The Bank is of course expected to apply prudent underwriting standards consistent with safe and sound banking practices.

This opinion is limited to the facts as you presented them to us, and any change in facts may compel a different conclusion. Please feel free to call me if you have any questions or comments.

Opinion No. 95-15

Mobile branch banking is an authorized activity for a Texas-chartered state bank if each branch has been approved as such with a specific service or marketing area, and logs are maintained by the mobile branch to track the specific locations in which the mobile unit is conducting business.

March 13, 1995
Everette D. Jobe, General Counsel

By letter dated March 6, 1995, you requested advice regarding what avenues are available to you to provide a convenient receptacle for deposits in neighboring communities, stating that you would like to drive to a designated location in each community, receive deposits, and return to the bank. You are requesting how to establish a messenger or courier service operated by the bank. Because Texas law does not specifically require a branch to have a fixed or permanent location, the Texas Department of Banking has previously issued opinions confirming the treatment of a mobile messenger service for picking up deposits as a mobile branch.

If a messenger service is operated by a [*licensed*] third party, the courier activities do not constitute branching [*see Finance Code §31.002(a)(8)(E)*]. Whether a messenger service is established by a third party is based on a case-by-case review of all of the circumstances, except that a messenger service is clearly established by a third party if a party other than the bank owns the service and its facilities (or rents them from another party other than the bank) and employs the persons engaged in the provision of the service, and the messenger service:

(1) Makes its services available to the public, including other depository institutions;

(2) Retains ultimate discretion to determine which customers and geographical areas it will serve;

(3) Maintains ultimate responsibility for scheduling, movement, and routing;

(4) Does not operate under the name of the bank, and the bank and the messenger service do not advertise, or otherwise represent, that the bank itself is providing the service, although the bank may advertise that its customers may use one or more third party messenger services to transact business with the bank;

(5) Assumes responsibility for the items during transit and maintains adequate insurance covering holdups, employee fidelity, and other in-transit losses; and

(6) Enters into contracts with customers which provide that the messenger service acts as the agent for the customer when the items are in transit between the bank and the customer and, in the case of items intended for deposit, the items are not considered to have been deposited until delivered to the bank at an established bank office, and, in the case of items representing withdrawals, the items are considered to be paid when the item is given to the messenger service.

Third party messenger services are generally most useful when dealing with large, commercial customers. The activity you wish to conduct would likely have to be performed by the bank itself. A messenger service operated by a state bank would have to be approved as a branch and be operated within the State of Texas. Although a mobile branch bank is not required to have a fixed, identifiable location, each mobile branch must have an identifiable service or marketing area. While the

state bank would not have to identify the specific sites where its mobile unit would stop, each mobile branch is required to maintain logs indicating the specific locations in which the mobile unit is operating in order to track branch activities.

In summary, mobile branch banking is an authorized activity for state banks in Texas if each branch has been approved as such with a specific service or marketing area, and logs are maintained by the mobile branch to track the specific locations in which the mobile unit is conducting business.

Opinion No. 95-16

A bank may not recover costs related to compliance with a criminal subpoena for customer records.

April 26, 1995
Everette D. Jobe, General Counsel

By letter dated March 10, 1995, you requested our interpretation of Article 342-705, Texas Banking Code [*now Finance Code §59.006*]; specifically, its application to criminal subpoenas. As we discussed by telephone several weeks ago, [*Finance Code §59.006*] has no application to criminal subpoenas and the bank may not recover its costs from the district attorney under the authority of any laws administered by the Texas Department of Banking.[1]

You contend that [*Finance Code §59.006*] clearly states that the article applies to civil law matters and not to criminal investigations, and for that reason cannot be construed as authority for a county to receive documents pertaining to a criminal matter or investigation without incurring costs. The criminal subpoena is not issued under this article and is therefore not subject to either its protections for customer records or its provisions for recovery of costs.

In addition, you feel that Article 35.27, §3, Texas Code of Criminal Procedure, authorizes reimbursement of non-resident witnesses for their unspecified expenses in criminal matters. As this provision of law is not administered by the Texas Department of Banking, we cannot issue an interpretation that would be persuasive. I do note that reimbursement of expenses other than transportation, meals, and lodging is authorized under this section only upon application by the state's attorney.

Opinion No. 95-17

Loans to related family members need not be aggregated for legal lending purposes under certain circumstances.

March 10, 1995
Everette D. Jobe, General Counsel

We have received your letter dated March 3, 1995, regarding the application of legal lending limit analysis to loans made by [*****] Bank ("Bank") to the [*****] family. This analysis is based on your representations and the assumptions noted, and may be relied on to the extent your representations and our assumptions are correct.

According to your letter:

(1) The Bank currently has loans to [Person A] aggregating $383,500, $355,000 in the form of a revolving draw loan for home improvements and $28,500 in the form of an unsecured loan, although you state that the unsecured loan is "100% participated out to an individual."

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[1] *Also see Acts 1983, 68th Leg., ch. 525, §3, 1983 Tex. Gen. Laws 3056, 3059-60 (Vernon). The original legislation that added this discovery procedure to Texas law contained an uncodified caveat that "[t]he provisions of this Act shall not apply to the investigation or prosecution of criminal offenses."*

(2) The Bank has a loan to [Person A's] son, [Person B], in the amount of $35,100, secured by real estate and guaranteed by [Person A]. You represent that the guarantee of [Person A] was obtained by the Bank out of an abundance of caution and that the Bank is primarily relying on [Person B] for repayment of the loan. You state that [Person B] is employed by a law firm and imply that his salary is sufficient to enable him to qualify for the loan without his father's guaranty. While you are aware that [Person A] has made some of the loan payments due on [Person B's] loan, the Bank still considers the source of repayment to be [Person B's] salary. Further, you state that [Person A] did not receive any benefit from the proceeds of the loan.

(3) The Bank has a loan to [Person A's] daughter, [Person C], in the amount of $17,443.34, guaranteed by [Person A]. You represent that the Bank is primarily relying on [Person C] for repayment of the loan. You state that [Person C] is employed and the Bank made the loan in reliance on her income from that employment to service the loan. The Bank believes all debt service on this loan has been made by [Person C]. While you did not state that [Person A] did not receive any benefit from the proceeds of the loan, I assume that is the case for purposes of this analysis, based on the general tenor of your letter.

<u>Analysis:</u>

Article 342-507(b) of The Texas Banking Code [*now Finance Code §34.201(a)*] (the "Code") states that "[t]he total loans and extensions of credit by a state bank to a person outstanding at one time may not exceed twenty-five per cent (25%) of its capital and certified surplus."[1] You have represented that the Bank's legal lending limit as provided by this calculation is $359,000, which I accept for purposes of this analysis.

Rule 12.4(a) [*now see 7 TAC §12.9(a), current text substituted*] provides in pertinent part:

> *(a) General rule. A loan or extension of credit to one borrower is attributed to another person, and each person will be considered a borrower, if:*
>
> *(1) proceeds of the loan or extension of credit are to be used for the direct benefit of the other person, to the extent of the proceeds so used, as provided by subsection (b) of this section;*
>
> *(2) a common enterprise is deemed to exist between the persons as provided by subsection (c) of this section; or*
>
> *(3) the expected source of repayment for each loan or extension of credit is the same for each person as provided by subsection (d) of this section; or*
>
> *(4) notwithstanding another provision of this section, the banking commissioner determines that a loan should be attributed to another person pursuant to the Finance Code, §34.201(c).*

Rule 12.2 [*now see 7 TAC §12.9(g), current text substituted*] states in pertinent part that:

> *The derivative obligation of a ... guarantor of a loan or extension of credit ... is not aggregated with direct loans or extensions of credit to such ... guarantor if the lending bank is relying primarily on the creditworthiness of the primary obligor and none of the tests set forth in this section are satisfied. The reliance of the lending bank on the primary obligor must be evidenced by the certification of an officer of the bank that the bank is, on stated facts, relying primarily on the responsibility and financial condition of the primary obligor for payment of the loan or extension of credit .... In the event that the loan ... experiences subsequent deterioration to the point that the primary obligor is no longer performing in accordance with the terms of the initial loan agreement, such event will not result in a lending limit violation on behalf of the guarantor by virtue of the primary obligor's nonperformance. However, the total amount of the deteriorated loans ... must be combined with all other obligations of such guarantor in determining whether the guarantor may obtain additional loans or extensions of credit from the bank.*

You have represented, with respect to the loan referenced in paragraph (2) above, that the proceeds of the loan were not used for the direct benefit of the guarantor, and I have assumed the same to be the case for the loan referenced in paragraph

[1] *Effective September 1, 2001, this limitation is stated as "25% of the lesser of bank's capital and certified surplus or total equity." Act of May 22, 2001, 77th Leg., H.B. 2155, §12.*

(3) above. You have further represented that the expected source of repayment for each loan is the primary obligor on the note. I also assume that evidence exists in the Bank's files, with respect to each loan referenced in paragraphs (2) and (3) above, to reasonably support the determination that the primary obligor has the ability and capacity to repay the loan, that the decision to fund the loan was based on that determination, and that an officer's certificate in satisfaction of the quoted requirements of [*7 TAC §12.9(g)*] is in each loan file.
Based on your representations and the assumptions made above, I conclude that the loans to [Person B], [Person A], and [Person C] need not be aggregated for purposes of applying the lending limitations of [*Finance Code §34.201*]. This letter does not address the potential applicability of 12 USC §371c and Regulation O (12 CFR Part 215).

Opinion No. 95-22
A perfected security interest in a segregated deposit account is necessary to satisfy the exemption from legal lending limits.

April 26, 1995

By letter dated April 7, 1995, you requested the opinion of the Texas Department of Banking regarding whether the plan you propose will result in correction of a legal lending limit violation relating to the "[*****] loans" at the [*****] Bank & Trust. We conclude that the action you propose does not correct the violation.

You indicated the sum of $747,000.00 has been deposited by the directors in the [*****] Bank & Trust, to be governed by the Trust Agreement enclosed with your letter, for the purpose of offsetting the legal lending limit violation on the [*****] loans. You stated the account would not be specifically pledged to the [*****] loans but would be available to purchase the principal, accrued interest, or any charged off portion of the loans. The directors propose this contingent purchase arrangement to avoid negating the potential liability of a former officer or director. The notes to be purchased would not include those with FmHA guaranties to avoid rendering the guaranty invalid.

Unless the account is specifically pledged against the [*****] loans, the arrangement you propose will not correct the violation. Article 342-507(b)(11) of the Texas Banking Code [*now Finance Code §34.201(a)(10)*] specifically provides that "indebtedness *secured* by a segregated deposit account in the lending bank" is not subject to the legal lending limit. A perfected security interest in the account is therefore required for the bank to avail itself of this exemption.

Opinion No. 95-24
"Car drafts" are not exempt from legal lending limits.

May 19, 1995
Everette D. Jobe, General Counsel

Your letter dated April 26, 1995, has been referred to me for response. You state that [*****] State Bank (the "Bank") has been approached by a car dealership that would like to obtain a line of credit for $1,000,000 from the Bank and also obtain immediate credit on drafts deposited with the Bank. On any one day the amount of outstanding drafts could be $1,000,000. The Bank's legal lending limit is $1,500,000.

As you describe the circumstances, the Bank's outstanding loans and extensions of credit to the car dealership would, if fully funded, violate the Bank's legal lending limit. While the Department does not consider amounts paid on items in the normal process of collection under Regulation CC (12 CFR Part 229) as loans or extensions of credit [*now see 7 TAC §12.3(b)(4)*], "car drafts" are generally not submitted through normal collection channels as envisioned by Regulation CC. Immediate credit on uncollected car drafts would therefore be considered an extension of credit by the Bank. Of course, payment by a bank against a dishonored item would also be an extension of credit.

You assert that the exception in Article 342-507(b)(2) of the Texas Banking Code [*now Finance Code §34.201(a)(3); also see 7 TAC §12.5(b)*] as covering the immediate credit on deposited drafts. That exception addresses a completely different situation. [*Finance Code §34.201(a)(3), current text no longer uses the term "draft"*] exempts certain secured borrowings from "loans and extensions of credit" as follows:

> Indebtedness evidenced by ... drafts drawn against actually existing values and secured by a lien upon goods in transit with shippers' order bills of lading or comparable instruments attached.
>
> The important characteristic of the collateral, "shippers' order bills of lading or comparable instruments," is that the holder of these documents has control of the goods in transit and can obtain possession from the shipper. In the event of default by the borrower, the bank must be in a position to sell the underlying goods or commodities and deliver good title and possession to its purchaser, thus being able to protect itself without extended litigation. Automobiles are generally not "goods in transit" as encompassed by this exception in that they are seldom shipped under a bill of lading.

Opinion No. 95-26

Loans to company's officers to secure employee stock options, secured by company stock, are not aggregated for legal lending limit purposes if there is another primary source of repayment.

June 14, 1995
Everette D. Jobe, General Counsel

By letter dated May 24, 1995, you requested whether certain loan transactions proposed by [*****] Bank (the "Bank") would be aggregated for purposes of legal lending limit analysis under Article 342-507 of the Texas Banking Code [*now Finance Code §34.201*]. We conclude that the loan transactions you describe should not be aggregated.

You indicated that the Bank is presently working with [*****], a publicly traded company, in a financial arrangement to offer your bank's lending services to approximately 68 individuals employed by the company in order to assist them in exercising their employee stock options. The plan allows these officers to purchase [*****] stock at a price substantially below market price, resulting in income taxes owed to the Internal Revenue Service payable at the time the option is exercised. Specifically, the Bank would provide short term loans to the officers for the taxes owed as a result of exercising the stock options. Each officer, on his or her own merit, would apply and qualify for the loan. Each loan will be secured by company stock and would not exceed 35% of the market value of the stock pledged to the loan. The primary source of repayment would consist of each individual's cash flow. Sale of the collateral stock would occur only as a secondary source of repayment.

Under these circumstances, we are of the opinion that the described loans would not be aggregated for legal lending limit analysis. We conclude that the "direct benefit" of the loan is for the borrower and not [*****], and that the "expected source of repayment" is the borrower and not [*****], see 7 TEX. ADMIN. CODE §12.4(a) [*now 7 TAC §12.9(d)*]. We assume for purposes of this opinion that the 68 individuals will not collectively own more than 50% of the voting securities of [*****] after exercise of the stock options, see 7 TEX. ADMIN. CODE §12.4(b) [*now 7 TAC §12.9(c)(1)(B)*].

As a practical matter, each loan file should be properly documented to reflect the creditworthiness of the individual borrower and the basis for the Bank's reasonable reliance on the individual borrower as the source of repayment.

Opinion No. 95-31

A state bank may give free, prepaid long distance telephone cards to its customers and later accept a fee from the card issuer if a card is renewed.

March 19, 1996
Everette D. Jobe, General Counsel

As we discussed by telephone, [*****] requested an opinion regarding the above question by letter dated July 27, 1995. My letter in reply, dated July 31, 1995, stated in effect that we suspected the answer was negative but additional research would be required.

Because some national banks were already engaged in the activity, on September 1, 1995, I wrote a letter to the Office of the Comptroller of the Currency (OCC) requesting the views of the legal staff in Dallas. The OCC responded by letter dated January 10, 1996, stating that the activity was permissible for a national bank provided certain precautions were taken by the bank. Pursuant to §3.010 of the Texas Banking Act [*now Finance Code §32.009*], we adopt the analysis of the OCC and conclude that the activity is permissible for a state bank as well, subject to the same precautions, as noted further below.

The activity described above is permissible for a state bank because the card is being offered free, rather than sold, to bank customers as an inducement for them to take advantage of the bank's services. As a promotional item, the card is part of the bank's overall marketing effort for its services. Such an effort on the part of the bank is permissible under the general bank powers' provisions of the Texas Banking Act, §3.001(a)(1) [*now Finance Code §32.001(b)(1)*]. Furthermore, the fee being received by the bank is compensation for its services in bringing together the telephone service provider and the bank customer, a service which is specifically addressed in 7 TAC §11.83(d).

There are, however, two precautions that a state bank would be required to take before engaging in the above activity. First, the bank must make sure that the customer is appropriately informed that he or she is dealing with the service provider as far as the telephone services are concerned, so that the customer will not look to the bank should some problem develop with the card. And, second, the bank should ensure that the contract between it and the telephone card issuer provides for (a) holding the bank harmless for any problems which might develop with the card or the issuer's servicing efforts; (b) a clear disclaimer that any relationship exists between the bank and the card users (bank customers) regarding the provision of telephone services; and, (c) assurance that the telephone service provider/card issuer has obtained all the requisite federal and state regulatory clearances (e.g., from the Federal Communications Commission, the Texas Public Utilities Commission, etc.) necessary for it to engage in the telephone card program with the bank. If these precautions are taken, then the bank may proceed with its program.

Opinion No. 95-53

An out-of-state affiliate may conduct wire transfers as agent for a state bank without being considered a branch of the bank.

December 12, 1995
Sharon Gillespie, Assistant General Counsel

By letters dated November 6 and 16, 1995, you have inquired as to the legality of [an out-of-state] bank affiliate acting as agent for a state bank, specifically with respect to centralizing the wire transfer operations of [the state bank] with the [out-of-state affiliate at its out-of-state location]. Once these operations are centralized, a [state bank] deposit account customer could initiate a wire transfer either through [state bank] or through [the out-of-state affiliate at its out-of-state location]. In either case, a [state bank] employee will have access to the affected [state bank] account and will conduct the transaction for [state bank]. You ask whether [the out-of-state affiliate] will be considered a branch of the [state bank] if it conducts wire transactions directly on a [state bank's] customer account. You also ask whether the customer must be informed that an employee of the [out-of-state affiliate] is conducting the transaction on your behalf and whether any employee of your affiliates can have unlimited access to information regarding your customers.

The Texas Banking Act (TEX. REV. CIV. STAT. ANN. arts. 342-1.001 et seq.) (the "Act") [*now Finance Code, Title 3, Subtitle A*], defines "branch" in §1.002(a)(8) [*now Finance Code §31.002(a)(8)*] as "a location of a bank, other than the bank's home office, at which the bank engages in the business of banking." Paragraph (F) of this subsection specifically excludes various facilities and services from the definition of a branch, including "a bank acting as an agent for a depository institution affiliate as provided by Section 8.009(a) of this Act [*now Finance Code §59.005(a)*]." Section 8.009(a) states that:

> A bank subsidiary of a bank holding company may receive deposits, renew time deposits, close loans, service loans, and receive payments on loans and other obligations as an agent for a depository institution affiliate. Notwithstanding any other provision of law, a bank acting as an agent for a depository institution affiliate as provided by this section is not considered to be a branch of the affiliate.[1]

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[1] *Finance Code §59.005 was amended by Acts 1999, 76th Leg., ch. 344, §2.016, eff. Sept. 1, 1999, to eliminate the requirement of affiliation. Section 59.005 was again amended by Act of May 22, 2001, 77th Leg., H.B. 2155, §14, eff. Sept. 1, 2001, to further ease requirements, including elimination of required commissioner approval. The cited provision now appears as Subsections (a) and (d):*

> *(a) A financial institution may receive deposits, renew time deposits, close loans, service loans, receive payments on loans and other obligations, and perform other services as an agent for another financial*

institution under a written agency agreement.

(d) Notwithstanding another law, a financial institution acting as an agent for another financial institution in accordance with this section is not considered to be a branch of the institution acting as principal.

You have asked if the listing of activities in this provision is "all inclusive" or if the provision only sets out examples of services that the affiliate is authorized to provide. [*Finance Code §59.005(a)*] merely serves to list those activities that could result in application of a branch banking analysis. Wire transfer activities are not such an activity and, therefore, are not included in this listing. Providing wire transfer services as an agent does not convert the agent into a branch bank. Moreover, §8.009(c)(1) of the Act [*now Finance Code §59.005(e)*] provides that this "section does not affect . . . the authority of a depository institution to act as an agent on behalf of another depository institution under another law."[2] Be advised however that wire transfer activities cannot be conducted by an affiliate acting as agent if prohibited by other state or federal law and that a depository institution that conducts activity as an agent on behalf of another depository institution under another law may be considered to be a branch of the other institution for such purposes. See the Act §8.009(b), (c)(2) [*now Finance Code §§59.005(b), (e)(2)*]. You should also be aware that an agency relationship between depository institutions under [*Finance Code §59.005(a)*] must be on terms that are consistent with safe and sound banking practices and all applicable rules.

With respect to customer confidentiality, you have indicated that [state bank] intends to add a statement to its depository contract that information may be shared with affiliates. With the exception of laws inapplicable to your inquiry, e.g., restrictions on bank sharing of customer data with federal agencies under the Right to Financial Privacy Act of 1978, 12 USC §§3401 et seq., statutory law regarding the confidentiality that banking institutions owe their customers is virtually nonexistent. For example, TEX. CIV. PRAC. & REM. CODE ANN., §30.007(b)(7) [*now Finance Code, §59.006(a)(8)*] specifically provides that its privacy provisions (relating to compelled discovery from a financial institution) do not apply to "the voluntary use or disclosure of a customer record by a financial institution subject to other applicable state or federal law." Despite this void, the common law right of privacy protects information which the bank has relating to its customers. Individual customers can, however, waive the right to privacy as it applies to them. See 59 TEX. JUR.3d *Privacy* §6 (1988) and authorities cited therein. Therefore, the precaution of contracting with bank customers to permit the full-breadth of release you anticipate is advisable. Also, since customer damage resulting from release of information through theft or embezzlement could result in liability to the bank, you may wish to address involuntary releases of customer information in the depository contract as well.[3]

This opinion is limited to the facts and circumstances stated in your letters of November 6th and 16th of this year and any facts or assumptions set out herein. Any change in those facts, circumstances, assumptions, or parties to the transaction may result in a different opinion.

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[2] *Finance Code §59.005(e) now provides as follows:*

(e) This section does not affect:

(1) authority under another law for a financial institution to act as an agent on behalf of another person or to act as a principal in employing another person as agent; or

(2) whether an agent's activities on behalf of a financial institution under another law would cause the agent to be considered a branch of the financial institution.

[3] *The textual discussion remains useful even though privacy rights have now been addressed by federal law. See 15 U.S.C. §§6801-6805; also see Regulation P, 12 C.F.R. part 216, implementing the provisions of the Gramm-Leach-Bliley Act that prohibit a financial institution from disclosing nonpublic personal information to third parties that are not affiliated with the financial institution.*

Opinion No. 95-54

A subsidiary of an out-of-state bank may operate an ATM network in Texas.

December 21, 1995
Sharon Gillespie, Assistant General Counsel

By letter dated November 14, 1995, you have asked for approval of a proposal by [out-of-state bank ("Bank")] to engage in the ownership, installation, and operation of automated teller machines ("ATMs") in Texas through a subsidiary (the "subsidiary"). [Bank] has filed notice of this proposal with the Federal Reserve Board under the Bank Holding Company Act, 12 USC §§1841 et seq., and Regulation Y, 12 CFR §§225.1 et seq. As proposed, the subsidiary will install, service, and operate ATMs in various retail locations in Texas, either directly or through contract with third parties. The subsidiary will hold membership in national and regional ATM networks, including [a specific network], to facilitate ATM transactions by non-bank customers. [Bank] proposes to initially offer six ATM transactions: cash withdrawal from deposit and loan accounts; balance information regarding deposit, loan or other bank accounts; fund transfers between various bank accounts; bill payment; statement printing; and postage stamp purchases. The ATMs will not accept deposits, and all loan accounts from which withdrawals could be made would be pre-existing accounts. Any bank would have the right to use the ATMs on a non-discriminatory basis subject only to network and user bank technology limitations in full compliance with TEX. CONST. art. XVI, §16(b), and §3.204(b) of the Texas Banking Act [*now Finance Code, §§59.201-59.202*], TEX. REV. CIV. STAT. ANN. arts. 342-1.001 et seq. (the "Act," hereinafter referenced by section number) [*now Finance Code, Title 3, Subtitle A*]. The Texas Department of Banking has determined that neither [Bank] nor the subsidiary would engage in the business of banking by owning, installing and operating ATMs based on these facts.

Section 3.204(a) of the Act [*now Finance Code §59.201(a)*] authorizes [Bank] to own, install and operate electronic terminals in this state through the subsidiary: "[a] person or group of persons, for the convenience of customers of depository institutions, may install, maintain, and operate one or more electronic terminals at any location within this state." Section 1.002(a)(9) of the Act [*now Finance Code §59.202(c)(2)*] defines "electronic terminal" as "an electronic device, other than a telephone or modem operated by a customer of a depository institution, through which a person may initiate an electronic fund transfer, as defined in 15 USC §1693a(6)." The definition further states that an electronic terminal includes a "point-of-sale terminal, automated teller machine, or cash dispensing machine."

The definition of "branch" in the Act specifically excludes "an electronic terminal subject to §3.204 " [*now Finance Code §59.201*]." Section 1.002(a)(8) [*now Finance Code §31.002(a)(8); also see §31.002(a)(19)*]. As a consequence, your proposed activities are not characterized as branching. Furthermore, under the Act, "banking" is defined to be "the performance of the exclusive depository institution functions of accepting deposits and discounting loans and the performance of related activities that are not exclusive to banks or other depository institutions, including paying drafts or checks, lending money, and providing related financial services authorized by [the] Act." Section 1.002(a)(4) [*now Finance Code §31.002(a)(4)*]. Since your proposal does not include ATM acceptance of deposits or discounting of loans, neither [Bank] nor the subsidiary would be engaging in the business of banking under the proposal you have submitted.

This opinion is limited to the facts and circumstances stated in your letter of November 14th of this year and any facts or assumptions set out herein. Any change in those facts, circumstances, assumptions, or parties to the transaction may result in a different opinion.

Opinion No. 95-55

A bank officer licensed as a real estate broker may receive customary commissions on the sale of property financed by the bank if certain conditions are satisfied.

December 6, 1995
Sammie K. Glasco, Assistant General Counsel

I have been asked to respond to your letter of October 10, 1995 to Catherine A. Ghiglieri, the Commissioner of Banking. You questioned in your letter whether it would be a violation of Article 342-417 of the Texas Banking Code for a bank officer, who is also a part-time real estate broker, to receive the customary real estate commission if [the bank] makes a loan to the buyer of property in which she has served as either the listing or selling agent. You explained in your letter that the bank officer in question is not on the loan committee of the bank and has no lending authority with either the bank or the mortgage company.

Most of the Texas Banking Code including Article 342-417 was repealed and replaced by Acts 1995, 74th Leg., ch. 914, §1, effective September 1, 1995.[1] The new Texas Banking Act ("the Act") does not have a provision comparable to former Article 342-417, which was patterned after the federal Bank Bribery Act, 18 United States Code §215. Therefore, this practice does not violate any specific provision of the current Act. In addition, this Department interpreted former Article 342-417 as applicable to the decision maker regarding a loan or investment by a bank, and not to a person who refers a prospect for decision by another.

In this situation, the Texas Department of Banking would only have a concern if this practice violated some state or federal law or constituted a conflict of interest. Your attention is directed to the Bank Bribery Act, cited above and Texas Penal Code §32.43 which concerns commercial bribery. However, as stated above, the situation detailed in your letter does not violate any provision of the Act. In addition, it does not appear to present any type of conflict of interest which would be a safety and soundness issue for the Department as long as the bank officer in question is not a member of the Loan Committee, has no lending authority and is not able to influence, either directly or indirectly, the loan approval process.

Opinion No. 95-57

A state bank may provide bookkeeping and data processing services for itself and for affiliated banks.

September 26, 1996
D'Ann Johnson, Assistant General Counsel

Your letter of September 28, 1995 has been forwarded to me for response. You have indicated that [Corporation A] contemplates merging its wholly owned subsidiaries, [Corporations B & C] into [state bank].

A state bank may engage in any activity, directly or through a subsidiary, authorized by the Texas Banking Act (the "Act") or determined by the Banking Commissioner to be closely related to banking. Sec. 3.001(a)(4) [*now in substance Finance Code §32.001(b)(6), pertaining to activities financial in nature, and (b)(7)*]. Additionally, a state bank may exercise incidental powers necessary to carry on the business of banking. Sec. 3.001(a)(1) [*now Finance Code §32.001(b)(1)*]. Providing bookkeeping and data processing services for itself and affiliated banks is incidental to the business of banking.

Section 5.107 of the Texas Banking Act [*now Finance Code §34.107*] prohibits a state bank from investing funds in trade or commerce by selling or otherwise dealing in goods or owning or operating a business not part of the business of banking. Selling excess data processing capacity to one unaffiliated bank does not violate this section.

Because we have determined that the activity you described is authorized under the provisions of the [*Finance Code*], there is no need to examine whether the activity is permissible for national banks pursuant to §3.010 of the Act [*now Finance Code §32.009*].

This opinion is limited to the facts and circumstances stated in your letter of September 28, 1995. Any change in those facts or circumstances may result in a different opinion.

[1] *Later codified in the Finance Code by Acts 1997, 75th Leg., ch. 1008, §1.*

Opinion No. 95-59

A state bank or its subsidiary may invest in a limited liability company under certain conditions.

December 11, 1995
Everette D. Jobe, General Counsel

By letter dated October 19, 1995, you requested our opinion concerning whether a subsidiary of a Texas-chartered bank, or the bank itself, may invest in a limited liability company ("LLC") pursuant to the Bank Service Corporation Act, 12 USC §§1861 et seq. ("BSC Act"), the other members of which would be the state and national bank subsidiaries of [*****]

The Texas Banking Act, TEX. REV. CIV. STAT. ANN. arts. 342-1.001 et seq. (the "Act") [*now codified to Finance Code*], directly addresses your question. Section 5.105(a)(1) [*now Finance Code §34.105(a)(1)*] authorizes a state bank to "purchase for its own account equity securities of any class issued by . . . a bank service corporation, except that not more than an amount equal to 15 percent of the bank's capital and certified surplus may be invested in a single bank service corporation and not more than an amount equal to five percent of its assets may be invested in all bank service corporations." The term "bank service corporation" is defined in §5.105(c)(3) of the Act [*now Finance Code §34.105(c)(3)*] as having the meaning assigned by the BSC Act.

As your letter stated, the BSC Act requires that a bank obtain approval from the Board of Governors prior to investing in a bank service corporation performing the services you propose. We assume the Board of Governors must first determine that a bank service corporation can be a LLC before it approves the investment. Therefore, if the Board of Governors acts affirmatively, a Texas-chartered bank may invest in the bank service corporation organized as a LLC. We request that you send us a copy of the determination of the Board of Governors for our files in this matter at your earliest convenience.

While unnecessary to resolve your question, the analysis you submitted demonstrating that the Act would permit a state bank subsidiary to be organized as a LLC is essentially correct. However, federal law must also be examined pursuant to 12 USC §1831a and 12 CFR Part 362, which restrict the powers of state banks. For present purposes, 12 CFR §362.3(a) adequately summarizes the import of these federal provisions by stating that "[n]o insured state bank may directly or indirectly acquire or retain any equity investment of a type, or in an amount, that is not permissible for a national bank." The Federal Deposit Insurance Corporation ("FDIC") issued two opinions in 1994 that, by implication, conclude that a state bank subsidiary cannot be in the form of a LLC, but indicated it would accept a determination by the Office of the Comptroller of the Currency ("OCC") that such an investment would be permissible for a national bank, FDIC Interpretive Letter Nos. 94-50 (October 12, 1994) and 94-52 (October 13, 1994). Because the OCC recently made a strong statement that a national bank can invest in a LLC, OCC Interpretive Letter No. 692 (November 1, 1995), we presume the question has been finally answered.

The OCC clearly stated in Interpretive Letter No. 692 that national banks may make investments in various entities, including a limited liability company, at levels less than that required for an operating subsidiary provided that the investment meets certain requirements or standards. These standards, distilled from previous OCC decisions over the years, are essentially four:

1. The activities of the entity or enterprise in which the investment is made must be limited to activities that are part of, or incidental to, the business of banking;

2. The investing bank must be in a position to prevent the enterprise or entity from engaging in activities that do not meet the foregoing standard and, to this end, the articles of organization or association and the operating or participation agreement, or similar documents, should specifically state this authority;

3. The bank's loss exposure must be limited, as a legal and accounting matter, and the bank must not have open-ended liability for the obligations of the enterprise; and

4. The investment must be convenient or useful to the bank in carrying out its business and not a mere passive investment unrelated to that bank's banking business.

Opinion No. 95-61

A successor trustee is not liable for improper investments made by the prior trustee but is obligated to take reasonable action to correct the breach of trust once discovered.

November 28, 1995
Sharon Gillespie, Assistant General Counsel

You have asked the Department of Banking (the "Department") for assurance that [*****] Bank, a successor trustee, will not be held liable for improper investments made by the prior trustee. Section 114.002 of the Texas Property Code sets out the rule for liability in such situations:

> A successor trustee is liable for a breach of trust of a predecessor *only* if he knows or should know of a situation constituting a breach of trust committed by the predecessor *and* the successor trustee:
> (1) improperly permits it to continue;
> (2) fails to make a reasonable effort to compel the predecessor trustee to deliver the trust property;[1]
> or
> (3) fails to make a reasonable effort to compel a redress of a breach of trust committed by the predecessor trustee.

Under this standard, once a successor becomes aware of a breach of trust, e.g., as in this instance, of improper investments, the successor becomes obligated to take reasonable action to correct the breach.

I am aware that you have been working closely with the Department and the Attorney General's Office to resolve the problems with the subject investments. Furthermore, it is my understanding that it would be imprudent at this time to convert the trust property to permissible investments. Instead, you are steadily improving the liquidity of the trust assets, which, in the view of our staff, is the proper way to handle them. It is also my understanding that to pursue the predecessor trustee, who is in bankruptcy, would be futile. On these facts, if no additional breach of trust occurs and you continue to manage the property in the prudent manner that you have in the past, the Department is satisfied you will fully discharge the obligation imposed on you as a successor trustee under §114.002.

Opinion No. 95-66

A state bank may not pledge assets to secure industrial development corporation bonds.

January 9, 1996
Jerry G. Sanchez, Assistant General Counsel

Your letter of December 1, 1995, to Everette Jobe, General Counsel of the Texas Department of Banking, has been referred to me for review. You inquired as to whether your bank is required to pledge assets to secure [*****] IDC funds on deposit with your bank.

The copy of the [*****] IDC's articles of incorporation which you provided to us, indicates that the [*****] IDC was incorporated on or about August 3, 1993, in accordance with Article 5190.6, the Development Corporation Act of 1979 (the "Development Act"), for the purpose of "... promoting and developing industrial and manufacturing enterprises to promote and encourage employment and the public welfare of the City of [*****]..." In connection thereof, the [*****] IDC can finance, issue bonds, develop, assist, and undertake promotions, programs and projects. The [*****] IDC's board of directors are appointed by the governing body of the City of [*****], Texas, and serve at its pleasure. However, as a nonprofit, nonstock, corporation, the [*****] IDC is a separate legal entity under Texas law.

Texas Banking Act, §5.304(a) [*now Finance Code §34.304(a)*], provides that "...a state bank may not pledge or create a lien on its assets or secure the repayment of a deposit except as authorized or required by this section, rules adopted under this Act, or other law." Texas Banking Act, §5.304(b) [*now Finance Code §34.304(b)*], further provides that "...a state bank may

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[1] As [*****] Bank Trust Department currently holds title to all assets as trustee, subsection (2) of §114.002 is not applicable to this discussion.

pledge its assets to secure a deposit of this state, an agency or political subdivision of this state, the United States, or an instrumentality of the United States." The pertinent question is whether the [*****] IDC is "an agency or political subdivision of this state." Section 22 of the Development Act provides that a development corporation "... is not intended to be and shall not be a political subdivision or a political corporation within the meaning of the constitution and the laws of the state..." Section 22 of the Development Act also provides that bonds issued by a development corporation are "... deemed not to constitute a debt of the state, of the unit, or of any other political corporation, subdivision, or agency of this state or a pledge of its full faith and credit, and such bonds are payable solely from the funds derived from ... revenues." Therefore, under [*Finance Code §34.304(b)*], your bank is not authorized or required to pledge assets to secure the [*****] IDC deposits in your bank.

Opinion No. 95-71
A state bank may establish a university branch.

February 15, 1996
Everette D. Jobe, General Counsel

By letter dated December 18, 1995, you advised that you were in the process of applying to the Office of the Comptroller of the Currency for approval to operate a "University Branch" as defined in OCC Advisory Letter 94-6, and requested the opinion of this Department whether Texas state chartered banks are allowed to establish such a branch under state law.

Texas law and regulations do not specifically address a "university branch" or other types of limited service branches, although limited purpose branches are permitted. Such branches are applied for and approved in the same manner as full service branches. Thus, a state bank may establish a "university branch" in the same manner as it would establish any branch. Expedited treatment is generally available for branch applications of eligible banks, see 7 TAC §15.3, copy enclosed. "Eligible bank" is defined in 7 TAC §15.1 as a bank that:

> [*Quoted text omitted; see 7 TAC §15.1*]

Opinion No. 95-72
A state bank may provide internet access for bank customers.

February 15, 1996
Everette D. Jobe, General Counsel

By letter dated December 21, 1995, you inquired whether a state bank has authority to provide Internet access through the bank for bank customers.

A state bank may engage in any activity, directly or through a subsidiary, authorized by the Texas Banking Act (the "Act") or determined by the Banking Commissioner to be closely related to banking, Act §3.001(a)(4) [*now in substance Finance Code §32.001(b)(6), pertaining to activities financial in nature, and (b)(7)*]. Additionally, a state bank may exercise incidental powers necessary to carry on the business of banking, Act §3.001(a)(1) [*now Finance Code §32.001(b)(1)*]. Section 5.107 of the Act [*now Finance Code §34.107*] prohibits a state bank from investing funds in trade or commerce by selling or otherwise dealing in goods or owning or operating a business not part of the business of banking.

Allowing bank customers to access the bank's Internet provider through the bank's system presents novel issues. You state that you intend to provide access only to bank customers. Because the bank is using this resource itself and is selling excess capacity only to its customers, we conclude that the bank is not owning or operating a business not part of the business of banking or engaging in commerce. Selling excess capacity in the bank's Internet connection is incidental to the bank's use of this resource, which itself is incidental to the business of banking. Therefore, the bank is empowered to provide this service.

Safety and soundness issues must be considered. The security of the bank's computer system must remain inviolate, and thoughtful precautions should therefore be taken to ensure that the system is insulated from viruses and unauthorized access to information. Computer "hackers" can be very skillful and no security system is foolproof. As to financial issues, you advise that you can provide this service for an estimated $2,000 additional investment beyond the $8,000 the bank will invest to gain Internet access for itself. You represent that this expense and any income from this endeavor will not be of any significance to your financial condition. Based on your representations, we believe the bank is empowered to make the additional investment.

The bank should conduct the activity pursuant to a written agreement with each customer that appropriately allocates risk and should maintain complete files of the activity for examination purposes. We also recommend notifying the bank's bonding company of the new activity being conducted by the bank.

Opinion No. 96-2

Participation established in a commitment letter is excluded from legal lending limits to the extent it results in pro rata sharing of risk.

March 25, 1996
Jerry G. Sanchez, Assistant General Counsel

Your letter dated January 5, 1996, to Larry Hearn has been forwarded to me for response. You requested an opinion as to whether a certain commitment letter, as opposed to a participation agreement, is adequate to cover the unfunded portion of certain construction loans which would cause [Bank A] to exceed its legal lending limit.

Specifically, [Bank A] seeks to make ten loans to [*****], Inc., at $100,000 each for a total line of credit of $1,000,000, with the amount funded on the loans totaling $500,000. [Bank A]'s lending limit is $700,000. The copy of the December 1, 1995, commitment letter from [Bank B] provides that they have approved a loan participation request up to $900,000 in a $1,250,000 line of credit to [Bank A]. [Bank B's] commitment letter specifies the loan amounts, interest rate, purpose, maturity date, collateral, and allocation of interest and principal payments. [Bank B]'s commitment letter does not specify if there will be a pro rata sharing of credit risk between it and [Bank A].

Under 7 TAC §12.4(a), "a commitment to lend, when combined with all other loans or extensions of credit to a borrower, must be within the bank's legal lending limit at the time the commitment becomes binding, and advances may be made under a binding agreement to lend even if the advances would exceed the bank's holding lending limit on the date of funding." To determine whether a commitment to lend is within a bank's lending limit when made, a bank may deduct from the amount of the commitment the amount of each legally binding loan participation agreement executed concurrently with the bank's commitment that would be excluded from a loan or extension of credit under 7 TAC §12.3(b)(3). Under §12.3(b)(3), loans or extensions of credit do not include "that portion of a loan or extension of credit sold as a participation by a bank on a nonrecourse basis, provided the participation results in a pro rata sharing of credit risk proportional to the respective interests of the originating and participating lenders. . ."

Although a formal participation agreement is not specifically required by §12.4(a) and §12.3(b)(3), §12.3(b)(3) requires that the participation result in a pro rata sharing of credit risk proportional to the respective interests of the originating and participating lenders. Therefore, so long as the participation established by [Bank B]'s December 1, 1995, commitment letter results in a pro rata sharing of credit risk between it and [Bank A], [Bank A]'s commitment to lend $1,000,000 will not cause it to exceed its $700,000 legal lending limit.

This opinion is limited to the facts and circumstances set forth in your letter, dated January 5, 1996, and any change in those facts and circumstances may result in a different opinion. Please call me if you have any questions or comments.

<u>Opinion No. 96-4</u>

The obligation of a bank customer/auto supplier, to repurchase residual value of leased autos from a state bank/lessor at the end of lease term, is not a loan to the customer/auto supplier for legal lending limit purposes.

April 15, 1996
Jerry G. Sanchez, Assistant General Counsel

Your letter dated February 5, 1996, has been forwarded to me for response. You requested an opinion as to whether the residual values of automobiles under The First State Bank of [*****'s] ("First State") automobile leasing program should be allocated to the lending limit of [*****] Leasing Inc. ("Corp."). Corp. is an independent company, based in Corp., Texas, which provides various bank services.

First State primarily disseminates the availability of its automobile leasing program through utilization of brochures, available in its lobby, and by having its loan officers verbally inform potential leasing customers of the leasing program. First State refers these bank customers to Corp. The bank customers are qualified by First State on the basis of their creditworthiness only. Corp. and each bank customer enter into written lease agreements. These lease agreements, along with ownership of the automobile(s), are assigned to First State which pays Corp. lease transaction fees. Following First State's acceptance and approval of a lease agreement, it pays the draft submitted by the car dealership which has supplied the automobile to be leased.

In the event that a lease is paid in full at the end of its lease term, Corp. is obligated to repurchase the automobiles from First State for their residual values. Corp.'s obligation to repurchase the leased automobiles does not entail First State advancing funds to Corp. When Corp. pays the residual value of an automobile, Corp. acquires ownership of the automobile. Utilizing a standardized guidebook, Corp. sets the residual values of the automobiles and estimates that only 15% of the automobiles will actually go to the end of the lease terms. In the event of an early termination of a lease, Corp. is not obligated to repurchase the automobiles or for any loss incurred on the automobiles.

Under TEX. REV. CIV. STAT. art. 342-5.201(a) (the "Act") [*now Finance Code §34.201(a)*], the total loans and extensions of credit by a state bank outstanding at any one time to a person may not exceed 25% of the bank's capital and certified surplus.[1] The term "loans and extensions of credit" are defined in the Act, §1.002(a)(34) [*now Finance Code §31.002(a)(34)*], as "...direct or indirect advances of funds by a state bank to a person that are conditioned on the obligation of the person to repay the funds or that are repayable from specific property pledged by or on behalf of the person."

Although Corp. is obligated to repurchase leased automobiles at the end of their lease term, First State is not directly or indirectly advancing funds to Corp. for the repurchase of these leased automobiles. Therefore, Corp.'s obligation to repurchase the leased automobiles does not constitute a loan or extension of credit as defined in [*Finance Code §31.002(a)(34)*]. Accordingly, the residual values of the leased automobiles which Corp. is obligated to repurchase at the end of the lease terms need not be allocated to Corp.'s lending limit. Of course, it would be prudent for the bank to be aware of the extent and condition of Corp.'s obligations to First State under the leasing program in connection with a future decision to extend credit to Corp.

This opinion is limited to the facts and circumstances in your letter, dated February 5, 1996, and subsequent information provided by you, and any change in those facts and circumstances may result in a different opinion. Please call me if you have any further questions.

[1] *Effective September 1, 2001, this limitation is stated as "25% of the lesser of bank's capital and certified surplus or total equity." Act of May 22, 2001, 77th Leg., H.B. 2155, §12.*

Opinion No. 96-9

Substantial financial interdependence does not exist between related entities and the loans are therefore not aggregated for legal lending limit purposes, even though an accommodation guaranty exists.

April 18, 1996
Jerry G. Sanchez, Assistant General Counsel

This letter is in response to your letters dated January 11, 1996, and February 23, 1996. You requested an opinion as to whether a proposed $500,000.00 line of credit for [*****] Timber Co., should be aggregated with the indebtedness of [Persons A's and B's] broiler farm ($330,139.00) and [*****] Farms, Inc. ($249,648.00), for lending limit purposes.

Based solely on the information in your letters, my understanding of the facts are as follows:

1. Three entities are involved: [Persons A's & B's] broiler farm; [*****] Farms, Inc.; and [*****] Timber Co., Inc.;

2. [Person A] owns 50% of [Persons A's & B's] broiler farm, 100% of [*****] Farms, Inc., and [*****] Timber Co., Inc.;

3. [*****] Timber Co., Inc.'s debt is personally guaranteed by [Person A];

4. [Person A] is the President of all three entities;

5. None of the gross receipts or expenditures of the three entities (on an annual basis) are derived from transactions with each other;

6. The sole interrelated transaction between the entities involved the recent sale of commercial real estate from [*****] Farms Inc., to [*****] Timber Co., evidenced by a promissory note secured by a second lien on said property; and,

7. The actual source of repayment of the outstanding indebtedness of the [Persons A's & B's] broiler farm ($330,139.00) and [*****] Farms, Inc. ($249,648.00), is derived from income received from the sale of birds raised on each farm, and the actual source of repayment of [*****] Timber Co.'s indebtedness is derived from the sale of timber.

Under TEX. REV. CIV. STAT. art. 342-5.201(a) (the "Act") [*now Finance Code §34.201(a)*], the total loans and extensions of credit by a state bank outstanding at any one time to a person may not exceed 25% of the bank's capital and certified surplus.[1] The term "loans and extensions of credit" are defined in the Act, §1.002(a)(34) [*now Finance Code §31.002(a)(34)*], as "...direct or indirect advances of funds by a state bank to a person that are conditioned on the obligation of the person to repay the funds or that are repayable from specific property pledged by or on behalf of the person."

Under 7 TAC §12.9, a loan or extension of credit to one borrower is attributed to another person, and each person will be considered a borrower if a common enterprise is deemed to exist or the expected source of repayment for each loan or extension of credit is the same for each person. Under 7 TAC §12.9(c)(1), a common enterprise is considered to exist and loans to separate borrowers will be aggregated if a loan or extension of credit is made to borrowers who are related directly or indirectly through common control, or made to a borrower directly or indirectly controlled by another borrower, if substantial financial interdependence exists between or among the borrowers. Under 7 TAC §12.9(c)(2), substantial financial interdependence exists if 50% or more of one borrower's gross receipts or gross expenditures (on an annual basis) are derived from transactions with the other borrower and is presumed to exist, subject to rebuttal, if 25% or more of one borrower's gross receipts or gross expenditures (on an annual basis) are derived from transactions with the other borrower. Gross receipts and expenditures include gross revenues and expenses, intercompany loans, dividends, capital contributions, and similar receipts and payments.

Because none of the entities' gross receipts or expenditures (on an annual basis) are derived from transactions with each other, it does not appear that a common enterprise exists between the entities. The one-time sale of commercial real estate from [*****] Farms, Inc., to [*****] Timber Co., is insufficient to constitute a common enterprise. Additionally, although

[1] *Effective September 1, 2001, this limitation is stated as "25% of the lesser of bank's capital and certified surplus or total equity." Act of May 22, 2001, 77th Leg., H.B. 2155, §12.*

[Person A] owns 50% of the [Persons A's & B's] broiler farm, 100% of [*****] Farms, Inc., and [*****] Timber Co., Inc., and he personally guaranteed [*****] Timber Co., Inc.'s indebtedness, it does not appear that [Person A] is the primary source of repayment for the [*****] Farms, Inc., and [*****] Timber Co., Inc., indebtedness. The actual source of repayment of the outstanding indebtedness of the [Persons A's & B's] broiler farm and [*****] Farms, Inc., is derived from income received from the sale of birds raised on each farm, and the actual source of repayment of [*****] Timber Co.'s indebtedness is derived from the sale of timber. Therefore, because it does not appear that a common enterprise exists between the three entities and the actual source of repayment for each of the entities' loans or extensions of credit is not the same person, it does not appear that the entities' loans or extensions of credit will be aggregated for lending limit purposes.

Also, under 7 TAC §12.9(g), the derivative obligation of a guarantor is not aggregated with direct loans or extensions of credit of the guarantor if the lending bank is relying primarily on the creditworthiness of the primary obligor. The reliance of the lending bank on the primary obligor must be evidenced by the certification of the bank officer that the bank, is on stated facts, relying primarily on the responsibility and financial condition of the primary obligor for repayment of the loan or extension of credit and not on the guarantee of the guarantor. Therefore, if your bank has the requisite certification, supported and evidenced by financial information in the bank's files and actual operating practices by the bank and the parties, that it is relying primarily on the creditworthiness of [*****] Timber Co., Inc., and not the personal guarantee of [Person A], then [*****] Timber Co., Inc.'s indebtedness need not be aggregated with [Person A's] indebtedness for purposes of the legal lending limit. If your bank does not have the requisite certification and financial information, [*****] Timber Co., Inc.'s indebtedness may be aggregated with [Person A's] indebtedness by examiners for purposes of the legal lending limit.

Please be advised that although the three entities' indebtedness need not be aggregated for purposes of the 25% general lending limit, under 7 TAC §12.9(e), loans or extensions of credit by a bank to a corporate group may not exceed 75% of the lesser of bank's capital and certified surplus or the bank's total equity capital. For purposes of 7 TAC §12.9(e), a "corporate group" includes a person and all of its subsidiaries, and a corporation or other entity is a subsidiary of a person if the person owns or beneficially owns directly or indirectly more than 50 percent of the voting securities or voting interests of the corporation or other entity.

Your bank is further cautioned that the purpose of the lending limit is to reduce risk by preventing one individual, or a relatively small group, from borrowing an unduly large amount of the state bank's funds. These types of loans will be closely scrutinized by an examiner.

Finally, this opinion is limited to the facts and circumstances set forth in your letters, dated January 11, 1996, and February 23, 1996, and subsequent telephone conversations between you and my office. Any change in those facts, circumstances, or the parties to the transaction may result in a different opinion.

Opinion No. 96-11

A state bank may acquire a company that provides consulting services to depository institutions.

May 6, 1996
D'Ann Johnson, Assistant General Counsel

This letter is in response to your letter dated April 2, 1996. You have requested confirmation that your client, a state bank, may acquire a company that provides consulting services with regard to designing loan applications and other forms, providing operations analysis and inventory control to other depository institutions and operate it as a subsidiary. You have also requested confirmation that the contemplated activities are "activities that may be engaged in directly by the bank" for purposes of §5.103(b) of the Texas Banking Act [*now Finance Code §34.103(b)*].

We view the contemplated activities you describe as activities that may be engaged in directly by the bank, and therefore conclude that your client may acquire a company providing such consulting services to other depository institutions.

A state bank may engage in any activity, directly or through a subsidiary, authorized by the [*Finance Code*] or determined by the Banking Commissioner to be closely related to banking. Sec 3.001(a)(4) [*now in substance Finance Code §32.001(b)(6), pertaining to activities financial in nature, and (b)(7)*]. Additionally, a state bank may exercise incidental powers necessary to carry on the business of banking. Sec. 3.001(a)(1) [*now Finance Code §32.001(b)(1)*]. Providing consulting services for depository institutions is considered incidental to the business of banking and is an activity that may be engaged in directly by the bank.

Likewise, providing the consulting services you describe does not violate §5.107 of the Texas Banking Act [*now Finance Code §34.107*].

This opinion is limited to the facts and circumstances stated in your letter of April 2, 1996. Any change in those facts or circumstances may result in a different opinion.

Opinion No. 96-15

A trust company may receive trustee fees based on the investment income of trusts in this particular circumstance because proposed contractual and policy restrictions on investments will substantially ameliorate any conflicts of interest that could arise.

May 24, 1996
Jerry G. Sanchez, Assistant General Counsel

Your letter to Larry Hearn of our office has been forwarded to me for response. You requested an opinion from the Texas Department of Banking (the “Department”) regarding the proposed activity of [*****], to serve as trustee for church bond issues. In particular, you indicate that [*****] would like to accept appointments as trustee for church bond issues which require all or a portion of the underwriter’s and/or trustee’s fees be derived from investments of bond proceeds or sinking fund payments. You assert that it is common practice in the church bond industry for churches to have the option to use all or a portion of the investment income on those funds to pay the fees of the trustee and underwriter. However, because the trustee’s fees will be measured by the amount of the underlying investments, a conflict of interest may arise between a trustee’s fiduciary duty to preserve the trust income for the income beneficiaries and remaindermen and the payment of its own fees as measured by the amount of investment income from bond proceeds and sinking funds.

The investment provisions in the proposed new trust indentures and [*****’s] investment policies impose quality, maturity, and diversification restraints designed to meet liquidity necessary to fund scheduled bondholder maturities. The trust indenture for new issues will restrict investments of the bond proceeds account and the bond redemption and interest payment account to: (1) direct obligations of, and obligations fully guaranteed by, the United States of America, or any agency or instrumentality of the United States of America; (2) demand and time deposits in, or certificates of deposits of, any depository institution or trust company incorporated under the laws of the United States of America or any state thereof and subject to supervision and examination by federal and/or state banking authorities; (3) pooled or common trust funds of Trustee or an affiliate of Trustee acting as trustee and custodian, or registered funds comprised of any of the above-captioned eligible investments; (4) repurchase agreements fully collateralized by U.S. Treasury obligations; and, (5) money market or investment funds consisting of any or all of the defined eligible investments.

[*****’s] investment policies further prohibit investing in any security with a maturity of more than four years and require that [*****] maintain an overall average maturity on a dollar weighted basis of no more than 180 days. Each month, management will provide the Board with a Sinking Fund Liquidity Analysis showing the sources for funding the semi-annual bondholder disbursements scheduled for the next 12 months, and the Board must review and approve the current trust investments as suitable for current liquidity requirements. [*****’s] policy requires that the investments of bond proceeds and sinking funds be valued monthly using end of the month market values. Investments may be sold only on Board approval based upon a determination that it appears likely that current liquidity requirements will not permit the investment to be held to maturity.

TEX. PROP. CODE §113.051, generally provides that, "... the trustee shall administer the trust according to its terms and this subtitle..." and "... in the absence of any contrary terms in the trust instrument or contrary provisions of this subtitle, in administering the trust the trustee shall perform all of the duties imposed on trustees by the common law." The TEX. PROP. CODE §113.056(a) (the "Code"), provides that, "... a trustee shall exercise the judgment and care under the circumstances then prevailing that persons of ordinary prudence, discretion, and intelligence exercise in the management of their own affairs, not in regard to speculation but in regard to the permanent disposition of their funds considering the probable income from as well as the probable increase in value and the safety of their capital." The Code, §113.056(b), provides further that, "... a trustee may acquire and retain every kind of property and every kind of investment that persons of ordinary prudence, discretion, and intelligence acquire or retain for their own account." The Code, §113.101(a), specifically provides that a trustee shall administer the trust with due regard for the interests of income beneficiaries and remaindermen with respect to allocation of receipts and expenditures to income or principal. The Code, §113.171(a), provides further that, "... a bank or trust company qualified to act as a fiduciary in this state may establish common trust funds to provide investments to itself as a fiduciary..." The Code, §113.171(b), further provides that, "...the fiduciary or cofiduciary may place investment funds in interests in common trust funds if: (1) the investment is not prohibited by the instrument or order creating the fiduciary relationship; and (2) if there are cofiduciaries, the cofiduciaries consent to the investment." Additionally, Articles 342-1101 et seq., of the Texas Banking Code [*now Finance Code §§181.001 et seq.*], does not prohibit the payment of trustee fees measured by the amount of investment income from bond proceeds and sinking funds.

In the past, the Texas Department of Banking has objected to the payment of trustee fees measured by the amount of investment income from bond proceeds and sinking funds because of serious conflict of interest concerns. A conflict of interest may arise between the trustee's fiduciary duty to preserve the trust principal for the income beneficiaries and remaindermen, and the payment of its own fees as measured by the amount of investment income from bond proceeds and sinking funds. However, it appears that [*****'s] proposed contractual and policy restrictions on investments will substantially ameliorate any conflicts of interest that could arise as a result of the trustee and/or the underwriter receiving all or a portion of the earnings on these funds as fees pending disbursement to the bondholders. Therefore, [*****'s] proposed appointment as trustee for church bond issues wherein it will receive its fees in the form of investment income from bond proceeds and sinking funds, is permissible. However, we are also of the opinion that any loss of principal in such an arrangement is per se a breach of trust and must be immediately restored to the trust by [*****] out of its corporate funds. In this regard, we expect [*****] to maintain monthly valuations of the investment portfolio. We also expect [*****] to maintain capital, in excess of that required under Article 342-1108 of the Texas Banking Code [*now Finance Code §182.103*], sufficient to absorb any market depreciation of the investment portfolio.

This opinion is limited to the facts and circumstances set forth in your letter, and any change in those facts or circumstances may result in a different opinion. Please call me if you have any questions or comments.

Opinion No. 96-18

A leased facility 500 feet from the home office of a state bank is considered a home office extension and not a branch.

July 8, 1996
D'Ann Johnson, Assistant General Counsel

This is in response to your letter of April 12, 1996. You have requested an opinion whether a leased facility, approximately 500 feet from the home office would be considered part of the home office of the Bank or a new form of banking facilities under the provisions of the Texas Banking Act, TEX. REV. CIV. STAT. ANN. arts. 342-1.001 et seq. (the "Act") [*now codified in the Finance Code*], particularly §3.201(c) of the Act [*now Finance Code §32.201(c)*]. Additionally, you have requested approval of the lease agreement for the new facility with a father and business partner of a director of the bank.

Texas has long-recognized an extension of bank office doctrine. See TEX. REV. CIV. STAT. ANN. art. 342-903(1)(b) and (1)(d)(3) (repealed); 7 TAC §3.91 (repealed); and Op. Atty. Gen. JM-498 (1986). The statutes, amendments, regulations and decisions, however, have not necessarily distinguished between the types of services offered and the physical connection attributes of the additional facility. *Id.* at 11.

Repealed Article 342-903 was replaced with the Act, §§3.201-3.205 [*now Finance Code §§32.201-32.204, 59.201*]. The Act also includes a definition of "home office" in §1.002(a)(30) [*now Finance Code §31.002(a)(30)*]. These provisions primarily address the types of services provided at different types of banking facilities. See §3.201(a) - drive in facilities

[*now Finance Code §32.201(a)*]; §3.201(b) - an office that does not involve banking contact with the public [*now Finance Code §32.201(b)*]; §3.201(c) - a new form of banking facility [*now Finance Code §32.201(c)*]; §3.203 - branch offices [*now Finance Code §32.203*]; §3.204 - electronic terminals [*now Finance Code §59.201*]; and §3.205 - loan production offices [*now Finance Code §32.204*]. The physical connection attributes concept, derived from prior statutes and opinions, is included by inference in the [*Finance Code*], most explicitly in [*Finance Code §32.201(a)*]. This section provides that a drive in facility within 2,000 feet of the nearest wall of a bank's home or branch office is considered an extension of that office.

Under the [*Finance Code*], we have not previously determined what other factors may be considered in determining whether a facility is an extension of an existing office. We note that the OCC has identified a nonexclusive list of factors that are relevant in making such a determination. We consider the following factors relevant:

- The distance between the existing office and the proposed facility.
- Whether there is a direct line of sight between the two facilities and how the intervening space is used.
- Whether the two facilities are connected in any way, such as by a pneumatic tube.
- The purpose of the proposed facility.
- Whether the facility is physically situated in such a way as to give the bank a material advantage over competitors in attracting customers.
- The dependency of the proposed facility on the existing office.
- The availability for expansion of adequate sites closer to the existing office.
- The existing facility's demonstrated need for such a facility.
- Whether a national bank could operate a proposed facility as an extension.
- Whether the arrangement provides convenience to the customers of the bank.

A determination whether a particular facility is an extension or some other form of banking facility must be made on a case by case basis. None of the factors alone is controlling. According to the facts as you have described them, the Bank has outgrown its current headquarters. The Bank proposes to use the facility to initiate a small consumer loan organization for area residents. The Bank contemplates that a competent lending officer will office at the leased facility, take and process loan applications, and prepare and execute loan documents. However, funding of the loans will occur at the existing bank facility. Additionally, the facility will house a collection officer and provide for supplemental parking spaces. You have also indicated that this location is approximately 500 feet from the present facility. There is a direct line of sight between the two facilities and no closer facility is available. The intervening space is occupied by some small business operations.

Based on these facts, we have determined that the proposed facility will be an extension of the existing home office and not a branch. Please notify the Department five days prior to the opening of the extension office. Please provide the address of the extension in the notice. You should also contact the appropriate federal regulator regarding their requirements.

Regarding your second question, you stated that the director is not involved in a business partnership involving real estate leasing rentals with his father and that he has no financial interest in this property. Additionally, a disinterested majority of the Board, excluding the affected director, approved the lease and the lease payment of $250 monthly.

Based on the facts as you have described them, approval by the Banking Commissioner of the lease agreement for the new facility is not required under the Act, §4.107(b).[1]

Opinion No. 96-19

Bank freeze-out mergers are permissible under Texas law.

May 23, 1996
Everette D. Jobe, General Counsel

Banking Commissioner Ghiglieri has requested that I respond to your letter dated April 15th, urging that the referenced, proposed merger not be approved as not in compliance with state and federal laws. Specifically, you object to the failure of the transaction to offer the same treatment to similarly situated shareholders, referring to the proposal as a "freeze out" merger. I have reviewed your letters of April 15th and May 10th as well as the reply letter from [*****] dated May 2nd. A "freeze out" merger is generally characterized as a merger in which selected shareholders receive stock in the new bank and all other shareholders must take cash under the terms of the plan of merger.

We disagree with your conclusion that a freeze out merger is impermissible under Texas law. The case you cite, *Lewis v. Clark* [sic], 911 F.2d 1558 (11th Cir. 1990), is not controlling, does not interpret Texas law, and in our view is an incorrect statement of the law governing bank mergers. The better view of modern law is expressed in *NoDak Bancorporation v. Clarke*, 998 F.2d 1416, 1423-24 (8th Cir. 1993). In our opinion, a freeze out merger is permissible under Texas law.

Pursuant to TEX. REV. CIV. STAT. ANN. art. 342-3.007(a) [*now Finance Code §32.008(a)*], "[t]he Texas Business Corporation Act ... [applies] to a state bank to the extent not inconsistent with this Act or the proper business of a state bank." TEX. BUS. CORP. ACT (TBCA) art. 5.01(B)(3) provides that a plan of merger must set forth "the manner and basis of converting <u>any</u> of the shares ... of each ... entity that is a party to the merger into shares, obligations, evidences of ownership, rights to purchase securities or other securities of one or more of the surviving ... entities, into cash or other property, ... or into any combination of the foregoing." (emphasis added). TBCA art. 5.06(A)(7) provides that "the former holders of the shares of each domestic corporation [in this context, a state bank] that is a party to the merger shall be entitled only to the rights provided in the articles of merger or to their rights under Article 5.11 of this Act." The articles of merger incorporates the plan of merger, see TBCA art. 5.04(A)(1).

TBCA art. 5.11 grants dissenters rights, implemented by the procedure set forth in TBCA art. 5.12 (also see TEX. REV. CIV. STAT. ANN. art. 342-3.303 [*now Finance Code §32.303*]). As stated in TBCA art. 5.12(G), "[i]n the absence of fraud in the transaction, the remedy provided by this Article to a shareholder objecting to any corporate action referred to in Article 5.11 of this Act is the exclusive remedy for the recovery of the value of his shares or money damages to the shareholder with respect to the action."

Nothing in the literal language of these Texas statutes prohibits cashing-out minority shareholders in a merger transaction. Protection of the minority shareholders is accomplished through the statutory right to dissent and the right to pursue appropriate, additional remedies in the event of fraud. Assuming the proposed merger is approved by regulatory authorities (regarding which I make no representation), in the absence of fraud, your clients as their sole remedy have the option of accepting the consideration specified in the plan of merger or dissenting from the merger in accordance with statutory procedures.

Prior to August 26, 1985, to approve a merger under former TEX. REV. CIV. STAT. ANN. art. 342-308 (repealed), we were required to find that the proposed merger "is to the best interest of the depositors, creditors and stockholders of the merging banks and of the public in general [and] that the distribution of the stock of the resulting bank is to be upon an equitable

[1] *Act §4.107(b) was codified as Finance Code §33.109(b) in 1997, but later repealed by Act of May 15, 2001, 77th Leg., ch. 412, 2001 Tex. Sess. Law Serv. 701 (Vernon), eff. Sept. 1, 2001.*

basis....” These quoted requirements were deleted in 1985 in connection with the addition of dissenters’ rights to the Texas Banking Code, determined with reference to the TBCA; Acts 1985, 69th Leg., ch. 639, §7. Therefore, again assuming that we approve the proposed merger, our approval merely constitutes permission to proceed with the merger and should not be construed as an approval or endorsement of the adequacy of consideration offered to any shareholder.

Opinion No. 96-25

A violation of the legal lending limit does not excuse the borrower from repaying the loan.

September 16, 1996
D’Ann Johnson, Assistant General Counsel

This is in response to your letter of July 16, 1996. You have requested an opinion whether a borrower is excused from repaying a loan if, when the loan was made, the amount of the loan exceeded the bank’s lending limit.

In such an instance, a borrower is not excused from repaying a loan. A violation of the lending limit statute does not enable a borrower to avoid repaying the funds received under a contractual agreement. A bank’s lending limit is a matter between the government and the bank; it does not affect the validity of the contract or obligations of the parties. *Teague Indep. School Dist. V. First State Bank*, 241 S.W. 608, 613 (Tex. Civ. App.–Dallas 1922, writ ref’d). Lending limits are designed to protect the bank’s finances, not to benefit borrowers. *Valente v. Dennis*, 437 F. Supp. 783, 786 (E.D. Pa. 1977). Moreover, excusing the borrower would sanction violations of the lending limit statute by compensating those who were parties to and beneficiaries of a forbidden excessive loan. *Id. See also*, *Goldstein v. Union Nat’l Bank*, 213 S.W. 584, 588 (Tex. 1919).

The United States Supreme Court has also held that a violation of the federal lending limit statute does not excuse the borrower from repaying the loan. *Union Gold Mining Co. v. Rocky Mountain Nat’l Bank*, 96 U.S. 640 (1878). The Court stated: “ We do not think that public policy requires or that Congress intended that an excess of loans beyond the proportion specified should enable the borrower to avoid the payment of money actually received by him.” *Id.* At 642.

In summary, a borrower is not excused from repaying a loan that was in excess of a bank’s legal lending limit when the loan was made.

Opinion No. 96-26

An Automated Loan Machine is considered an electronic terminal, not a branch, and may be established under ATM licensing rules.

November 18, 1996
D’Ann Johnson, Assistant General Counsel

Your letter of July 12, 1996 has been referred to me for response. You have asked what type of application and approval will be required from the Banking Department in order to install Automated Loan Machines (“ALMs”).

An ALM is an automated and consumer-driven loan process. Through the use of new technology, a consumer can apply and receive a loan in a short period of time without intervention by bank personnel. The electronic terminal uses touch-screen technology and instant identity verification to receive and process loans. The terminals are similar in appearance to ATMs and may be accessible to consumers 24 hours a day. ALMs are not restricted to bank lenders.

The ALM requires the applicant to provide personal identification information, which the ALM verifies through a fraud detection analysis. After passing this analysis, the applicant provides background and financial information. If the applicant meets the basic underwriting requirements, the ALM obtains a credit report and applies the lenders’ credit scoring to the application. If the applicant is approved, the applicant chooses insurance and repayment options and signs the loan documents appearing on the screen with an electronic pen. The applicant chooses how the funds will be disbursed, including the receipt of a cashier’s check received at the electronic terminal or deposit into an existing account. No cash is disbursed and no deposits are taken. No credit decision is made at the terminal; rather the lending decision is made and funds are disbursed from the principal office of the financial services provider. Therefore, loans initiated through an ALM are not subject to the [*Home Solicitation Transactions Act, now Tex. Bus. & Comm. Code §39.01 et seq.*].

Under Texas law, an ALM is considered an electronic terminal. "Electronic terminal" means an electronic device, other than a telephone or modem operated by a customer of a depository institution, through which a person may initiate an electronic fund transfer, as defined in 15 USC §1693a(6). The term includes, but is not limited to, a point-of-sale terminal, automated teller machine, or cash dispensing machine. TEX. REV. CIV. STAT. ANN. art. 342-1001(a)(19) ("Texas Banking Act") [*now Finance Code §31.002(a)(19)*]; see also 15 USC §1693a(7). An electronic terminal is exempted from the definition of branch under state law. See §1.001(a)(8) of the Texas Banking Act [*now Finance Code §31.002(a)(8)*]. Additionally, recent amendments to federal statutes likewise have clarified that the term "branch" does not include an automated teller machine or a remote service unit. As an electronic terminal, an ALM is subject to the standards of §3.204 of the Texas Banking Act [*now Finance Code §§59.201, 59.202*] and the safety standards required by the ATM User Safety Act, TEX. REV. CIV. STAT. ANN. art. 342-903d [*now Finance Code §§59.301 et seq.*] and 7 TAC §3.92.

Currently, to establish an ATM, the Department requests that the bank inform the Department of the location, the date service will be initiated, and whether the terminal will be shared with another institution. These same requirements would apply to an ALM.

The conclusion in this opinion is limited to the facts as described. Please contact me if you have further questions.

Opinion No. 96-27

A state bank may make an unsecured loan to its employee stock ownership plan under certain conditions.

September 27, 1996
Jerry G. Sanchez, Assistant General Counsel

Your letter of July 15, 1996, to Larry Hearn, has been referred to me for response. You have asked whether [Bank A], may make an unsecured loan to its Employee Stock Ownership Plan (the "ESOP") which would be fully offset by previously booked liability. Pursuant to prior approval obtained from the Texas Department of Banking (the "Department"), [Bank A] currently guarantees the repayment of principal and interest of a loan made to the ESOP by [Bank B]. The bank stock held by the ESOP is not used as collateral for the [Bank B] loan. Also, [Bank A] has reduced its capital in the amount of this contingent liability. You have represented that the trustee of the ESOP is an executive officer of [Bank A].

[Bank A] proposes to make an unsecured loan to the ESOP for the purpose of retiring the ESOP's indebtedness to [Bank B]. We conclude that [Bank A] may do so if it carefully considers safety and soundness issues in making the proposed unsecured loan, subject to limitations regarding loans to affiliates under 12 USC §371c, and loans to executive officers, directors, or principal shareholders under 12 USC §375b, to the extent applicable.

First, so long as [Bank A's] proposed loan to the ESOP is unsecured, [Bank A] would not be at risk of violating the general prohibition against a state bank acquiring a lien or title to its own shares or participation shares under §5.102 of the Texas Banking Act [*now Finance Code §34.102*]. However, an unsecured loan must be a good loan and must not constitute an unsafe or unsound banking practice. Whether [Bank A's] proposed loan to the ESOP will constitute an unsafe or unsound banking practice will be based on an analysis of the size of the loan as measured against the size and condition of [Bank A].

Second, the proposed loan to the ESOP may be includible within loans to the trustee for purposes of the limitations on extensions of credit imposed by Reg O (12 CFR Part 215), applicable with limited exceptions to nonmember banks by virtue of 12 USC §1828(j)(2) and 12 CFR §337.3. For example, 12 USC §375b(5) provides that loans to an executive officer, director, or principal shareholder, or to any related interest of such a person, when aggregated with the amount of all outstanding loans by a bank to its executive officers, directors, principal shareholders, and those persons' related interests must not exceed the bank's unimpaired capital and unimpaired surplus. Under 12 CFR §215.4(b) and §337.3(b), a loan to a person subject to Reg O or such person's related interests must be approved in advance by a majority of the disinterested members of the board of directors if the aggregate amount of loans to such person and such person's related interests, including the proposed ESOP loan, would exceed $500,000, or exceed the higher of $25,000 or five percent of the bank's unimpaired capital and unimpaired surplus. Related interest of a person is defined in 12 USC §375b(9)(G)(1) and 12 CFR §215.2(n) as a company that is controlled by that person. Thus, because the trustee controls the ESOP, the ESOP is a related interest of the trustee, and the trustee is an executive officer of [Bank A], the proposed loan to the ESOP may be included within loans to the trustee for purposes of the limitations on extensions of credit imposed by Reg O (12 CFR Part 215).

Third, an inquiry must be made as to whether the ESOP is an affiliate of [Bank A] for purposes of 12 USC §371c, made applicable to nonmember insured banks by virtue of 12 USC §1828(j)(1). Affiliate is defined in 12 USC §371c(b)(1)(C) in pertinent part as:

> (c) any company--
> (i) that is controlled directly or indirectly, by a trust or otherwise, by or for the benefit of shareholders who beneficially or otherwise control, directly or indirectly, by trust and otherwise, the member bank or any company that controls the member bank; or
> (ii) in which a majority of its directors or trustees constitute a majority of the persons holding any such office with the member bank or any company that controls the member bank.

12 USC §371c(b)(6) defines the term "company," as a "...corporation, partnership, business trust, association, or similar organization..." OCC Interpretative Letter No. 719 (May 1996) construes an ESOP to be a "business trust or similar organization." Accordingly, for purposes of 12 USC §371c, an ESOP is a "business trust or similar organization," which falls within the definition of "company." 12 USC §371c(b)(3)(A)(i)-(iii) defines the term "control" to include the power to vote twenty-five percent (25%) or more of any class of voting stock of the Bank, the power to appoint a majority of the board of directors or trustees of the Bank, or the power to influence the management and policies of the Bank. Therefore, if the ESOP is in "control" of [Bank A], it is an "affiliate" and subject to the provisions of 12 USC §371c.

The limitations of 12 USC §371c may also be applicable to the proposed loan to the ESOP if the ESOP is controlled by a trustee who controls, directly or indirectly, [Bank A]. 12 USC §371c (b)(3)(A)(i)-(iii) defines the term "control" to include the power to vote twenty-five percent (25%) or more of any class of voting stock of the Bank, the power to appoint a majority of the board of directors or trustees of the Bank, or the power to influence the management and policies of the Bank. If the executive officer that is the trustee of the ESOP has the power to influence the management and policies of [Bank A], then the proposed loan to the ESOP may be subject to the limitations of 12 USC §371c.

Finally, you may wish to consider that under 26 USC §4975(c)(1)(B), the lending of money or other extension of credit between a plan and a "disqualified person" is considered a prohibited transaction which is subject to federal taxation. 26 USC §4975(e)(2) defines "disqualified person" as "an employer any of whose employees are covered by the plan." However, under 26 USC §4975(d)(3), a loan to a leveraged employee stock ownership plan may be exempt from designation as a prohibited transaction if such a loan is primarily for the benefit of participants and beneficiaries of the plan, and such a loan is at a reasonable rate of interest, and any collateral which is given to a disqualified person by the plan consists only of qualifying employer securities. It is recommended that [Bank A] consult with a tax professional to ensure that its proposed loan to the ESOP will be qualified under the Internal Revenue Code §401, 26 USC §401.

The opinion is limited to the facts and circumstances stated in your letter of July 15, 1996, our telephone conversation of September 5, 1996. Any change in those facts or circumstances could result in a different conclusion regarding this issue.

Opinion No. 96-31

A state bank may make a non-controlling minority investment in another entity under certain conditions.

September 24, 1996
Jerry G. Sanchez, Assistant General Counsel

Commissioner Ghiglieri has requested that I respond to your letter dated August 13, 1996, regarding your client's desire to make a minority investment in an entity in which it will have a 44 percent voting interest and a 40 percent equity interest. As a matter of parity pursuant to the Texas Banking Act ("Act"), §3.010 [*now Finance Code §32.009*], we have concluded that a state bank may make a direct equity investment into an entity in which it will own less than a 50 percent interest, and the locations at which that entity will conduct business are not subject to branching restrictions as further described and limited by this letter, notwithstanding the provisions of the Act, §5.103 [*now Finance Code §34.103*].

[*Finance Code §34.103*] clearly provides the authority for a state bank to invest in an operating subsidiary that conducts activities authorized for a state bank or bank holding company. The statute further permits a state bank to make a minority investment indirectly through an operating subsidiary in certain types of entities. A "minority interest" has been interpreted to mean 50 percent or less. However, the statute does not provide the authority to make a direct investment of this type.

According to your letter, the Bank currently has not been active in the mortgage business. The Bank has been presented with an opportunity to make a minority investment in [*****] Holding Company ("Holding Company") and thereby engage in residential mortgage lending activities through Holding Company's wholly-owned subsidiary, [*****] Mortgage Company ("Mortgage"). Holding Company's only activity is holding the stock of Mortgage. Mortgage's only activity is the origination of single family mortgage loans.

You represent that the Bank has concluded that it would be desirable to offer mortgage origination services through an entity in which the Bank would have a significant role but would not be the sole shareholder. The proposal contemplates that the Bank will hold approximately 40 percent of the outstanding shares of Holding Company, and 44 percent of the voting stock of Holding Company.

The Bank and all other investors who own voting stock of Holding Company propose to enter into an Operating Agreement that includes the following provisions:

1. Neither Holding Company nor Mortgage will conduct any line of business or engage in any material transaction or series of transactions other than the origination and servicing of residential mortgage loan and other matters incidental to that activity;

2. Holding Company and Mortgage will submit themselves to the extent legally required to the examination authority of the Texas Department of Banking ("TDB");

3. Holding Company's board of directors will have five members, including two directors designated by the Bank, two designated as the two outside investors owning voting stock and one, who will be selected by the two outside investors. The Bank will continue to have the right to designate two members of the Board as long as the 5,000 outstanding shares of class-B non-voting, cumulative preferred stock have not been redeemed by Holding Company through a simple majority vote of its Board;

4. Supermajority voting provisions will afford the Bank an effective veto power over certain major corporate actions, including any proposal that Holding Company or Mortgage enter into any line of business other than holding the shares of Mortgage and conduct any line of business or engage in any material transaction or series of transactions other than the origination and servicing of residential mortgage loans and other matters incidental to that activity. Under the supermajority provision, the approval of four of the five directors is required; and

5. The bylaws of Holding Company and Mortgage will be amended to provide that, in the event that Holding Company or Mortgage, with the necessary concurrence of at least four of the five directors of Holding Company, should determine to conduct any line of business or engage in any material transaction or series of transactions other than the origination and servicing of residential mortgage loans and other matters incidental to that activity, the Bank shall, within 180 days after such determination but in any event prior to the commencement of said transaction(s), either (a) obtain any requisite regulatory approval, including any requisite notices to or approvals or waivers from the TDB, or (b) divest itself of ownership of its shares in Holding Company.

Analysis

A. Incidental Powers (Act, §3.001(1) [*now Finance Code §32.001(b)(1)*])

The OCC has permitted national banks to own minority interests stock in subsidiary corporations. Recent OCC interpretive letters extensively analyzed the authority of national banks under 12 USC 24(Seventh) to own stock, and reviewed OCC precedents on the ownership of stock in amounts less than that required for an operating subsidiary, See Interpretive Letters No. 697, 711, 731 and 732 as well as Conditional Approvals 194 and 202. Those documents concluded that such ownership is permissible provided that four standards, drawn from OCC precedents, are satisfied. They are:

1. The activities of the enterprise in which the investment is made must be limited to activities that are part of, or incidental to, the business of banking;

2. The bank must be able to prevent the enterprise from engaging in activities that do not meet the foregoing standard, or be able to withdraw its investment;

3. The bank's loss exposure must be limited, as a legal and accounting matter, and the bank must not have open-ended liability for the obligations of the enterprise; and

4. The investment must be convenient or useful to the bank in carrying out its business and not a mere passive-investment unrelated to that bank's banking business.

As a matter of parity with national banks pursuant to [*Finance Code §32.009*], we are of the opinion that the Bank may make a direct investment in an entity in which the Bank will have a minority interest. Each of the above four standards are discussed below, and applied to your proposal.

1. The activities of the enterprise in which the investment is made must be limited to activities that are part of, or incidental to, the business of banking, under [*Finance Code §32.001(b)(1)*].

It is clear that mortgage banking activities are permissible for state banks. Therefore, this standard is satisfied.

2. The bank must be able to prevent the enterprise from engaging in activities that do not meet the foregoing standard, or be able to withdraw its investment.

The activities of an enterprise in which a state bank invests must be part of or incidental to the business or banking not only at the time the bank initially purchases stock, but they must remain so for as long as the bank has an ownership interest. However, minority shareholders in a corporation do not possess a veto power as a matter of corporate law. One way to address this problem is for the corporation's articles of incorporation or bylaws to limit its activities to those that are permissible for state banks. In this instance, the bylaws of Holding Company and Mortgage are being amended to restrict the activities of those entities.

Contractual solutions are also feasible. In the present case, the Bank and all other investor groups have entered into an Operating Agreement to address this concern. The Agreement provides that neither the Holding Company nor any of its subsidiaries (e.g., Mortgage) will conduct any business or engage in any material transaction or series of transactions other than the origination and servicing of residential mortgage loans and other matters incidental to that activity. In addition, as described above, board of directors supermajority voting provisions will give the Bank a veto power over certain major corporate actions, as long as the Bank's 5,000 outstanding shares of Class B non-voting, cumulative preferred stock have not been redeemed by Holding Company. Without more, this would be insufficient; however, the operating agreement provides that in the event that Holding Company or Mortgage should determine to conduct or engage in any line of business or engage in any material transaction(s) other than the origination and servicing of residential mortgage loans and other matters incidental to that activity, the Bank shall either obtain any requisite regulatory approvals, including the TDB, or divest itself of ownership of its shares in Holding Company. These provisions assure that neither Holding Company nor Mortgage will engage in any activity that is not permissible for a corporation having a Texas bank shareholder.

3. The bank's loss exposure must be limited, as a legal and accounting matter, and the bank must not have open-ended liability for the obligations of the enterprise.

A primary concern of the OCC and this Department is that banks should not be subjected to undue risk. Where an investing bank will not control the operations of the entity in which the bank holds an interest, it is important that a bank's investment not expose it to unlimited liability. Normally, this is not a concern when investing in a corporation, for shareholders are protected by the "corporate veil" from liability for the debts of the corporation.

In the present case, both Holding Company and Mortgage will be separate corporations, with their own capital, directors, and officers. You represent that corporate formalities will be properly observed so as to minimize the possibility that the Bank could be subjected to liability for the obligations of those entities. Since all operations will be conducted by Mortgage, or at the second tier level, the Bank will have an extra layer of protection.

Further, you have informed us that the Bank has been advised by its independent accountants that the appropriate accounting treatment for its investment in Holding Company will be to report it as an unconsolidated subsidiary under the equity method of accounting. Under this method, which is used for equity interests of 20 to 50 percent in corporations, losses recognized by the investor will not exceed the amount of the investment (including extensions of credit or guarantees, if any) shown on the investor's books. See generally, Accounting Principles Board, Op. 18, 19 (1971) (equity method of accounting for investments in common stock).

Therefore, for both legal and accounting purposes, the Bank's potential loss exposure should be limited to the amount of its investment (plus, potentially, the amount of any extensions of credit that remain outstanding). Based on your representation that this exposure will be quantifiable and controllable, this standard is satisfied.

4. The investment must be convenient or useful to the bank in carrying out its business and not a mere passive investment unrelated to that bank's banking business.

[*Finance Code §32.001(b)(1)*], gives state banks incidental powers that are "necessary" to carry on the business of banking as provided by the [*Finance Code*]. "Necessary" has been judicially construed to mean "convenient or useful." *Arnold Tours, Inc. v. Camp*, 472 F.2d 427, 432 (1st Cir. 1972). While the Act, §5.101 [*now Finance Code §34.101*], generally prohibits state banks from investing in equity securities, its intent is to prevent speculation. The Act, §5.103(d)(2) [*now Finance Code §34.103(d)*], allows a state bank to make a minority investment directly through an operating subsidiary in equity securities of a company that engages solely in an activity that is permissible for a bank service corporation or a bank holding company subsidiary. National banks are permitted to directly own a minority interest in stock of subsidiary corporations under 12 USC 24 (Seventh). Thus, as a matter of parity pursuant to the Act, §3.010 [*now Finance Code §32.009*], a state bank may make a direct equity investment into an entity in which it will own less than a 50 percent interest.

The Bank wishes to reduce the resources that it must commit to providing capital and funding for Mortgage. The proposed investment will make that possible while retaining for the Bank the ability to offer a ready source of mortgage lending to customers and prospective customers of the Bank. As of March 31, 1996, Mortgage had approximately $50.5 million in total assets, $41.8 million of which was in first mortgage real estate loans held for sale. Total liabilities equaled $44.7 million and capital totaled $5.8 million. Net income for the first 3 months of 1996 totaled $371.8 million. During 1995, personnel and administrative expenses for Mortgage totaled in excess of $4.5 million, more than double the Bank's proposed investment in Holding Company.

The transaction will not result in a mere passive investment, for the Bank will continue to play an active part in the venture. With the exception of a small number of shares owned by officers and employees, there will be only two other shareholders in addition to the Bank. This, in itself, suggests that it will not be a passive investment. The Bank will hold two seats on the board of directors.

The TDB focuses its examination efforts on the levels of risk in the state banks that it supervises. By reducing its current financial commitment to Mortgage, the Bank will be able to diversify its use of funds and thereby reduce its level of risk. These factors demonstrate that the Bank's investment in Holding Company will provide a benefit that is convenient or useful to the Bank in carrying out its banking businesses, and the fourth standard is therefore satisfied.

B. Other Issues

1. Branching

The Bank's proposal also raises the issue of whether loans made by Mortgage should be attributed to the Bank, and locations of Mortgage treated as the Bank's locations, for purposes of applying branching restrictions.

The operations of a subsidiary are not attributed to a state bank for branching purposes merely because the bank conducts some of its core banking business through that subsidiary. State banks frequently use affiliates, third parties, or instrumentalities controlled by third parties, to facilitate their banking business, yet these entities are not considered to be branches of the bank. Also, state banks often own and operate subsidiaries. We conclude that the locations of Mortgage will not be treated as the Bank's locations for purposes of applying branching restrictions. See Attorney General Opinion H-1292 (1978); *Brenham Production Credit Ass'n v. Zeiss*, 264 S.W. 2d 95 (Tex. 1953); and, *Independent Bankers Association of New York v. Marine Midland Bank*, 757 F.2d 453 (2d Cir. 1985), cert. denied, 476 U.S. 1186 (1986).

2. Extensions of Credit

Sections 23A and 23B of the Federal Reserve Act, 12 USC 371c and 371c-1, place restrictions on extensions of credit and other transactions between member banks and their affiliates, but these restrictions will not apply to extensions of credit from the Bank to Holding Company or Mortgage after the restructuring. The Bank's ownership of Holding Company will qualify it and Mortgage as subsidiaries of the Bank for purposes of section 23A. With respect to a specified company, a "subsidiary" is a company that is controlled by the specified company, 12 USC 371c(b)(4); and a company is deemed to control another company if it has the power to vote 25 percent or more of any class of voting securities of that company, 12 USC 371c(b)(3)(A)(i). Since the statute excludes nonbank subsidiaries of member banks from the definition of "affiliate," 12 USC 371c(b)(2)(A), nonbank subsidiaries are not subject to the restrictions on transactions with affiliates. Section 23B incorporates the same definition of "affiliate." 12 USC 371c-1(d)(1).

In the event that Holding Company or Mortgage receive any loans from the Bank in the future, they will be treated as entities distinct from the Bank, and they will be subject to the lending limit rules established by the Act, §§5.201 et seq. [*now Finance Code §§34.201 et seq.*], as any other borrower unrelated to the Bank. The Act, §5.201(a)(13) [*now Finance Code §34.201(a)(13)*], exempts the indebtedness of an affiliate of a bank from the general 25 percent loan limitation if the transaction is subject to 12 USC §371c; however, this exemption will not be applicable to loans from the Bank to Mortgage. Also, the Act, §5.201(a)(14) [*now Finance Code §34.201(a)(14)*], exempts the indebtedness of an operating subsidiary of the bank from the general 25 percent loan limitation; however, this exemption will not be applicable to any loans from the Bank to Mortgage. Therefore, Holding Company and Mortgage will be subject to the lending limits established by [*Finance Code §§34.201 et seq.*].

3. Examination

Under the Act, §2.008 [*now Finance Code §31.107*], TDB requires that entities in which state banks invest be subject to TDB examination. The Operating Agreement to be entered into by the Bank and the other proposed investors in Holding Company provides that Holding Company and its subsidiaries will submit themselves to the examination authority of TDB. Accordingly, the Bank is prepared to proceed with this investment subject to the condition that Holding Company and Mortgage will be subject to periodic examination by the TDB. Furthermore, the Bank agrees that this condition is mandatory in order to obtain the TDB's approval of its application to acquire a 40% equity interest in Holding Company.

Conclusion

For the reasons outlined above, it is our conclusion that the Bank may legally hold a 40 percent equity interest in Holding Company, pursuant to the transaction proposed in your letter. We also conclude that branching restrictions will not apply to Mortgage.

Our conclusion is conditioned upon compliance with the commitments made in your letter of inquiry and with the conditions listed below:

1. Holding Company and Mortgage's activities will be restricted to the origination and servicing of residential mortgage loans and other matters incidental to that activity;

2. the Bank will have veto power over any activities and major decisions of Holding Company and Mortgage that are inconsistent with condition number one, or the Bank will withdraw its investment from Holding Company if it or Mortgage proposes to engage in an activity that is inconsistent with condition number one;

3. in the event that Holding Company or Mortgage, with the necessary concurrence of at least four of the five directors of Holding Company, should determine to conduct or engage in any line of business or engage in any material transaction or series of transactions other than the origination and servicing of residential mortgage loans and other matters incidental to that activity, the Bank shall, within 180 days after such determination but in any event prior to the commencement of such activity, either obtain any requisite regulatory approvals, including notices to or approvals or waivers from the TDB, or divest itself of ownership of its shares in Holding Company;

4. Holding Company and Mortgage will be subject to TDB supervision and examination; and

5. the Bank will not account for its investment in Holding Company under the consolidated method of accounting.

These commitments and conditions are conditions imposed in writing by the TDB in connection with its action on the request for a legal opinion confirming that the proposed investment is permissible under [Finance Code §34.103] and, as such, may be enforced under applicable law.

Opinion No. 96-42

Loans made to the same individual by two separate banks, which complied with the lending limits of the two banks at the time of funding but now exceed the lending limit of the merged banks, are considered nonconforming and not a violation, and will be cited in examination reports as nonconforming until the balance is brought under the new lending limit.

November 12, 1997
Sammie K. Glasco, Assistant General Counsel

This letter is in response to your letter of October 29, 1996 and our conversation of January 16, 1997. Your question involves whether Texas legal lending statutes and regulations were violated as a result of the merger of [Bank A] into [Bank B]. Prior to the merger, the president of [Bank B] had loans with both [Bank A] and [Bank B]. The merger caused the aggregate loans of the president to exceed the legal lending limit of [Bank B], even though the loans were within legal lending limits when made by the individual institutions.

Texas legal lending statutes and regulations do not specifically address the question you have presented. 7 TAC §12.10 does address the effect of a merger on borrowers. Section 12.10(a)(2) provides that the legal lending limit is not violated if a loan no longer complies with the bank's lending limit because borrowers have merged or become affiliated in such a way to invoke aggregation of the loans. Such loans are considered nonconforming. It is the policy of this Department to also afford such treatment to loans that no longer comply with legal lending limits solely because of the merger of banks. Therefore, it is our opinion that the transaction you have described in which loans were within the legal lending limits of the individual banks when made, but no longer comply solely as a result of a merger, are not a violation of Texas legal lending statutes and regulations, but rather are considered nonconforming loans.

7 TAC §12.10(b) provides that " a bank must exercise reasonable efforts to bring a loan or extension of credit that is nonconforming ... into conformity with the legal lending limit, consistent with safe and sound banking practices." This means that the loans will be cited on any examination of [Bank B] by the Department, until brought into conformity. In addition, during any examination of [Bank B], Departmental bank examiners may seek evidence of actions taken to bring the loans into conformity. A copy of the current regulations concerning legal lending limits, 7 TAC §§12.1-12.11, is attached for your reference.

In addition, this Department's regulations permit, as a last resort, the renewal or restructuring of an existing, nonconforming loan unless additional funds are advanced by the bank to the borrower, the original borrower is replaced by a new borrower or the banking commissioner determines that the renewal or restructuring was designed to evade the bank's legal lending limit [*7 TAC §12.10(b)*]. It is suggested that [Bank B] contact this Department prior to renewing or restructuring the loans in question if this is deemed essential for some reason.

The loans in question, also, raise issues under federal provisions imposing limitations on extensions of credit by Regulation O (12 CFR Part 215), applicable with limited exceptions to nonmember banks by virtue of 12 USC §1828(j)(2) and 12 CFR §337.3. Generally member (and nonmember) banks of the Federal Reserve System may not extend credit to any insider of the bank, unless certain conditions are followed [12 CFR §215.4(a)]. An insider includes an executive officer of a bank [12 CFR§215.2(h)]. However, §215.3 provides that an extension of credit does not include a "merger or consolidation of banks or a similar transaction by which a bank acquires the assets and assumes the liabilities of another bank or similar organization." This Department cannot authoritatively interpret the cited provisions. It is suggested that you contact the Federal Reserve Bank in Dallas for an opinion regarding the above federal provisions.

This opinion is limited to the facts and circumstances stated in your letter of October 29, 1996, and telephone conversation of January 16, 1997. Any change in those facts or circumstances could result in a different conclusion.

Opinion No. 96-47
Securities investment limits are calculated on par value, not market value.

February 5, 1997
Jerry G. Sanchez, Assistant General Counsel

This letter is in response to your letter dated December 10, 1996. You requested an opinion as to whether the purchase of a portfolio of securities investments, legal when made, violates the investment limitations when its market appreciation subsequently causes it to exceed its investment limitations.

TEX. REV. CIV. STAT. ANN. arts. 342-5.101 et seq. (the "Act") [*now Finance Code §§34.101 et seq.*], provides the applicable limitations for investments in securities. The Act is made applicable to state trust companies by TEX. REV. CIV. STAT. art 342-1102.[1] A rule recently adopted to partially address your concerns, 7 TAC §12.61(b),[2] prohibits the making of a securities investment on or after September 1, 1995, that is not in compliance with law or that would cause investments made prior to September 1, 1995, which are not in compliance with the Act's applicable investment limitations, to become further out of compliance.

The purpose of the investment limitations is to protect the safety and soundness of state-chartered financial institutions by preventing investments in the securities of a single maker or obligor or a relatively small group of such persons who are financially interdependent, and to promote diversification of investments in order to reduce risks. Securities investment limitations are calculated based on par value. Thus, if securities investments conform with the applicable investment limitations (based on par value), subsequent market appreciation of those investments will not cause it to be in violation of its investment limitations.

This opinion is limited to the facts and circumstances set forth in your letter, dated December 10, 1996, and a subsequent telephone conversation between you and my office. Any change in those facts or circumstances may result in a different opinion.

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[1] *Investment limits for state trust companies can now be found at Finance Code §§183.101 et seq.*

[2] [*A comparable rule for state trust companies is now found at 7 TAC §19.21, and "grandfathers" investments made prior to September 1, 1997, that were legal when made.*]

Opinion No. 96-49

A foreign bank agency may issue guarantees for obligations of customers under an umbrella credit facility.

March 5, 1997
Sammie K. Glasco, Assistant General Counsel

By letter dated December 2, 1996, and supplemented on December 30, 1996, you have requested an opinion regarding whether, under limited circumstances, [*****] (the "Bank"), acting through its licensed, Houston, Texas, agency office (the [*****]) may issue guarantees in favor of foreign country subsidiaries ("[*****] Subsidiaries") of the Bank. The facts are as follows:

The [*****] Agency is a foreign bank agency of the Bank licensed in the State of Texas. The [*****] Agency seeks authorization to issue guarantees in connection with credit extended to its customers who have worldwide borrowing needs, designated by the Bank as "global customers." The [*****] Agency would offer an umbrella credit facility ("umbrella facility") to the global customers. This umbrella facility would, among other functions, establish the maximum amount of credit available to a global customer at the Bank or at any [*****] Subsidiary. A global customer would receive funds from the umbrella facility by either direct borrowing or lines of credit. The [*****] Agency would maintain the primary credit relationship, process the application, and obtain the necessary credit approval for each global customer. In addition, the Houston Agency would be the primary party on the loan documents setting forth the reimbursement obligations of the global customer. The [*****] Agency would then issue the guarantees in favor of [*****] Subsidiaries making loans under the umbrella facility, thereby assuming the credit risk for the entire umbrella facility.

We understand that it has been the Bank's past policy to require the [*****] branch (and similar branches) to issue letters of credit to the [*****] Subsidiaries. However, according to correspondence attached to your request,[1] the practice of issuing letters of credit has become increasingly burdensome to global customers. These customers are reluctant "after having initially negotiated loan documentation related to the umbrella facility, to negotiate additional letter of credit documents, including an application and reimbursement agreement, each time a borrowing" is requested of an [*****] Subsidiary. The Bank believes it would be better able to accommodate global customers if its agencies, such as the [*****] Agency, were authorized to issue direct guarantees to the [*****] Subsidiaries for its credit customers.

Finally, you note that the income of the [*****] Agency, an office of the Bank, is reported as a part of the Bank's income. In addition, the [*****] Subsidiaries are 100% held subsidiaries of the Bank, and thus report income on a consolidated basis with that of the Bank.

Foreign bank agencies are authorized under Chapter 9, TEX. REV. CIV. STAT. ANN., arts. 342-1.001 et seq., Texas Banking Act (the "Act") [*now Chapter 204, Finance Code*]. Section 9.012 of the Act [*now Finance Code §204.105(a)*] provides that a foreign bank corporation licensed to transact business in this state through a foreign bank agency may generally exercise the powers of a state bank. There is no express provision in the [*Finance Code*] that grants state banks the power to guarantee obligations of others. However, this Department has, by regulation, recognized a limited power of state banks to issue guarantees; 7 TAC §11.83(b) provides that a state bank "may lend its credit, binds itself as a surety to identify another, or otherwise become a guarantor, if it has a substantial interest in the performance of transaction involved or has a segregated deposit sufficient amount to cover the bank's total potential liability."

There is no indication from your correspondence that the [*****] Agency or the Bank has segregated deposits. Therefore, we must analyze the transaction under the "substantial interest" test. A bank has a substantial interest in activities validly incidental to authorized bank activities, such as lending. The guarantees in question are related to the lending activities of the [*****] Agency, which is an office of the Bank. The [*****] Subsidiaries, although separate corporate entities, are wholly owned by the Bank. The profit and loss on the books of the [*****] Subsidiaries is reported on a fully consolidated basis in the Bank's financial statements. Thus, in effect, the credit risk of the [*****] Agency and the Bank is not altered. Based on the above, we are of the opinion that the Bank, acting through its [*****] Agency has a substantial interest in the transactions you have detailed and may issue guarantees to the [*****] Subsidiaries.

[1] Letter of ***, Associate General Counsel of the Bank, dated March 14, 1996 to the Illinois Office of the Commissioner of Banks and Trust Companies.

We note that the Office of the Comptroller of the Currency (the "OCC") has reached a similar result in analyzing analogous federal law [See OCC Interpretative Letter No. 542, dated February 6, 1991 ("Letter 542")]. The OCC allows national banks to issue guarantees under limited circumstances.[2] In Letter 542, the OCC did not object to a proposal by a national bank to guarantee repayment of a non-affiliated third party's loan from the bank's Canadian subsidiary. The OCC found that the issue of whether a national bank has a substantial interest sufficient to issue guarantees turns ultimately on whether the guarantee is validly incidental to another authorized activity of the bank involved in the transaction. The OCC also noted that the transaction did not alter the bank's position regarding credit risk, since the bank and the foreign bank subsidiary were affiliates.

In summary, the Bank may issue guarantees in favor of wholly owned [*****] Subsidiaries of the Bank through the [*****] Agency. Our conclusions should not be construed as an endorsement of the advisability of issuing these guarantees, determinations that the Bank's board of directors must make based on appropriate information and considerations.

This opinion is limited to and based solely on the facts and circumstances set forth in your letter of December 2, 1996 and supplemental materials provided on December 30, 1996. Any changes in the facts and circumstances surrounding the proposed transaction could result in a change of this opinion.

Opinion No. 97-02

Separate loans to spouses must be aggregated for legal lending limit purposes unless the loan files fully document separate sources of repayment.

April 1, 1997
Jerry G. Sanchez, Assistant General Counsel

This letter is in response to your letter dated December 30, 1996, addressed to Everette Jobe, General Counsel. You requested an opinion as to whether separate loans to you and your spouse at [*****] (the "Bank") must be aggregated for legal lending limit purposes.

You are a director of the Bank. You have two individual loans at the Bank and your spouse has three individual loans at the Bank. Both you and your spouse have one joint loan at the Bank. You have represented that both you and your spouse own separate and community property. You have also represented that both you and your spouse maintain separate bank accounts. You have also represented that each spouse services their own individual indebtedness.

Under TEX. REV. CIV. STAT. ANN. art. 342-5.201(a) (the "Act") [*now Finance Code §34.201(a)*], the total loans and extensions of credit by a state bank outstanding at any one time to a person may not exceed 25% of the bank's capital and certified surplus.[1] The term "loans and extensions of credit" is defined in the Act, §1.002(a)(34) [*now Finance Code §31.002(a)(34)*], as "...direct or indirect advances of funds by a state bank to a person that are conditioned on the obligation of the person to repay the funds or that are repayable from specific property pledged by or on behalf of the person." The term "person" is defined in the Act, §1.002(44) [*now Government Code §311.005(2)*], as "... an individual or any legal entity."

Under 7 TAC §12.9(a)(3), a loan or extension of credit to one borrower is attributed to another person, and each person will be considered a borrower if the expected source of repayment for each loan or extension of credit is the same for each person. 7 TAC §12.9(d) provides that the expected source of repayment for each loan or extension of credit is considered the same if the primary source of repayment is the same for each borrower.

[2] See 12 C.F.R. §7.1017.

[1] *Effective September 1, 2001, this limitation is stated as "25% of the lesser of bank's capital and certified surplus or total equity." Act of May 22, 2001, 77th Leg., H.B. 2155, §12.*

Under TEX. FAM. CODE ANN. §5.21 [*now Family Code §3.101*][2], each spouse has the sole management, control, and disposition of his or her separate property. Under TEX. FAM. CODE ANN. §5.01(a) [*now Family Code §3.001*], a spouse's separate property consists of: (1) the property owned or claimed by the spouse before marriage; (2) the property acquired by the spouse during marriage by gift, devise, or descent; and (3) personal injury recoveries sustained by the spouse during the marriage, except any recovery for loss of earning capacity during the marriage.

Under TEX. FAM. CODE ANN. §5.01(b) [*now Family Code §3.002*], community property consists of the property, other than separate property, acquired by a spouse during marriage. Under TEX. FAM. CODE ANN. §5.02 [*now Family Code §3.003*], property possessed by either spouse during marriage is presumed to be community property. If the assets belong to the community, a complex set of rules govern the managerial powers of each spouse, depending on whether the property is either spouse's sole management community property or joint community property. TEX. FAM. CODE ANN. §5.22(a) [*now Family Code §3.102(a)*] provides that each spouse has the sole management, control, and disposition of the community property that he or she would have owned if single, including but not limited to: (1) personal earnings; (2) revenue from separate property; (3) recoveries for personal injuries; and (4) the increase and mutations of, and the revenue from, all property subject to his or her sole management, control, and disposition. TEX. FAM. CODE ANN. §5.22(b) [*now Family Code §3.102(b)*] provides that if community property subject to the sole management, control, and disposition of one spouse is mixed or combined with the community property subject to the sole management, control, and disposition of the other spouse, then the mixed or combined community property is subject to the joint management, control, and disposition of the spouses, unless the spouses provide otherwise by power of attorney or other agreement in writing.

Theoretically, it is possible for you and your spouse to service each's individual indebtedness entirely from personal earnings and revenue earned from each individual's separate property or sole management community property, thus avoiding aggregation of each individual's indebtedness. However, unless each loan file is fully documented to reflect that the expected source of repayment is not the same, the loans will be aggregated. This documentation should include the following:

> (1) sworn financial statements which clearly reflect whether assets and liabilities are separate or community property, including individual cash flow statements reflecting the separate or community property income and expenses;
>
> (2) If a spouse claims property to be subject to his or her sole management, control, and disposition: a power of attorney; muniment of title; contract; deposit of funds; or other written agreement or evidence of ownership (TEX. FAM. CODE ANN. §§5.22(c), 5.24(a) [*now §§3.102(c), 3.104(a)*]); and
>
> (3) If a spouse claims property to be his or her separate property: a subscribed and acknowledged schedule of the spouse's separate property recorded in the deed records of the county in which the parties, or one of them, reside and in the county or counties in which the real property is located (TEX. FAM. CODE ANN. §5.03 [*now §3.004*]).

If you and your spouse are servicing all or some of your individual indebtedness from revenue earned from your joint community property, then your individual indebtedness will be aggregated. This is because you and your spouse are the expected source of repayment of each other's individual indebtedness. Joint loans will also be aggregated with each spouse's individual indebtedness because both you and your spouse are the expected source of repayment. I have assumed for purposes of this opinion that the loans to you and your spouse do not meet the "direct benefit" test of 7 TAC §12.9(a)(1), (b), or the "common enterprise" test of 7 TAC §12.9(a)(2), (c).

Additionally, please be advised that loans to directors or such person's related interests are governed by Reg O (12 CFR Part 215), applicable with limited exceptions to nonmember banks by virtue of 12 USC §1828(j)(2) and 12 CFR §337.3. For example, 12 USC §375b(5) provides that loans to an executive officer, director, or principal shareholder, or to any related interest of such a person, when aggregated with the amount of all outstanding loans by a bank to its executive officers, directors, principal shareholders, and those person's related interests must not exceed the bank's unimpaired capital and unimpaired surplus. These loans must be approved in advance by a majority of the disinterested members of the board of

[2] *The cited "Family Code" was later formally codified by Acts 1997, 75th Leg., ch. 7, §1. Corrected citations are supplied in the text.*

directors if the aggregate amount of loans to such person and such person's related interests would exceed $500,000, or exceed the higher of $25,000 or five percent of the bank's unimpaired capital and unimpaired surplus. Related interest of a person is defined in 12 USC §375b(9)(G)(1) and 12 CFR §215.2(n) as a company that is controlled by that person. Also, under 12 CFR §215.4(a), a bank may not make an extension of credit to a director unless it is made on substantially the same terms as, and following credit underwriting procedures that are not less stringent than, those prevailing at the time for comparable transactions by the bank with other persons that are not covered by this part and who are not employed by the bank; and does not involve more than the normal risk of repayment or present other unfavorable features.

Banks are cautioned that the purpose of the lending limit is to reduce risk by preventing one individual, or a relatively small group, from borrowing an unduly large amount of the state bank's funds. Thus, these types of loans will be closely scrutinized by an examiner.

Finally, this opinion is limited to the facts and circumstances set forth in your letter dated December 30, 1996, and a subsequent telephone conversation between you and my office. Any change in those facts, circumstances, or the parties to the transaction may result in a different opinion. Please call me if you have any questions or comments.

Opinion No. 97-06

A state bank cannot sell phone cards as principal but may allow a third party to sell phone cards on premises or sell phone cards as agent for a merchant customer.

March 20, 1997
Jerry G. Sanchez, Assistant General Counsel

Commissioner Ghiglieri has requested that I respond to your letter dated January 21, 1997, regarding the sale of prepaid telephone cards. According to your letter, the Bank requests an opinion as to the permissibility of engaging in the following two activities involving the sale of prepaid phone cards:

1. The Bank will purchase an inventory of prepaid phone cards which it will sell to its customers at more than face value and earn a profit from each transaction; and/or

2. An independent third-party, a customer of the Bank (the "Merchant"), will sell prepaid phone cards on the Bank's premises for approximately one month and the Bank will receive no compensation from the sale of the phone cards or for the use of the bank's premises.

You have represented that the Merchant has introduced a line of commemorative prepaid telephone cards featuring local athletes. A portion of the proceeds from the prepaid phone card sales will be donated the non-profit [*****] fund. The prepaid phone cards are not tied to a customer's account and are not "reload-able."

Bank's Direct Sale of Prepaid Phone Cards

Under §3.001(a)(4) of the Texas Banking Act (the "Act"), a state bank may engage in any activity, directly or through a subsidiary, authorized by the [*Finance Code*] or determined by the Banking Commissioner to be closely related to banking [*now in substance Finance Code §32.001(b)(6), pertaining to activities financial in nature, and (b)(7)*]. The Act, §3.001(a)(1) [*now Finance Code §32.001(b)(1)*], gives state banks incidental powers that are "necessary" to carry on the business of banking as provided by the [*Finance Code*]. "Necessary" has been judicially construed to mean "convenient or useful." Arnold Tours, Inc. v. Camp, 472 F.2d 427, 432 (1st Cir. 1972). Similarly, courts have applied the following three factors in analyzing whether activities fall within the "business of banking" under 12 USC §24(7): 1) whether the activity is the functional equivalent to or a logical outgrowth of a recognized business activity; 2) whether the activity benefits bank customers or is convenient or useful to banks; and 3) whether the activity presents risks of a type similar to those already assumed by banks. See NationsBank v. Variable Annuity Life Insurance Co., 115 S.Ct. 810, at 811-12 (1995). We have previously found the following activities, among others, to be incidental to the business of banking and permissible for state banks: providing free prepaid phone long distance telephone cards to bank customers (fee from service provider); selling excess data capacity to affiliated banks; selling excess Internet access to bank customers; providing payroll services for customers; and providing consulting services for other depository institutions. However, the Bank's direct sale of prepaid phone cards for profit does not meet the requirements of the "business of banking" test.

We believe that the OCC would likely reach the same conclusion. The Bank has indicated that OCC Interpretative Letter #718 (April 1996) authorizes national banks to sell prepaid phone cards. This interpretative letter opined that under 12 USC §24(7), national banks could dispense "alternate media," including prepaid phone cards, through the use of automated teller machines (ATMs) located at their branches. However, the OCC's letter did not give national bank's blanket authority to directly sell, for profit, prepaid phone cards. The OCC's letter determined the following: 1) the dispensing of prepaid phone cards through an ATM represents the cardholder's prepayment for a merchant's goods or services; 2) the transferring of funds from the customer's account to the merchant's account is a fundamental part of banking; 3) because the transaction will not be consummated until the cardholder uses the media to obtain the merchant's good and services, banks are not selling the merchant's products or services by dispensing the "alternate media"; and 4) banks are providing a convenience to their customers, in connection with the performance of a core banking activity of transferring funds between a customer and merchants' accounts. Clearly, the Bank's proposed activity involving its direct sale of its own inventory of prepaid phone cards for profit does not meet the foregoing requirements. Therefore, parity under §3.010 of the Act [*now Finance Code §32.009(a)*] is not implicated as to the Bank's proposed activity involving its direct sale of prepaid phone cards for profit.

Additionally, §5.107 of the Act [*now Finance Code §34.107*] prohibits a state bank from investing funds in trade or commerce by selling or otherwise dealing in goods or owning or operating a business not part of the business of banking. The Bank's proposed activity of directly selling the prepaid phone cards to its customer violates [*Finance Code §34.107*] and is not permissible.

<u>Merchant's Sale of Prepaid Phone Cards On Bank's Premises</u>

Under the Bank's second proposed activity, its customer, the Merchant, would sell the prepaid phone cards on the Bank's premises for approximately one month. The Bank would not receive any compensation from the sale of the prepaid phone cards or for the use of its premises.

The Bank's proposed activity does not entail the Bank owning or operating a business not part of the business of banking or engaging in commerce, which is prohibited by [*Finance Code §34.107*], and is permissible under the general bank powers' provisions of [*Finance Code §32.001(b)(1)*]. Therefore, the Bank is empowered to allow the Merchant to sell the commemorative prepaid phone cards on its premises, provided the following conditions are met:

(1) The Bank must ensure that the customer is appropriately informed that he or she is dealing with the Merchant as far as the telephone services are concerned;

(2) The Bank must obtain an agreement from the Merchant to hold the Bank harmless for any problems which may arise with the prepaid phone cards or the Merchant's servicing efforts; and

(3) The Bank must obtain assurance from the Merchant that it has obtained all the requisite federal and state regulatory clearances (e.g., from the Federal Communications Commission, the Texas Public Utilities Commission, etc.).

<u>Bank's Sale of Prepaid Phone Cards As Agent For Its Customer</u>

While you have not asked the question directly, we also find that the Bank can, if it desires, sell the commemorative prepaid phone cards as an agent for its customer, the Merchant. Under, §3.001(a)(2) [*now Finance Code §32.001(b)(2)*], a state bank may act as an agent. Further, this activity does not entail the Bank owning or operating a business not part of the business of banking or engaging in commerce, which is prohibited by [*Finance Code §34.107*]. Therefore, it is permissible for the Bank to disperse the prepaid phone cards on its premises, to collect the proceeds from the sale, remit these proceeds to its customer, the Merchant, and receive a fee for its services from the Merchant.

We note that under 12 USC 24(7), national banks are also authorized to sell certain items as agents for its customers. For example, national banks are permitted to act as agents for customers for the purpose of collecting prepaid tolls from toll road patrons who obtain the tags and set up special accounts at the bank. See OCC Interpretative Letter #731 (July 1, 1996). National banks have also been allowed to act as agents for states in selling and renewing license plates and license tags, with the fee income being remitted to the bank. See <u>Corbett v. Devon Bank</u>, 299 N.E. 2d 521, 529 (Ill. App. Ct. 1988); and OCC Interpretative Letter from Stephen B. Brown, Attorney (Dec. 13, 1989) (unpublished). Additionally, national banks have also been allowed to disperse food stamps and government welfare checks. See Philadelphia Check Cashiers Association v. Heimann, No. 79-1318 (D. Pa. March 12, 1980) (unpublished decision). Finally, national banks have been allowed to disperse, on behalf of their customers, theater tickets and amusement tickets. See Vogel v. Saenger Theatres, Inc., 22 So. 2d 189, 192 (La. 1945) and Greenfield v. Maryland Jockey Club of Baltimore, 57 A.2d 335, 336-37 (Md. 1948). In these cases, the courts and the OCC have determined that the performance of collection and remittance activities by a national bank, as agents for its customers, including the sale of prepaid phone cards, are part of the business of banking and serve as a public convenience. See also OCC Interpretative Letter #718 (April 1996).

Finally, this opinion is limited to the facts and circumstances set forth in your letter dated January 21, 1997, and subsequent telephone conversations between you and my office. Any change in those facts, circumstances, or the parties to the transaction may result in a different opinion. Please call me if you have any questions or comments.

Opinion No. 97-12

Loans under programs of the Export-Import Bank would generally be exempt from the legal lending limit but the conditions and claims experience of each program must be reviewed before determining exemption.

October 14, 1997
D'Ann Johnson, Assistant General Counsel

This is in response to your letter of February 12, 1997. I received additional information from you on August 27, 1997. You have requested a blanket exemption from the legal lending limits on loans to the extent the loans are guaranteed or insured by the Export-Import Bank of the United States for state-chartered banks. In addition, you have requested that the same percentage capital risk weights be assigned to Ex-Im Bank guarantees and insurance policies for state-chartered banks as national banks.

Exemption

The total loans and extensions of credit outstanding at one time by a state bank to a person may not exceed 25% of the bank's capital and certified surplus. TEX. FIN. CODE §34.201(a).[1] However, certain classes of loans or obligations are excluded from this limitation.

The Ex-Im Bank is an independent corporate agency of the United States, which is empowered to provide guarantees, insurance, and extensions of credit to aid in the financing of imports and exports. See, 12 USC §635(b)(1)(A). Contractual liabilities of the Ex-Im Bank incurred pursuant to its authority constitute full faith and credit obligations of the United States. 42 Op. Atty. Gen. 327 (1966).

Consequently, loans guaranteed by Ex-Im Bank may be exempt from loan limitations. Pursuant to the TEX. FIN. CODE §34.201(a)(8), loan limitations do not apply to:

[1] *Effective September 1, 2001, this limitation is stated as "25% of the lesser of bank's capital and certified surplus or total equity." Act of May 22, 2001, 77th Leg., H.B. 2155, §12.*

> the portion of an indebtedness that this state, an agency or political subdivision of this state, the United States, or an agency or instrumentality of the United States has unconditionally agreed to purchase, insure, or guarantee.[2]

A loan will not qualify for this exception unless the insurance or guarantee is unconditional. "A takeout commitment insurance or guarantee is considered unconditional if the protection afforded the bank is not substantially diminished or impaired if the loss should result from factors beyond the bank's control. Protection against loss is not materially diminished or impaired by procedural requirements such as an agreement to take over only in the event of default, including default over a specific period of time, a requirement that notification of default be given within a specific period after its occurrence, or a requirement of good faith on the part of the bank." 7 TAC §12.6(f). This regulation also requires that the commitment or guarantee is payable only in cash or its equivalent within 60 days after demand for payment is made. Id. The exception to the lending limit provision applies only to the portion of the credit actually covered by a guarantee or Ex-Im Bank insurance policy.

This Department has previously exempted several Ex-Im Bank programs from the legal lending limit. See Opinion 94-02a (New to Export Credit Insurance Policy); Opinion 94-38 (Short Term Comprehensive Single Buyer Export Credit Insurance Policy); Opinion 94-60 (Medium-Term Comprehensive Export Credit Program); and Opinion 94-73 (Working Capital Guarantee Program).

I have reviewed the claims experience of the Working Capital Guarantee Program. It appears from this information that the claims were denied only because the lender did not conform to the terms of the guarantee agreement by not perfecting liens on collateral, lack of timely notification of default or claim filing, or amending terms without Ex-Im Bank's approval. The Department does not consider these types of conditions to be so significant as to cause the guarantee to be considered conditional. 7 TAC §12.6(f). No claims experience information was submitted regarding other Ex-Im Bank programs.

In general, Ex-Im Bank programs would be exempt from legal lending limits. As a caveat, however, the precise conditions and the claims experience of each program is critical to the determination whether the insurance or guarantee is conditional. The Department declines to give a blanket exemption from the legal lending limits for every future Ex-Im Bank program and prefers to consider each one on a case-by-case basis.

Capital Risk Assessment

Federal standards for capital risk assign 0% risk to Ex-Im Bank's Medium and Long Term Guarantee Programs and 20% risk to the Working Capital Guarantee Program. The Texas Department of Banking agrees with the federal risk assessment of these programs.

Opinion No. 97-19

Debt to a partnership and a related Subchapter S corporation, both guaranteed by the same person, must be aggregated for legal lending limit purposes due to financial interdependence of the borrowers.

May 7, 1997
Jerry G. Sanchez, Assistant General Counsel

This letter is in response to your letter dated April 15, 1997. You requested an opinion as to whether a proposed $850,000 loan by [***** Bank] (the "Bank"), to the [***** Partnership] (the "Partnership"), to be fully guaranteed by [*****] ("Guarantor"), should be aggregated with the outstanding indebtedness of [***** Corporation] (the "Corporation"), a Subchapter S corporation, consisting of three loans totaling $979,672.03 guaranteed by Guarantor, for legal lending limit purposes.

Based solely on the information in your letter and subsequent telephone conversations between you and my office, my understanding of the facts are as follows:

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[2] *Effective September 1, 2001, Finance Code §34.201(a)(8) exempts "the portion of an indebtedness that this state, an agency or political subdivision of this state, the United States, or an instrumentality of the United States has unconditionally agreed to repay, purchase, insure, or guarantee." Act of May 22, 2001, 77th Leg., H.B. 2155, §12.*

1. Two entities are involved: the Corporation and the Partnership;

2. Guarantor owns 49% of the Corporation, and as a shareholder, receives dividends from the Corporation; Guarantor will own a majority interest of the Partnership (Guarantor's family members will constitute the remaining partners);

3. The Corporation's three outstanding loans are personally guaranteed by Guarantor (limited and full guarantees);

4. Guarantor is the Chairman of the Board and Vice-President of the Corporation, but earns no salary;

5. The proceeds of the proposed Partnership loan will be utilized to purchase improved real estate (a medical clinic) which will be leased to the Corporation and the improved real estate will secure the Partnership loan;

6. Guarantor will fully guarantee the proposed Partnership loan;

7. The Corporation will not be party to the proposed Partnership loan;

8. 100% of the gross receipts of the Partnership (on an annual basis) will be derived from income received from the medical clinic lease with the Corporation;

9. The Bank has represented that the primary source of repayment of the proposed Partnership loan will be derived from income received from the medical clinic lease; although, the Bank has represented that Guarantor has sufficient secondary income to service the Partnership loan should the lease payments cease; and

10. The Bank has represented that the primary source of repayment of the three Corporation loans is derived from the Corporation's income (medical services), and not Guarantor's guarantees.

Under TEX. REV. CIV. STAT. ANN. art. 342-5.201(a) (the "Act") [*now Finance Code §34.201(a)*], the total loans and extensions of credit by a state bank outstanding at any one time to a person may not exceed 25 percent of the bank's capital and certified surplus.[1] The term "loans and extensions of credit" is defined in the Act, §1.002(a)(34) [*now Finance Code §31.002(a)(34)*], as "...direct or indirect advances of funds by a state bank to a person that are conditioned on the obligation of the person to repay the funds or that are repayable from specific property pledged by or on behalf of the person."

Under 7 TAC §12.9(a)(1), a loan or extension of credit to one borrower is attributed to another person, and each person will be considered a borrower if a "common enterprise" is deemed to exist. Under 7 TAC §12.9(c)(1), a "common enterprise" is considered to exist and loans to separate borrowers will be aggregated if a loan or extension of credit is made to borrowers who are related directly or indirectly through common control, or made to a borrower directly or indirectly controlled by another borrower, if substantial financial interdependence exists between or among the borrowers. Under §1.002(a)(13) of the Act [*now Finance Code §31.002(a)(13)*], "control" means the ownership of or ability or power to vote, directly, acting through one or more other persons, or otherwise indirectly, 25% or more of the outstanding shares of a class of voting securities. Under 7 TAC §12.9(c)(2), "substantial financial interdependence" exists if 50% or more of one borrower's gross receipts or gross expenditures (on an annual basis) are derived from transactions with the other borrower and is presumed to exist, subject to rebuttal, if 25% or more of one borrower's gross receipts or gross expenditures (on an annual basis) are derived from transactions with the other borrower. Gross receipts and expenditures include gross revenues and expenses, intercompany loans, dividends, capital contributions, and similar receipts and payments.

The Corporation and the Partnership are related through common control because Guarantor owns 49% of the Corporation and a majority interest in the Partnership. Further, "substantial financial interdependence" exists between the Corporation and the Partnership because 100% of the Partnership's gross receipts (on an annual basis) will be derived from the real estate lease proceeds to be received from the Corporation. In essence, the Partnership will provide the physical facilities to be operated as a medical clinic by the Corporation. Therefore, under 7 TAC §12.9(a)(2) and (c), a "common enterprise" is

[1] *Effective September 1, 2001, this limitation is stated as "25% of the lesser of bank's capital and certified surplus or total equity." Act of May 22, 2001, 77th Leg., H.B. 2155, §12.*

deemed to exist between the Corporation and the Partnership and the proposed Partnership loan will be aggregated with the Corporation's outstanding indebtedness.

Also, please be advised that should Guarantor subsequently incur any individual indebtedness at the Bank, that indebtedness and his guarantees of the Corporation's indebtedness may be aggregated under 7 TAC §12.9(g).

Your bank is cautioned that the purpose of the lending limit is to reduce risk by preventing one individual, or a relatively small group, from borrowing an unduly large amount of a bank's funds. These types of loans will be closely scrutinized by an examiner.

Finally, this opinion is limited to the facts and circumstances set forth in your letter, dated April 15, 1997, and subsequent telephone conversations between you and my office. Any change in the facts, circumstances, or the parties to this transaction may result in a different opinion.

Opinion No. 97-20

Statutory age limits applicable to interstate acquisition of a bank are satisfied by acquisition of an existing state bank charter sold separately from the bank assets.

April 29, 1997
Everette D. Jobe, General Counsel

Deputy Commissioner Randall James asked me to articulate the basis in state law for a merger between two banks with both surviving the transaction, and the subsequent sale of one charter to new owners, as well as the interaction between state law and federal law as amended by the Riegle-Neal Interstate Banking and Branching Act of 1995.

"Interstate banking," the ownership of an in-state bank charter by an out-of-state bank holding company, was initially authorized in Texas in 1986. The Legislature amended the Banking Code by enacting what was called the Interstate Banking bill, Acts 1986, 69th Leg., 2nd C.S., ch. 14, effective January 1, 1987. The bill was intended to constitute specific authorization, as required by federal law (12 USC §1842(d) as then in effect), for an out-of-state bank holding company to acquire a bank located in Texas. The last sentence of TEX. CONST., art., §16(a), of the Texas Constitution created a potential problem for the Interstate Banking bill in that it provides that "no foreign corporation, other than the national banks of the United States domiciled in this State, shall be permitted to exercise banking or discounting privileges in this State." This difficulty was eliminated by a Texas Attorney General Opinion (No. JM-630) which held that the constitutional provision prohibits foreign corporate ***exercise*** of banking or discounting privileges in Texas but not foreign corporate ***ownership*** of a Texas bank.

"Interstate branching," on the other hand, would constitute foreign corporate ***exercise*** of banking or discounting privileges in Texas as prohibited by the Texas Constitution. Riegle-Neal was designed to preempt any limitation on interstate branching like that in the Texas Constitution unless the state specifically "opted out" of interstate branching. Texas did opt out, TEX. REV. CIV. STAT. ANN. art. 489f [*now repealed Finance Code §32.0095*].[1]

TEX. REV. CIV. STAT. ANN. arts. 342-3.301 et seq. (the Texas Banking Act, §§3.301 et seq.) [*now Finance Code §§32.301 et seq.*], govern mergers involving state banks if a state bank is to be a survivor of the transaction. Section 3.301(a) [*now Finance Code §32.301(a)*] provides in pertinent part that "[t]wo or more financial institutions, corporations, or other entities with all requisite legal authority to participate in a merger, at least one of which is a state bank, may adopt and implement a plan of merger in accordance with this section." Section 3.301(b) [*now Finance Code §32.301(b)*] provides that "Implementation of the merger by the parties and approval of the board, shareholders, participants, or owners of the parties must be made or obtained in accordance with the Texas Business Corporation Act as if the state bank were a domestic corporation and all other parties to the merger were foreign corporations and other entities, except as may be otherwise provided by applicable rules. Section 3.301(c) [*now Finance Code §32.301(c)*] states that "[a] consummated merger has the effect provided by the Texas Business Corporation Act."

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[1] *But see Opinion No 98-27. Finance Code §32.0095 was repealed by Acts 1999, 76th Leg., ch. 344, §9.002(a)(2). Now see Finance Code Chapter 203.*

The definition of "merger" under state law is provided by the Texas Business Corporation Act (TBCA). Under TBCA, art. 1.02(A)(12):

> "Merger" means (a) the division of a domestic corporation into two or more new domestic corporations or into a surviving corporation and one or more new domestic or foreign corporations or other entities, or (b) the combination of one or more domestic corporations with one or more domestic or foreign corporations or other entities resulting in (i) one or more surviving domestic or foreign corporations or other entities, (ii) the creation of one or more new domestic or foreign corporations or other entities, or (iii) one or more surviving domestic or foreign corporations or other entities and the creation of one or more new domestic or foreign corporations or other entities.

Thus, statutory language clearly includes a traditional merger, consolidation, split-up, split-off, and any other form of business combination or recombination within the modern definition of "merger," and any number of participants and survivors are permitted. This inherent flexibility is in the nature of modern corporate law, law that is now applicable to (and available to) Texas state-chartered banks.

If, as a result of a merger, a state bank loses most of its assets and some or all of its pre-existing banking business, yet survives, the bank is legally still in existence as an incorporated entity, although regulatory consent or forbearance would obviously be required to permit the bank to engage in future banking business. The net result of such a transaction is very similar to the result of a more traditional transaction, a purchase and assumption. The remaining charter of the selling or merging yet surviving bank, legally still in existence as an incorporated entity, can theoretically be sold to an out-of-state bank holding company in an "interstate banking" transaction if the requirements of the Texas Banking Act, §§8.301 et seq. [*now Finance Code §§202.001 et seq.*], are met.

Restrictions regarding age limits and deposit concentrations are clearly permissible in interstate bank charter acquisitions under federal law as amended by Reigle-Neal, see 12 USC §1842(d). Under the Texas Banking Act, §8.303(a) [*now Finance Code §202.003(a) in substance; also see §203.005(a)*]:

> An out-of-state bank holding company may not make an acquisition ... unless each bank in this state that would on consummation of the acquisition be directly or indirectly controlled by the out-of-state bank holding company has existed and continuously operated as a bank at least five years.

Under the Texas Banking Act, §8.302 [*now Finance Code §202.002(a) in substance; also see Finance Code §§32.304, 32.406, and 203.004(a)*]:

> [A] bank or bank holding company may not acquire control of or acquire all or substantially all of the assets of a bank located in this state or of a bank holding company that controls a bank in this state if the acquiring bank or bank holding company and all its insured depository institution affiliates controls, or after consummation of the acquisition would control, more than 20 percent of the total amount of deposits of insured depository institutions located in this state, as reported in the most recently available reports of condition or similar reports filed with state or federal authorities. For purposes of this section, "deposit" and "insured depository institution" have the same meanings assigned by Section 3, Federal Deposit Insurance Act (12 USC Section 1813).

We interpret the age limits in [*Finance Code §§202.003(a) and 203.004(a)*], as a public policy device to enhance the value of existing state banks by preventing out-of-state entry into the state through acquisition of a de novo charter. That policy is not violated, and is in fact enhanced, by permitting the charter to simultaneously be sold separately from the bulk of the assets, provided the combined transactions involve only one out-of-state bank holding company availing itself of the age on the charter.

Opinion No. 97-24

Out-of-state bank can "table fund" loans originating in Texas (closed by an agent) without filing or registration.

July 10, 1997
Jerry G. Sanchez, Assistant General Counsel

Your letter dated June 12, 1997, addressed to Lynda Drake, has been forwarded to me for reply. You inquired as to whether a license or approval is required of the Department in order for [*****] (the "Bank") to table fund commercial loans in Texas. You have also inquired as to whether the Department must approve or review a notice to do business in Texas which will be filed with Texas Secretary of State.

The Bank is interested in table funding commercial loans in Texas. You have represented that the Bank will not have a physical location or office in Texas. All decisions relating to loan approval or disapproval will be made at the Bank's out-of-state home office; however, the Bank will work with financial institutions, packagers, or third parties in Texas to finance business loans. The third party will act as the Bank's "agent" to assist in executing loan documents and funding the loans. The Bank will wire the loan proceeds and the loans will be closed in the Bank's name.

Texas law does not prevent out-of-state banks from table funding commercial loans in Texas. However, Texas law may require the bank to designate the Texas Secretary of State as its agent for service of process in Texas,[1] and its advertising in Texas must not be misleading. See TEX. REV. CIV. STAT. ANN. art. 342-8.003 [*now see Finance Code §§201.101 et seq.*]. The Department does not need to review or approve the Texas Secretary of State designated agent filing.

Finally, please be advised that should the Bank decide to table fund consumer loans in the future, the Bank may need to comply with certain licensing and registration requirements of the Office of Consumer Credit Commissioner.

This opinion is limited to the facts and circumstances stated in your letter dated June 12, 1997. Any change in those facts or circumstances could result in a different conclusion.

Opinion No. 98-01

A state bank may acquire a company that provides software and consulting services.

January 28, 1998
D'Ann Johnson, Assistant General Counsel

This letter is in response to your letter dated December 24, 1997. You have requested confirmation that a state bank may acquire a company engaged in providing software and consulting services to depository institutions as a subsidiary.

According to your letter, the business of the company consists of developing and maintaining software packages for modeling and tracking interest rate and other risks of depository institutions as well as providing related telephone support services.

The activity you propose is clearly permissible for state banks. Monitoring interest rate and other risks are functions traditionally performed by banks.

A state bank may engage in any activity, directly or through a subsidiary, authorized by the Texas Finance Code or determined by the Banking Commissioner to be closely related to banking, TEX. FIN. CODE §32.001(b)(4) [*now in substance §32.001(b)(6), pertaining to activities financial in nature, and (b)(7)*]. Additionally, a state bank may exercise incidental powers necessary to carry on the business of banking, TEX. FIN. CODE §32.001(b)(1). This activity is not barred by TEX. FIN.

[1] *Pursuant to Acts 1999, 76th Leg., ch. 344, §§1.001 and 2.016, the registration provisions of Finance Code §59.001, originally codified in 1997 from TEX. REV. CIV. STAT. ANN. art. 342-8.003, were replaced by Finance Code Chapter 201, Subchapter B (§§201.101 et seq.). An out-of-state bank now may qualify to do business in Texas in the same manner as any foreign business corporation, and may designate a party of its choosing as registered agent.*

CODE §34.107, which prohibits a state bank from investing funds in trade or commerce by selling or otherwise dealing in goods or owning or operating a business not part of the business of banking.

We view the contemplated activities you describe as activities that may be engaged in directly by the bank, and therefore conclude that your bank may acquire a company providing such software and consulting services to other depository institutions.

A state bank may conduct any activity through an operating subsidiary that a state bank is authorized to conduct if the subsidiary is adequately empowered and appropriately licensed to conduct its business. TEX. FIN. CODE §34.103(a).

The bank must comply with the notice requirements of TEX. FIN. CODE §34.103. The Corporate Division should be contacted for specific requirements for the acquisition of operating subsidiaries, including fees. Importantly, the bank must demonstrate Year 2000 compliance.

This opinion is limited to the facts and circumstances stated in your letter of December 24, 1997. Any change in those facts or circumstances may result in a different opinion. Please notify the Department.

Opinion No. 98-02
A state bank may sell its excess marketing and advertising capacity to third-parties.

March 23, 1998
D'Ann Johnson, Assistant General Counsel

Your letter of December 26, 1997, to Everette D. Jobe, General Counsel of the Texas Department of Banking, has been referred to me for review.

You have requested an opinion whether a state bank employee who conducts marketing and advertising activities for the bank may provide marketing and advertising activities for non-bank clients. This activity is permissible for state banks.

Background

According to your letter, your bank has, in the past, outsourced bank advertising. Because of the high production cost and unsatisfactory service, you investigated the option of bringing this function in-house. You have located a suitable candidate for this position at a salary less than the current cost for outsourcing this function. As a practical matter, the bank cannot currently utilize an employee full-time for these activities, but the most suitable candidate will not accept less than a full-time position. The candidate has offered to continue servicing her existing accounts and pay the revenue to the bank.

Discussion

A state bank may exercise incidental powers necessary to carry on the business of banking, TEX. FIN. CODE §32.001(b)(1). Advertising activities are activities traditionally performed by banks. Banks have long engaged in solicitation of prospective customers. See, Franklin National Bank of Franklin Square v. New York, 347 U.S. 373, 377 (1954). The Franklin court recognized that advertising is a usual and customary business practice. In conducting their business, bankers have used many strategies to sell the banks' services, including the mail, the telephone, the internet, the news media, billboards and little league team sponsorships. A bank may contract with a third-party to provide advertising, direct mail, or telemarketing services or the bank may conduct such activities itself. The bank may hire an employee to perform advertising functions because such functions are incidental to banking.

A state bank that acquires excess capacity in good faith to meet the needs of the bank may use the excess capacity profitably even though the activities involving the excess capacity are not themselves incidental to the business of banking. Such a rationale reflects the notion that the bank would incur economic waste if the bank could not make full use of an asset, including an employee. We have not previously addressed the issue of whether the under-utilization of an employee could be considered excess capacity. We conclude that it does.

Several factors influence a determination on whether the utilization of excess capacity is acquired in good faith. In this case, the bank has decided to conduct its marketing and advertising activities itself. This proposal benefits the bank and its customers by minimizing its advertising costs and enabling the bank to better compete with larger institutions. It is clear that the bank cannot divest itself of the excess capacity since all of the excess is represented by one individual with special expertise. Moreover, it is possible the banks' utilization of the employee could increase. The salary requirements of the candidate are less than the cost of outsourcing these activities. And failure to use the excess capacity would result in loss of income to the bank. Thus, it appears that the bank has acquired the excess capacity in good faith.

A state bank may provide customers with advertising services as a permissible use of its excess capacity acquired in good faith. Consequently, the sale of excess advertising capacity does not violate TEX. FIN. CODE §34.107, which prohibits a bank from engaging in commerce or operating a business that is not part of the business of banking.

However, the utilization of the employee to perform advertising services for other clients is not without risk. As with dual employees, there is a concern about divided loyalties or conflict of interest. In addition, to avoid confusion, the employee must disclose the nature of her employment to the other clients. The bank should enter into a written agreement with the existing advertising account customers. The bank should develop an appropriate job description and policies and procedures to supervise and monitor the sale of excess advertising capacity. It is our understanding that the bank intends to obtain a liability policy to insure against losses arising from this activity. The bank may not expand the sale of advertising capacity beyond the employment of one person. As long as the bank has excess capacity, it may renew the contracts.

This opinion is limited to the facts and circumstances stated in your letter of December 26, 1997, and subsequent communications. Any change in those facts or circumstances may result in a different opinion.

Opinion No. 98-08
A third-party vendor may certify compliance with ATM safety requirements.

February 20, 1998
D'Ann Johnson, Assistant General Counsel

Your letter of February 12, 1998, has been referred to me for response. You have asked whether a third-party vendor may certify compliance with the safety requirements applicable to unmanned teller machines.

We are of the opinion that the owner or operator of an unmanned teller machine may designate to any person, including a third-party vendor, the task of certifying compliance with the statutory requirements.[1] The security officer of a depository institution may rely on the certification to meet the requirements of 7 TAC §3.92(h), which states that the "security officer of each depository shall certify compliance with the ATM User Safety Act and this regulation on a basis no less frequently than annually."

However, such a designation does not operate to transfer any obligations of the owner or operator of an unmanned teller machine to the third-party vendor.

[1] *A third-party vendor that offers evaluations of ATM site safety may be required to register as a private security consultant with the Texas Commission on Private Security. See Opinion No. 00-13.*

Opinion No. 98-09

An ATM unit in an office tower lobby with restricted access is not subject to ATM safety requirements.

February 19, 1998
D'Ann Johnson, Assistant General Counsel

Your letter of February 12, 1998, has been referred to me for response. You have asked whether an ATM unit in an office tower is subject to the safety requirements of TEX. FIN. CODE, §§59.301 et seq. ("ATM User Safety Act"). We are of the opinion that the ATM unit you described is not subject to the ATM User Safety Act.

According to your letter, the ATM in question is a walk-up unit located in its own vestibule inside an office/bank tower. The ATM vestibule is situated between the bank lobby and the lobby of the office tower. During banking hours, the ATM may be accessed from the bank lobby. It may also be accessed during banking hours from the lobby of the office tower.

After banking hours the ATM is accessible by way of the lobby of the office tower. In addition, there is a staffed guard station in the lobby of the office tower and it is adjacent to the ATM vestibule. A person wishing to make an ATM transaction after banking hours must enter the office tower lobby and approach the guard station and "sign in" prior to entering the ATM vestibule. That person must also "sign out" prior to exiting the office tower lobby.

The Texas Finance Code requires certain safety precautions for unmanned teller machines, TEX. FIN. CODE §§59.301 et seq. The statute excludes unmanned teller machines inside a building unless a transaction can be conducted from outside the building, TEX. FIN. CODE §59.302(2)(A). In addition, if there is 24 hour access to an unmanned teller machine in a bank vestibule from outside the building, the safety precautions are applicable to that location. 7 TAC §3.92(g).

The unmanned teller machine you describe is clearly located inside a building and no transaction can be conducted from outside the building. Even though there may be 24 hour access to the machine, one may access the machine only from inside the office lobby, which itself has restricted access, not from outside the building. Consequently, the unmanned teller machine is not subject to the safety requirements of TEX. FIN. CODE §§59.301 et seq.

This opinion is limited to the facts and circumstances you describe. Any change could result in a different opinion.

Opinion No. 98-18

A state bank may provide links from its web page to web pages of bank customers and provide website hosting services to bank customers.

June 9, 1998
D'Ann Johnson, Assistant General Counsel

By letter dated April 20, 1998, you inquired whether a state bank has the authority to offer a low cost web page to your business customers. We are of the opinion that this activity is permissible for state banks.

According to your letter, *** Bank currently operates its own web page and would like to offer its business customers the ability to link their services from the bank's home page. You have not indicated whether there would be any links to an insider-related company. In addition to offering the business link, the bank would allow the business customers to establish their own home pages on the bank's domain. The bank would offer a low cost web page design to the business customers for a small fee, and would charge hosting fees to these customers, but revenue generated is expected to be minimal. The bank has determined that offering this service will bring the bank's customers closer to the bank. Moreover, the bank believes the internet compatibility between the bank and its business customers will better position the bank to facilitate internet payments in the future.

The Finance Code prohibits a state bank from investing funds in trade or commerce by selling or otherwise dealing in goods or owning or operating a business not part of the business of banking, TEX. FIN. CODE §34.107. However, a state bank may engage in any activity, directly or through a subsidiary authorized by the Texas Finance Code (Finance Code) or determined by the Banking Commissioner to be closely related to banking, TEX. FIN. CODE §32.001(b)(4) [*now in substance*

§32.001(b)(6), pertaining to activities financial in nature, and (b)(7)]. Additionally, a state bank may exercise incidental powers necessary to carry on the business of banking, TEX. FIN. CODE §32.001(b)(1). A state bank that has acquired excess capacity in the bank's internet connection in good faith may sell the excess capacity to its business customers, Opinion No. 95-72. Providing internet capacity for itself and business customers of the bank is incidental to the business of banking. Consequently, this activity does not violate TEX. FIN. CODE §34.107.

Safety and soundness must be considered. The security of the bank's computer system must remain inviolate and thoughtful precautions should therefore be taken to ensure that the system is insulated from viruses and unauthorized access to information. In addition, the bank should avoid any indication that it endorses any product or service or that products offered are FDIC-insured.

The bank should conduct the activity pursuant to a written agreement with each customer that appropriately allocates risk and should maintain complete files of the activity for examination purposes. We also recommend notifying the bank's bonding company of the new activity being conducted by the bank.

This opinion is limited to the facts and circumstances described in your letter. Any changes in the facts and circumstances could result in a different opinion.

Opinion No. 98-20

An out-of-state bank and its Texas-based operating subsidiary may invoke the compliance review committee privilege in Texas law if the bank has registered to transact business in this state.

July 20, 1998
Sharon Gillespie, Assistant General Counsel

You have inquired as to whether a wholly-owned operating subsidiary in Texas of an out-of-state national bank is entitled to the privilege provided by TEX. FIN. CODE §59.007(b) [*now §59.009(b)*].[1] Under [*§59.009(a)*], a financial institution and/or its affiliates can "establish a compliance review committee to test, review, or evaluate the institution's conduct, transactions, or potential transactions for the purpose of monitoring and improving or enforcing transactions for the purpose of monitoring and improving or enforcing compliance with" governing laws and regulations. Generally, documents produced by a compliance review committee are confidential and not discoverable in a civil action.

In connection with the subsidiary operations in Texas, the bank has registered with the Secretary of State under §59.001(a) of the Finance Code[2] to transact business in this state. The subsidiary, headquartered in Texas with offices throughout the state, engages primarily in originating and servicing first-lien residential mortgages and acts as a loan production office for the bank. The bank and its holding company have established a compliance review committee for the purpose set out in [*§59.009(a)*]. Section [*59.009(b)*] grants certain privileges regarding the discovery and admissibility of compliance review documents and, with limited exception, testimony of compliance review committee members.

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[1] *Effective September 1, 1999, Subchapter A of Chapter 59, Texas Finance Code, was significantly rewritten by Acts 1999, 76th Leg., ch. 344, §2.016. The privilege is now contained in Finance Code §59.009.*

[2] *Pursuant to Acts 1999, 76th Leg., ch. 344, §§1.001 and 2.016, Finance Code §59.001 registration provisions were replaced by Finance Code Chapter 201, Subchapter B (§§201.101 et seq.). An out-of-state bank must now qualify to do business in Texas in the same manner as any foreign business corporation.*

Pursuant to [*§59.009(a)*], a "financial institution or an affiliate of a financial institution, including its holding company, may establish a compliance review committee . . . ." Section 31.002(a)(25) of the Texas Finance Code defines "financial institution" as "a bank . . . maintaining an office, branch, or agency office in this state."[3] The term "bank" is defined as "a state or national bank" under §31.002(a)(2). Pursuant to §31.002(a)(37), a "national bank" is a "banking association organized under 12 USC §21." Furthermore, the term "affiliate" is defined by §31.002(a)(1) to include a company that is controlled by or under common control with a bank.

On these facts, the subject bank is a "financial institution," and its subsidiary is an "affiliate" as contemplated by [*§59.009*]. Consequently, the privilege afforded under [*§59.009(b)*] is available to a compliance review document or testimony of a compliance review committee member (as defined or otherwise limited in [§59.009]) in testing, reviewing, or evaluating the subsidiary's conduct, transactions, or potential transactions for the purpose set out in [*§59.009(a)*].

This opinion is limited to the facts and assumptions set out herein. Any change in those facts, assumptions, or parties to the transaction may result in a different opinion.

Opinion No. 98-21

An appropriately licensed state bank may sell crop insurance as agent or refer customers to an outside agent and receive a portion of commissions generated as a result of referrals.

May 20, 1998
Everette D. Jobe, General Counsel

By letter dated April 27, 1998, you referred to two recent interpretations issued by the Office of the Comptroller of the Currency (OCC) and inquired whether a state bank can take advantage of those rulings. A state or national bank in Texas is unaffected by these interpretative letters in that Texas law already permits the activities authorized.

In OCC Interpretive Letter No. 812 (Dec. 29, 1997), the OCC concluded that a national bank may offer, as agent, multiple peril crop insurance and hail/fire insurance (collectively, "crop insurance") in connection with loans to its farmer customers, because the sale of such credit related insurance is part of, or incidental to, the business of banking. You suggest that the significance of this letter is to authorize the sale of crop insurance as an "incidental power" under 12 USC §24(Seventh) rather than as an insurance power under 12 USC §92, thereby avoiding the "place of 5,000" limitation on insurance agent activities (§92 impliedly bars national banks in towns with more than 5,000 inhabitants from engaging in insurance agency activities in general). Because the "place of 5,000" limitation does not apply to the activities of a bank as crop insurance agent in Texas, this interpretation does not affect banks in Texas.

Under Article 21.14-2 of the Texas Insurance Code, any resident of Texas, including a bank, may become a crop insurance agent under a two-year, renewable license by submitting a completed written application to the commissioner of insurance on a form prescribed by the commissioner and pay a $50 nonrefundable fee. The application must bear an endorsement signed by an agent of an insurance company that limits its insurance business to the transaction of the business of insurance of risks on growing crops. The applicant for an original or renewal license is not required to pass an examination or meet any basic or continuing educational requirements to obtain or renew the license. I am told that most production credit associations are licensed as crop insurance agents but banks for whatever reason have not taken advantage of this provision.

In OCC Interpretive Letter No. 824 (Feb. 27, 1998), the OCC analyzed a proposed activity by a national bank, located in a "place of 5,000" and appropriately licensed as an insurance agency, described as involving customer referrals to an outside agent and the distribution of informational materials on insurance, for which the national bank receives a percentage of the premium, commission, or net income generated as a result of the bank's referrals. The OCC concluded the activity was permissible for a national bank on two alternative grounds. First, to the extent that the described activities constitute acting as an agent to sell insurance, they are within the scope of activities permitted by 12 USC §92. Second, a national bank may

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[3] *For purposes of Finance Code §59.009, the term "financial institution" is defined in §59.001(5) as having "the meaning assigned by Section 201.101, except that the term does not include a financial institution organized under the laws of another state or organized under federal law with its main office in another state that does not maintain a branch or other office in this state." Finance Code §201.101(1) defines "financial institution" broadly, including a bank, savings bank, savings and loan association, credit union, and certain other regulated entities, regardless of its state or country of incorporation.*

engage in permissible insurance-related finder activities and receive a fee for these activities based on 12 USC §24(Seventh) rather than on 12 USC §92, see 12 CFR §7.1002.

Based on the second "finder activities" ground, your letter seems to imply that agent licensing would not be required of the referring bank to permit commission splitting. That conclusion would be incorrect. As the OCC itself states on page 4 of Interpretive Letter No. 824:

> Some state laws may, however, treat these finder activities as activities that constitute acting as an insurance agent under state law. Such a state law characterization does not alter the characteristics of what are permissible finder activities under federal law. But, where a state law characterizes finder activities as activities of an insurance agent, national banks should comply with the applicable state insurance licensing and other requirements.

Texas law generally prohibits commission splitting except among licensed agents. Therefore, a state or national bank in Texas may sell crop insurance as agent or refer customers to an outside agent and receive a portion of commissions generated as a result of referrals, without regard to the geographic location of the bank in a rural or urban area, provided the bank is appropriately licensed as a crop insurance agent under Texas law.

Opinion No. 98-25
A state bank may sell promotional goods in the bank lobby.

July 13, 1998
D'Ann Johnson, Assistant General Counsel

Your letter to Catherine A. Ghiglieri dated July 6, 1998, has been referred to me for response.

You have requested an opinion whether a state bank may sell promotional goods in the bank lobby. This activity is permissible for state banks.

According to your letter, the bank intends to offer T-shirts, golf shirts, baseball caps and similar products with the bank's logo emblazoned on the item. The items will be sold at cost, including shipping and handling. The bank will not make a profit on the sale, but simply to promote its name to the public.

A state bank may exercise incidental powers necessary to carry on the business of banking, TEX. FIN. CODE §32.001(b)(1). Advertising activities are activities traditionally performed by banks. Banks have long engaged in solicitation of prospective customers. See, Franklin National Bank of Franklin Square v. New York, 347 U.S. 373, 377 (1954). The Franklin court recognized that advertising is a usual and customary business practice. In conducting their business, bankers have used many strategies to sell the banks' services, including the mail, the telephone, the internet, the news media, billboards and little league team sponsorships.

The activity you describe clearly falls within incidental banking powers of a state bank.

The sale of promotional goods does not violate TEX. FIN. CODE §34.107, which prohibits a bank from engaging in commerce or operating a business that is not a part of the business of banking.

This opinion is limited to the facts and circumstances stated in your letter of July 6, 1998. Any change in these facts or circumstances may result in a different opinion.

Opinion No. 98-27

The responsible federal banking agency may approve a merger transaction between insured banks with different home states, one of which is Texas, without regard to Texas Constitution Art. XVI, §16(a).

July 30, 1998
Everette D. Jobe, General Counsel

By letter dated July 30, 1998, you advise us that the Federal Reserve Bank of *** has asked for the legal basis under Texas law for the proposed merger of [Bank-Texas] with and into [Bank-Other State], in light of Texas Finance Code §32.0095, which purports to prohibit the transaction. In that connection, you request our opinion regarding whether Texas law prohibits a federal banking agency from approving a merger transaction under 12 USC §1828(c) between insured banks with different home states, one of which is Texas.

Beginning on June 1, 1997, 12 USC §1831u(a)(1) authorizes federal approval of "a merger transaction under section 1828(c) of this title between insured banks with different home States, *without regard to whether such transaction is prohibited under the law of any State*," unless a prohibiting state law exists that meets the requirements of 12 USC §1831u(a)(2) (emphasis added). Among other requirements, the state law must have been enacted after September 29, 1994, and before June 1, 1997, and apply equally to all out-of-State banks.

Texas Constitution Article XVI, §16(a), provides that "[n]o foreign corporation, other than the national banks of the United States domiciled in this State, shall be permitted to exercise banking or discounting privileges in this State." This sentence has remained unchanged in the Texas Constitution since it was added by amendment effective November 8, 1904, and fails to meet the requirement of 12 USC §1831u(a)(2)(A) that, to be validly recognized under federal law, it must have been enacted after September 29, 1994, and before June 1, 1997.

In 1995 the Texas legislature attempted to prohibit interstate merger transactions, as permitted by 12 USC §1831u(a)(2), by enacting Texas Civil Statutes Article489f, codified in 1997 as Texas Finance Code §32.0095.[1] As the Comptroller of the Currency pointed out in her Decision on the Application of NationsBank of Texas, N.A. and NationsBank, N.A. (OCC Corporate Decision #98-19, April 2, 1998), this attempt failed to meet the requirement of 12 USC §1831u(a)(2)(A)(I) that the state law apply "equally to all out-of-State banks." Specifically, other Texas law expressly permits an out-of-State state savings bank to engage in an interstate merger with a domestic savings bank and thereafter operate as a branch office in Texas, see Texas Finance Code §§92.401 et seq. Therefore, Texas Finance Code §32.0095 does not apply equally to all out-of-State banks because an out-of-State state savings bank is a "bank" for purposes of 12 USC §1831u(a)(2)(A)(I), see 12 USC §1813(a)(1) and (2).

In our opinion, pursuant to 12 USC §1831u(a)(1), the responsible federal banking agency may approve a merger transaction between insured banks with different home states, one of which is Texas, without regard to Texas Constitution Article XVI, §16(a), because that provision was not enacted after September 29, 1994, and before June 1, 1997, or Texas Finance Code §32.0095,[1] because that provision does not prohibit an interstate merger transaction in the manner required by federal law by applying equally to all out-of-State banks.

Other Texas law continues to apply to a merger transaction between insured banks with different home states, one of which is Texas, including Texas Finance Code §§38.001-38.003 and 59.001 [*now Finance Code §§202.001-202.003, 203.001, and 203.003-203.005*] and 59.001 [*now 201.102*]. We anticipate full compliance with these provisions as well as any other applicable Texas law.

[1] *Interstate branching became authorized and Finance Code §32.0095 was repealed by Acts 1999, 76th Leg., ch. 344, §§1.001 and 9.002(a)(2). Now see Finance Code Chapter 203.*

Opinion No. 98-31

The existence of a separate, subsequently executed representation letter from a borrower, stating that the Bank is not obligated to extend funds under an outstanding commitment if funding would cause disbursements outstanding to exceed the lending limit, does not constitute a legally enforceable modification of the terms of commitments in excess of the Bank's legal lending limit.

October 12, 1998
Randall S. James, Deputy Commissioner

This letter is in response to Senior Vice President ***'s letter to me requesting reconsideration of the position expressed in the *** 1997 Report of Examination that the Bank's loan commitments to ***, Inc., and affiliates ("Borrower") constituted an extension of credit in excess of the Bank's legal loan limit.

As I understand the situation, based on the examination report and your letter, the Bank enters into loan commitments with Borrower for interim construction financing of one or more individual homes on a periodic and continuing basis. These commitments are not entered into without a commitment from the ultimate purchaser of these homes for permanent financing upon completion. The Bank monitors disbursements under these commitments, and payments received from Borrower upon completion of the homes, to assure that the actual aggregate disbursed balance of the loans does not exceed the Bank's legal lending limit. As I understand it, no instances were noted in which the funded balances exceeded the lending limit. However, because new commitments are made over a period during which other commitments mature and are paid-off, the aggregate amount of commitments outstanding frequently exceeds the Bank's lending limit, sometimes by a substantial amount. The problem which arises is that, under rule 7 TAC §12.4, binding commitments are combined with all other extensions of credit in determining whether the legal lending limit has been exceeded.

The Bank does not dispute that the amount of outstanding commitments to Borrower has at times exceeded the Bank's $*** loan limit, having reached over $***, or more than twice the Bank's lending limit, subsequent to ***, 1997. The question set forth in your letter is, rather, whether the existence of a separate letter from Borrower stating that the Bank is not obligated to extend funds under a commitment if such would cause disbursements outstanding to exceed the lending limit renders these commitments in excess of the legal lending limit not "binding." In other words, does the letter effect a legally enforceable modification of the terms of the individual loan commitments? If it does, then only outstanding balances would be used to determine whether the Bank's lending limit had been exceeded.

One principal concern is that the Bank's right to refuse disbursements in excess of the legal lending limit is not part of the individual contracts. As you correctly point out in your letter, these are "individually approved loans rather than under a line of credit." A line of credit is subject to a master agreement which governs all disbursements, and a modification of the master agreement would clearly apply to subsequent disbursements. Here, however, even though the Bank's relationship with Borrower functions in many ways like a line of credit, the actual form is a series of discrete, closed-end loans, the terms of which are expected to be contained wholly within the documents related to that loan. You agree with this in the third paragraph of your letter, stating that the Construction Loan Agreement executed with each commitment incorporates limitations set forth in "Related Documents," and that "Related Documents" are defined as ". . .all other instruments, agreements, and documents, whether now or hereafter existing, executed in connection with the indebtedness." The problem with this argument is that the Borrower letter was not executed "in connection with the indebtedness," since the "indebtedness" referred to must be construed to be that individual loan, not the overall indebtedness of Borrower. The quoted language therefore cannot be relied upon to make the Borrower letter part of the individual contracts.

Given this, there is, at best, considerable doubt about the efficacy of the Borrower letter in giving the Bank a right to refuse disbursements under any individual loan commitment based on the aggregate funded balances under all commitments. Because of this doubt, our position must be that the violations noted in the examination report are valid, and must be corrected.

Our concern over this issue is heightened by the fact that the courts have traditionally been unsympathetic toward banks that raise a lending limit defense to a claim for damages resulting from a refusal to meet a loan commitment. For a recent and precautionary example, I would invite the Board to review the case of *Int'l Bank of Commerce- Brownsville v. Int'l Energy Dev. Corp.*, [981 S.W.2d 38 (Tex. App.–Corpus Christi , June 18, 1998, no writ)]. In that case, IBC had refused to fund requests made under a $9MM loan commitment because its lending limit was only $1.35MM. IBC argued that its non-performance should be excused because the $9MM commitment was illegal, and an illegal contract is unenforceable. The Court rejected this argument, noting that the facts that made the original commitment illegal were known only to IBC, and that IBC would not be permitted to be the beneficiary of its own misconduct. In addition, the Court held that the contract was *not* illegal *per se*, because it could have been performed legally if IBC had obtained a participant for the over line amounts. IBC failed to do so, but that did not render the contract illegal. The Court upheld an arbitration award that cost the bank over $2.5MM (after offsets).

If the Bank wishes to continue its present practices with regard to the Borrower loans, you should obtain an opinion from legal counsel that the current documentation on these loans, including the Borrower letter, allows the Bank to refuse disbursements under existing Borrower commitments, without subjecting the Bank to liability for so doing, and submit that opinion to this office for review.

In lieu of current practice, there are several alternatives which we believe would also resolve this issue. First, the loans could be extended under a "line of credit." The line could then be granted up to the Bank's lending limit, with the normal sequencing of draws and payoffs resulting in the same disbursed balances as under the current arrangement. Second, the Bank could arrange for over limit participation agreements with other lenders to cover any commitment amounts which exceed the Bank's lending limit. Such an agreement would have to comply with 7 TAC §12.3(3). And third, the loans could continue to be disbursed under individual commitments if each contract had explicit language that the Bank would not be obligated to disburse funds under that agreement if such a disbursement would result in the aggregate Borrower balances exceeding the Bank's legal lending limit. If this option is selected, the contract should clearly state which entity balances will be aggregated, the funded aggregate balances outstanding at the time of the commitment, and the Bank's lending limit.

The law and the rules are written to limit the risk to the Bank inherent in an over-concentration of loans to any one borrower, and to provide clarity and certainty in calculating the dollar limitation. The Bank may be placing itself in an untenable position by beginning funding on more individual projects than it could legally fund to completion. Such a practice raises serious safety and soundness concerns, and must be avoided.

Opinion No. 98-36

A trust company may not serve as the general partner of a limited partnership with clients as limited partners.

November 30, 1998
Jeffrey L. Schrader, Assistant General Counsel

Your letter of October 29, 1998 has been referred to me for a response. You have asked whether ***, a state trust company ("Trust Company"), may serve as the general partner of ***, Ltd., a Texas limited partnership ("Partnership").

The question you pose was the subject of an opinion issued by the Department in a letter dated March 16, 1993. At that time the Trust Company was advised that Texas law prohibited it from serving as general partner of the Partnership. Because of subsequent changes in the law you have asked the Department to revisit the issue of the ability of a state trust company to serve as general partner of a limited partnership.

In your letter you describe briefly the background which led to the original opinion issued by the Department, and the events leading to your present request, as follows. Trust Company created the Partnership several years ago as an investment partnership to manage the investments of the limited partners. Partnership does not conduct any other business. All of the limited partners are Trust Company clients. Trust Company was initially the general partner of the Partnership. However, in an examination conducted by the Department in 1992 the examiners cited Trust Company for violating former Article 342-503 of the Texas Banking Code, which prohibited a bank or trust company from investing funds in trade or commerce by buying and selling goods, wares or merchandise except when necessary to avoid loss. The examiners asserted the position that, by serving as general partner, Trust Company violated that prohibition. Trust Company appealed this finding. In the March 16, 1993 letter referred to above, the Department issued an opinion affirming the examiners' conclusion that Trust Company was not permitted to serve as general partner of the Partnership under Texas law. In response to this determination, but without agreeing with the Department's position, Trust Company at that time elected to pursue an alternative course, and the parent holding company owning all of the stock of Trust Company was substituted as general partner. This leads to the present opinion request. The owners of the holding company are now considering dissolving the holding company and taking ownership of the Trust Company directly, which will necessitate the selection of a new general partner. Trust Company has again expressed an interest in serving as general partner of the Partnership, if permissible under current Texas law.

The primary reason identified by the Department in disapproving the Trust Company's previous investment in the Partnership was long-standing policy that a state bank or trust company may not own a general partnership interest in, or act as a general partner in, any partnership. Indeed, this was, and continues to be, the general rule applicable to national banks and trust companies (discussed further below). In reaching its conclusion that it was unlawful for Trust Company to serve as the general partner the Department pointed out in the opinion letter that Texas law precluded Trust Company from making an investment that would expose it to unlimited liability for the actions of the Partnership. In addition, the Department also cited the following issues: that the Partnership agreement did not require that all limited partners be trust company clients; that the Partnership might enable the Trust Company to circumvent applicable state law because its relationship with its trust account holders, as limited partners, could possibly no longer be subjected to the provisions of state law and the Department's scrutiny; and finally, that Trust Company's interests, duties, or obligations as general partner might dictate that it take actions that are not in the best interests of the trust account holders invested in the Partnership.

Despite numerous changes in Texas law since that opinion was issued, including the enactment of Texas Revised Civil Statutes Annotated, arts. 342a-1.001 et seq. (the "Texas Trust Company Act") [*now Finance Code §§181.001 et seq.*], all of the issues articulated in that March 16, 1993 opinion letter are present today. Accordingly, it is my opinion that Trust Company may not serve as general partner of the Partnership under current Texas law.

The subject of trust company investments is addressed in Chapter 5 of the Texas Trust Company Act [*now Finance Code, Chapter 184*]. Texas law provides that a trust company may invest its <u>restricted</u> capital in any type or character of equity or investment securities, with certain limitations.[1] The most notable restriction prohibits, with certain exceptions, an investment in equity or investment securities of any one issuer that would exceed an amount equal to 15 percent of the state trust company's restricted capital.[2] Further, a trust company is required to exercise prudent judgment in all trust company investments of restricted capital, taking into account safety and soundness considerations, the overall investment strategy of the trust company, as well as economic conditions.[3]

Similarly, a trust company may invest its <u>secondary</u> capital in any type or character of equity or investment securities for the purpose of generating income or profits.[4] Likewise, a trust company is required to exercise prudent judgment in all trust company investments of secondary capital.[5] Despite this broad grant of authority, a trust company is prohibited from making an investment of its secondary capital in any investment that incurs or may incur, under regulatory accounting principles, a liability or contingent liability for the state trust company, without the prior written approval of the banking commissioner.[6] Further, a trust company is prohibited from investing its funds in trade or commerce by owning or operating a business not part of the state trust business.[7]

Accordingly, it is clear that Texas law continues to prohibit a state trust company from investing in a partnership if the investment will expose the state trust company to unlimited liability for the actions of the partnership. Moreover, Texas law continues to prohibit a state trust company from investing its funds in a business not part of the state trust company (as did former Article 342-503, Texas Banking Code). Therefore, for the same reasons cited in the Department's previous opinion letter, a state trust company is not permitted to serve as general partner of a limited partnership under current Texas law.

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[1] Texas Revised Civil Statutes Annotated, art. 342a-5.101(a) [*now Finance Code §184.101(a)*].

[2] Texas Revised Civil Statutes Annotated, art. 342a-5.101(c) [*now Finance Code, §184.101(c)*].

[3] Texas Revised Civil Statutes Annotated, art. 342a-5.101(f) [*now Finance Code, §184.101(f)*].

[4] Texas Revised Civil Statutes Annotated, arts. 342a-5.101(g), 342a-5.301(c) [*now Finance Code, §§184.101(g), 184.104(c)*].

[5] *Id.*

[6] Texas Revised Civil Statutes Annotated, art. 342a-5.301(a) [*now Finance Code, §184.104(a)*].

[7] Texas Revised Civil Statutes Annotated, art. 342a-5.302 [*now Finance Code, §184.105*].

As discussed above, this is the same conclusion that would be reached for national banks and trust companies. As a general rule, a national bank may not enter into a partnership because it lacks authority to assume liability for the actions of its partners.[8] The Office of the Comptroller of the Currency has, however, permitted national banks to invest in partnerships where the bank's partnership liability is in some way limited, provided such investments are restricted to investments in limited partnerships that engage solely in activities in which a national bank may engage.[9] Similarly, under Texas law a state trust company would be permitted to invest in partnership interests, provided the investment complied with the limitations and restrictions pertaining to state trust company investments, summarized above. This would include, of course, the requirement that the state trust company's partnership liability be in some way limited.

Opinion No. 98-39

An out-of-state state bank, legally operating in this state, may branch at any location in the state, without regard to geographic limitation. Compliance with the public notice requirements of the Board of Governors of the Federal Reserve System satisfies the notice requirements of state law.

December 10, 1998
D'Ann Johnson, Assistant General Counsel

You have requested our opinion whether an Alabama state bank that has merged with a Texas bank can establish new branches in Texas. We have concluded that an Alabama state bank, legally operating in this state, may branch at any location in the state, without regard to geographic limitation. You have further inquired whether the public notice requirements of the Federal Reserve satisfy the public notice requirements of Texas state law. We have concluded that compliance with the public notice requirements of the Federal Reserve satisfies the requirements of state law.

Under 12 USC §1831u(d)(2), following an interstate merger, the resulting bank may establish, acquire, or operate additional branches at any location where any bank involved in the transaction could have established, acquired, or operated a branch under applicable federal or state law if such bank had not been a party to the merger transaction. Texas law provides that a state bank may establish and maintain a branch office at any location on prior written approval of the banking commissioner. TEX. FIN. CODE §32.203. An Alabama state bank, legally operating in Texas, may therefore, establish a branch at any location in the state to the same extent as a Texas state bank.

You have also requested an opinion whether the proposed branches comply with the branching laws of Texas. Regulations establish additional guidance relating to the establishment of a branch office. See, 7 TAC §15.42. The applicant must publish notice of the application in the community of the proposed branch. The regulations provide for a particular form of the notice. The applicant has published notice in the community of the proposed branch, in accordance with the notice requirements of the Federal Reserve. Pursuant to 7 TAC §15.4(e), the Commissioner has determined that the notice requirements of the Federal Reserve satisfy the public notice requirements of Texas law.

[8] *Merchants National Bank v. Wehrmann*, 202 U.S. 293 (1906).

[9] OCC Interpretive Letter No. 435 (June 30, 1988); OCC Interpretive Letter No. 617 (March 4, 1993); OCC Interpretive Letter No. 687 (September 5, 1995).

Opinion No. 98-41

A charitable organization may serve as the executor of a decedent's estate if the charitable organization has a beneficial interest in the decedent's estate.

November 30, 1998
Jeffrey L. Schrader, Assistant General Counsel

This is in response to your telephone call which you followed up with a letter dated November 10, 1998. You asked whether a charitable organization may serve as the executor of a decedent's estate under current Texas law. The question you pose was the subject of an opinion issued by the Department in a letter dated December 3, 1993. At that time the requestor was advised that Texas law prohibited a Texas nonprofit corporation from serving as a trustee or serving in any similar fiduciary capacity. However, since the time that opinion was issued the Texas Legislature has enacted Acts 1997, 75th Leg., ch. 769, §1, which created the Texas Trust Company Act (Articles 342a-1.001 et seq., Revised Civil Statutes) [now Finance Code, §§181.001 et seq., codified by Act approved May 10, 1999 (S.B. 1368), 76th Leg., §7.16, eff. Sept. 1, 1999] and amended portions of the Texas Non-Profit Corporation Act (Articles 1396-1.01 et seq., Revised Civil Statutes). As a result of the law change a Texas nonprofit corporation now may serve as executor of a decedent's estate if the charitable organization has a beneficial interest in the decedent's estate.

The Texas Trust Company Act provides that a company does not engage in the trust business in a manner requiring a state charter by serving as trustee of a charitable trust as provided by Article 2.31, Texas Non-Profit Corporation Act.[1] The Texas Non-Profit Corporation Act provides at Article 2.31 that a charitable corporation may serve as the trustee of a trust of which the corporation is a beneficiary.[2] Therefore, a charitable organization that is described in §501(c)(3) or §170(c) of the Internal Revenue Code may serve as the executor of a decedent's estate provided the charitable organization has a beneficial interest in the decedent's estate. The December 3, 1993, legal opinion issued by this Department has been superseded by the change in Texas law.

Legal requirements applicable to fiduciaries can be extremely complex. Therefore, it is strongly recommended that any charitable organization considering serving as a fiduciary under Texas law obtain appropriate legal counsel with the necessary expertise in this highly specialized area before proceeding with such an undertaking.

Opinion No. 99-08

Loans to limited partnerships with the same general partner will be aggregated to the general partner for legal lending limit purposes, even if the loans are made without recourse to the general partner.

April 27, 1999
Loren E. Svor, Assistant General Counsel

[1] Article 342a-3.022(16), Revised Civil Statutes [*now Finance Code §182.021(16)*].

[2] The Texas Non-Profit Corporation Act (Article 1396-2.31, Revised Civil Statutes) [*now Article 1396-2.31.A., pursuant to Acts 1999, 76th Leg., ch. 344,, §8.001, eff. Sept. 1, 1999*] provides as follows:

> A corporation that is described by Section 501(c)(3) or 170(c), Internal Revenue Code of 1986, or a corresponding provision of a subsequent federal tax law, or a corporation listed by the Internal Revenue Service in the Cumulative List of Organizations Described in Section 170(c) of the Internal Revenue Code of 1986, I.R.S. Publication 78, may serve as the trustee of a trust:
> (1) of which the corporation is a beneficiary; or
> (2) benefitting another organization described by one of those sections of the Internal Revenue Code of 1986, or a corresponding provision of a subsequent federal tax law, or listed by the Internal Revenue Service in the Cumulative List of Organizations Described in Section 170(c) of the Internal Revenue Code of 1986, I.R.S. Publication 78.

By letter dated March 3, 1999, you requested our opinion on whether a proposed $*** loan to [Limited Partnership A], would result in *** Bank exceeding its legal lending limit, either directly or under the aggregation or attribution principles set forth in the pertinent rules. Your concern is prompted by the fact that the partners involved in [Limited Partnership A], both general and limited, are also involved in various capacities in numerous loans that the Bank has extended to other limited partnerships, with current outstanding balances of $***. It is our opinion that the proposed loan would result in a violation of the Bank's legal lending limit, which you state is $***, because [General Partner, a limited liability company], the general partner in [Limited Partnership A], is also the general partner in other limited partnerships with existing loan balances with the Bank amounting to $***, with a resulting attribution of balances, present and prospective, to the General Partner of $***.

For purposes of our analysis, the complex financial interrelationships among and between the individuals and legal entities involved in the loans in question can be summarized as follows:

· The principal investors in the various legal entities involved in all of the loans relevant to your question are six individuals: [Persons A & B], [Person C], [Person D], [Person E], and [Person F] (the "Principals").

· The individual loans involved are to different limited partnerships for the purpose of holding and operating various commercial retail properties in [the city]. The loans are limited to 67% or less of the appraised value of the related property, and have debt service ratios of 1.4 or better. The largest of these loans is the proposed loan to [Limited Partnership A] in the amount of $***, which would be the only loan to this partnership.

· The general partner in [Limited Partnership A] is [General Partner], which is owned by the Principals.

· [General Partner] is also the general partner in [Limited Partnership B], with a present loan balance of $***, and [Limited Partnership C], with a present loan balance of $***. The total of present loans to limited partnerships in which [General Partner] is the general partner is $***; after the proposed loan the total would be $***.

· None of the limited partnerships are financially interrelated in the sense that none make payments to or receive income from another.

· The Bank has obtained guaranties from the Principals in amounts limited to 150% of their direct or beneficial interests in the various projects. The Bank represents that it is not relying on the guaranties for repayment, but obtains them as incidental security and to assure the involvement of the Principals in the projects. The largest total amount of these guaranties is from [Person F] in the present amount of $*** ($*** if the proposed loan is made). In all cases, the Bank represents that the primary source of repayment is expected to be the cash flows from the properties, and the secondary source, should one be needed, is the properties themselves.

Total loans or extensions of credit outstanding to a person (any legal entity) are limited to 25 percent of the Bank's capital and certified surplus (the "legal lending limit.").[1] TEX. FIN. CODE §34.201. You state that the Bank's legal lending limit is $***. None of the loans or a combination of loans, existing or proposed, to a single limited partnership exceed this amount. However, rules adopted by the Department set forth certain circumstances in which individual loans will be "attributed" such that they will be deemed to be loans to a person or entity in addition to the nominal borrower, or contingent liabilities will be "aggregated" with direct obligations for purposes of determining the Bank's compliance with its legal lending limit. These rules provide, in general, that a loan will be considered to have been made to a person in addition to the nominal borrower if: (1) the proceeds of the loan or assets purchased with the proceeds are transferred to the other person other than in an arm's-length purchase transaction ("direct benefit"); (2) the loans are to affiliated borrowers, defined as a borrower that directly or indirectly controls, is controlled by, or is under common control with another borrower, and 50% or more of one borrower's gross receipts or expenditures are derived from another borrower (25% unless rebutted) ("common enterprise"); and, (3) the primary source of repayment is the same for several borrowers ("source of repayment"). Under the facts which you have set forth, direct benefit attribution would not apply because the proceeds of each loan go to each

[1] Loans with certain types of collateral, such as liens on readily marketable goods or stored agricultural products, are subject to a higher lending limit. See 7 TAC §12.5(b)-(f). None of the exceptions are applicable in this case. [*Effective September 1, 2001, this limitation is stated as "25% of the lesser of bank's capital and certified surplus or total equity." Act of May 22, 2001, 77th Leg., H.B. 2155, §12.*]

individual partnership and the property is held in the name of the partnership. The loans would not be attributed under the source of repayment test, because the expected source of repayment is the individual and discrete property securing each loan. And a “common enterprise” does not exist because, while several of the borrowers may be affiliated in that they are controlled by [General Partner], they are not financially interdependent to any extent, much less to the degree required by the rule. See 7 TAC §12.9.

Similarly, under the facts which you have presented the contingent liabilities of the guarantors would not require aggregation with other obligations of the guarantors. You do not indicate that the guarantors have individual direct loans with the Bank, and none of the guarantees, present or prospective exceed the Bank’s lending limit. If this should change, the obligations would nonetheless not be aggregated provided that the Bank is relying on the financial condition and responsibility of the primary obligor rather than the guarantor for repayment of the loan, and that this fact is evidenced by the certification of a Bank officer. See 7 TAC §12.9(g).

However, a special rule applies to loans to a partnership. 7 TAC §12.9(f) provides:

> A loan or extension of credit to a partnership, joint venture, or association is considered to be a loan or extension of credit to each member of the partnership, joint venture, or association other than those partners or members that, by the terms of the partnership or membership agreement, are not held generally liable for the debts or actions of the partnership, joint venture, or association, provided those provisions are valid against third parties under applicable law, and that have not otherwise agreed to guarantee or be personally liable on the loan or extension of credit.

A loan to a limited partnership would not be considered a loan to the limited partners because the Texas Revised Limited Partnership Act provides that limited partners are not generally liable for the debts and actions of the partnership, and this limitation on general liability is valid against third parties. See V.T.C.S. art. 6132a-1, §3.03. But a general partner is jointly and severally liable for all debts and obligations of the partnership (except as may have been agreed otherwise with an individual claimant). V.T.C.S. art. 6132a-1, §4.03; art. 6132b-3.04. Consequently, the existing loans to [Limited Partnership B] and [Limited Partnership C], totaling $***, and the proposed loan to [Limited Partnership A] in the amount of $***, are or would be considered loans to [General Partner] as well. Because the $*** total of these loans exceeds the Bank’s $*** legal lending limit by $***, the Bank cannot legally make the proposed loan.

In a telephone conversation subsequent to your letter, you asked whether this result could be avoided by simply making the loan non-recourse with respect to [General Partner], citing as support for this possibility our opinion 94-1 (Oct. 18, 1994). Opinion 94-1 dealt with the question of whether a loan to a current borrower must be aggregated with a proposed participation in a loan to a limited partnership in which the current borrower was a general partner. The loan agreement for the loan to the limited partnership provided that liability extended only to the partnership, not to the individual partners. Relying on the wording of the rule then in effect, the opinion held that the loan to the limited partnership would not be attributed to the general partner.

The question would, I believe, be answered differently under the current rule. Former 7 TAC §12.4 (repealed effective March 1, 1996) read as follows:

> (1) Loans to partnerships, joint ventures, or associations. Loans or extensions of credit to a partnership, joint venture, or association shall, for the purposes of these sections, be considered loans or extensions of credit to each member of such partnership, joint venture, or association, if under applicable law, each member of such partnership, joint venture, or association is liable for repayment of the loan or extension of credit *to the entity involved.* (Emphasis added.)

This rule would not require attribution to the limited partners, because they would not have liability to the entity under statute. The loan also would not be attributed to a general partner under the former rule because the loan terms provided that the general partner was not liable to the entity involved, i.e., the inquiring bank. Under the present rule, however, which was quoted above, it is not sufficient that there be no liability only with respect to the bank, but also with respect to *third parties*, such as creditors or litigants. A waiver of liability with respect to the lending bank does not affect general liability with respect to third parties. Consequently, under the present rule, the participation in question would have been attributed to the general partner and aggregated with the bank’s direct loan, and the participation could not legally have been entered into. Similarly, under your hypothetical, loans to any limited partnership in which [General Partner] is the general partner must be attributed to [General Partner], and the loans to all such limited partnerships aggregated for legal lending limit purposes even if the loan or loans are without recourse to [General Partner].

This rule was changed as part of a general updating of the banking rules subsequent to the adoption of the Texas Banking Act by the 74th Legislature in 1995. The change discussed above was the only substantive modification of the former rule, and was based on the otherwise similar legal lending limit rules promulgated the Office of the Comptroller of the Currency ("OCC") for the regulation of national banks.[2] The policy reasons for the change were the same as those that prompted the OCC to make the same change several years earlier: (1) the former rule "encouraged banks to exclude borrowers from personal liability in situations where banking prudence . . . clearly counseled otherwise;" and (2) regardless of whether the general partner is directly obligated to repay the loan, the fact remains that the success of the limited partnership depends on the expertise and management skills of the general partner. OCC Letter No. 134 [1981-1982 Transfer Binder] Fed. Banking L. Rep. (CCH) 85,245, at 77,368 (Oct. 9, 1980); see also OCC No-Objection Letter No. 88-3, [1988-1989 Transfer Binder] Fed. Banking L. Rep. (CCH) 84,043, at 76,656 (March 29, 1988). The OCC has since 1971 interpreted their rule to require loans to a limited partnership to be attributed to the general partner even when the general partner is not personally liable on the loan; 7 TAC §12.9(f) requires the same result. *Id.* Consequently, Opinion No. 94-1 is overruled and is withdrawn. Additionally, although not referenced by you, Opinion No. 97-03, on similar facts and reasoning, concludes that full aggregation can be avoided through a limited-recourse provision; consequently Opinion No. 97-03 is also overruled and is withdrawn.

Opinion No. 99-11

A state bank may process applications for internet provider services and process payments as an agent for the holding company of the bank. Further, a state bank may, incidental to providing or planning to provide internet banking services, serve as a full internet access provider to both customers and non-customers as a necessary ancillary activity required to engage in internet banking.

May 13, 1999
D'Ann Johnson, Assistant General Counsel

By letter dated March 19, 1999, you have inquired whether a state bank may process applications for internet provider services and process payments as an agent for the holding company of the bank. We are of the opinion that this activity is permissible for state banks.

Background

According to your letter and conversations that I have had with you, the bank is owned by a one-bank holding company. The holding company, subject to the approval of the Federal Reserve, intends to engage in the sale of internet provider services to customers in the bank's service area. Such a service supplies an electronic gateway by which a customer connects a computer to the internet using a modem and a telephone line. The holding company will employ a person to install and service internet customers. This person will also receive a commission for any sales. The bank would house the equipment under a lease with the holding company. The equipment will consist of a computer, modem, and telephone lines. This computer system will be completely separate from the bank's computer system. There will be no links between the two systems.

The bank desires to enter into an agreement with the holding company to process applications for internet provider services and process payments as an agent for the holding company. New account representatives of the bank will offer information and applications for the internet services to both customers and non-customers of the bank. The bank will not receive a commission or fee for performing these functions as an agent of the holding company.

[2] The current OCC rule is at 12 CFR §32.5(e)(1) and reads: "*Partnership loans*. Loans or extensions of credit to a partnership, joint venture, or association are deemed to be loans or extensions of credit to each member of the partnership, joint venture, or association. This rule does not apply to limited partners in limited partnerships or to members of joint ventures or associations if the partners or members, by the terms of the partnership agreement, are not held generally liable for the debts or actions of the partnership, joint venture, or association, and those provisions are valid under applicable law."

As part of its Business Plan, the bank has decided to offer home banking products to its customers. The bank will also utilize the internet services offered by the holding company in order to offer these products. The bank, under agreement, will pay a fee to the holding company for internet access. Because of the initial start-up costs of home banking alternatives, the strategy of the bank is to assist the holding company as a processing and collection agent in order to develop a base of customers with internet access. When the customer base will support the investment in home-banking software, the bank intends to offer internet banking alternatives to its customers.

Discussion

The Finance Code prohibits a state bank from investing funds in trade or commerce by selling or otherwise dealing in goods or owning or operating a business not part of the business of banking. TEX. FIN. CODE §34.107. However, a state bank may engage in any activity, directly or through a subsidiary authorized by the Texas Finance Code or determined by the Banking Commissioner to be closely related to banking, TEX. FIN. CODE §32.001(b)(4) [*now in substance Finance Code §32.001(b)(6), pertaining to activities financial in nature, and (b)(7)*]. Additionally, a state bank may exercise incidental powers necessary to carry on the business of banking, TEX. FIN. CODE §32.001(b)(1). Under TEX. FIN. CODE §32.001(b)(2), a state bank may act as agent and, in that capacity, receive and disburse money.[1]

Banking is defined as "the performance of the exclusive depository institution functions of accepting deposits and discounting loans and the performance of related activities that are not exclusive to banks or other depository institutions, including paying drafts or checks, lending money, and providing related financial services authorized by this subtitle." TEX. FIN. CODE §31.002 (a)(4). This list is not exhaustive. Other powers of a state bank are outlined in TEX. FIN. CODE §32.001(b). See also, 7 TAC §11.83. Activities that are not included in the lists of enumerated powers are also part of the business of banking. In addition to these enumerated powers, state banks may engage in any activity that is permissible for a national bank. TEX. FIN. CODE §32.009; 7 TAC §11.81. [*Now also see Finance Code §§32.010 and 32.011.*]

Internet banking is part of the business of banking. Providing banking services via phone lines or by the internet simply utilizes advancing technology to provide traditional banking services. This alternative means of serving customers responds to customer needs. Customers may bank day or night, and are not required to bank only during business hours. Providing home banking services also benefits the bank because it allows the bank to utilize less costly distribution channels.

In addition, it is part of the business of banking to collect and remit monies. Such activity also serves as a public convenience. See, Opinion No. 97-06 (a state bank may sell prepaid phone cards as an agent). Moreover, a state bank, pursuant to request, may act as a "finder" in bringing together a buyer and seller where the bank provides the information and does not engage in negotiation. 7 TAC §11.83(d). In acting as a finder, the bank may advertise the availability of, and accept a fee for such services. See also, Opinion Nos. 98-25 and 95-31 (advertising activities are the business of banking); and 12 CFR §7.1002 (a national bank may act as a finder and may advertise and accept a fee). According to the information you provided, the bank will offer information about the internet provider services to its customers and noncustomers and collect payments on behalf of the holding company. Therefore, in response to your direct question, it is part of the business of banking for the bank to act as agent for the holding company to offer internet provider services and collect payments from customers. In addition, it is part of the business of banking for the bank to act as a finder on behalf of the holding company to sell internet provider services.

The question whether the bank could engage in this activity directly has not previously been determined by this Department. We note that we have not articulated a test to determine which incidental powers are necessary to carry on the business of banking. "Necessary", for purposes of federal law, has been construed to mean "convenient or useful" and national banks are authorized to engage in any activity that is incidental to enumerated powers or incidental to the business of banking. *NationsBank of North Carolina, N.A. v. Variable Life Annuity Co.*, 115 S.Ct. 810 (1995).

[1] *Effective September 1, 2001, §32.001(b)(2) authorizes a state bank to "act as agent, or in a substantially similar capacity, with respect to a financial activity or an activity incidental or complementary to a financial activity." Act of May 22, 2001, 77th Leg., H.B. 2155, §4.*

The questions posed regarding permissible activities are often very fact specific. However, in addition to statutory authority, several rules identify some activities that are permissible for state banks. See, 7 TAC §3.1 (a state bank may act as a broker for private placement of securities); §3.2 (a state bank may provide investment and financial management services and act as a dealer-manager in connection with tender offers). The Federal Reserve Board has likewise, by rule, determined a number of nonbanking activities that are so closely related to banking as to be a proper incident thereto. The list includes collection agency services, asset management, servicing, and collection activities, and data processing as long as the data to be processed are financial, banking, or economic. 12 CFR §225.28. The Office of the Comptroller of the Currency has rules that further elaborate the powers of national banks. See, 12 CFR part 7, subchapter A. Under these rules, "[a] national bank may perform, provide, or deliver through any electronic means and facilities any activity, function, product, or service that it is otherwise authorized to perform, provide or deliver. A national bank may also, in order to optimize the use of the bank's resources, market and sell to third parties electronic capabilities acquired or developed in good faith for banking purposes." 12 CFR §7.1019.

Several legal opinions issued by this Department have discussed activities that are incidental to the business of banking. One opinion permitted a state bank that in good faith acquired excess capacity in the bank's internet connection to sell the excess capacity to its business customers. Opinion No. 95-72. In another opinion, we found that a bank may provide links from its web page to web pages of bank customers and provide website hosting services to bank customers because such activity is incidental to the business of banking. Opinion No. 98-18.[2]

In this case, offering internet provider services facilitates the bank's business plan to provide home banking services to its customers. While the bank does not yet offer electronic banking alternatives, the bank may develop the infrastructure and conditions to facilitate a successful electronic banking program. Providing full internet access creates a package of related services that permits the bank to offer internet banking alternatives to its customers and enables the bank to successfully market such alternatives. While the technology is more recent, offering internet access may one day be viewed as permissible as the bank's sale of checkbooks to its customers for the purpose of withdrawing and transferring funds from a checking account. The activity will benefit the bank by bringing customers closer to the bank and could attract new customers. It will better position the bank to reduce costs and encourage customers to utilize internet banking alternatives. The bank, through its participation in offering these services, will likely build relationships with its customers and obtain opportunities for cross-selling of bank products.

Providing internet service access does not limit customers to solely financial, banking or economic uses. However, full internet service access is necessary so that a customer may engage in internet banking. And there is no additional expense to offer a full range of service. The fact that a customer could utilize another internet service provider does not exclude a bank from offering a service that is incidental to the business of banking. A state bank may own the means of distribution to provide banking services to their customers. Therefore, a state bank may, incidental to the business of banking, provide full internet access because it is a necessary ancillary activity required to engage in internet banking.

Internet access may be offered to non-customers. Excess capacity in internet access acquired in good faith to provide internet banking alternatives to bank customers may be offered to non-bank customers. In this case, it adds nothing to the cost of providing internet access to customers. And, it is impractical to separate customers from non-customers, for one could fall into either category by opening or closing an account. The basic equipment necessary to establish internet service would have capacity far in excess of that required to provide banking services over the internet. A state bank need not allow excess capacity to go to waste. Moreover, the bank to customers may offer its non-banking services in order to expand its goodwill in the community with the hope of attracting new customers.

Finally, the risks in providing internet access are similar to providing banking services electronically. The bank has experience protecting existing data processing systems from unauthorized access. The bank represents that the computer system of the bank and its financial data will be completely separate from the system housing the server. The bank and the server system will maintain separate phone lines and data bases.

[2] State banks, through their incidental powers, may also provide bookkeeping and data processing services for itself and affiliated banks (Opinion No. 95-57), acquire a company that provides consulting services to depository institutions (Opinion No. 96-11), and offer archive management services to banks (Opinion No. 93-11).

Therefore, we find this activity to be incidental to the business of banking, specifically internet banking. Consequently, because the bank is pursuing a business plan that will ultimately result in the offer of internet banking alternatives, this activity does not violate TEX. FIN. CODE §34.107 and is an activity that the bank may enter into directly.

Internet access service may be utilized for nonfinancial purposes. Therefore, the bank must ensure that any investment by the holding company complies with federal restrictions.

Safety and soundness must be considered. The bank should avoid any indication that it endorses this service. The bank must ensure that customers are informed that the service is offered by the holding company and not the bank. In addition, the bank should obtain an agreement from the holding company to hold the bank harmless for any problems that may arise from the internet services. And the holding company should require all customers to sign a user agreement that limits liability to the cost of service.

The bank also should maintain complete files of the activity for examination purposes. We also recommend notifying the bank's bonding company of the new activity being conducted by the bank.

This opinion is limited to the facts and circumstances described above. Any changes in the facts and circumstances could result in a different opinion.

Opinion No. 99-12

A foreign corporate fiduciary may serve as a fiduciary in Texas under certain conditions

May 12, 1999
Everette D. Jobe, General Counsel

By Internet e-mail dated April 9, 1999, you requested a letter from this Department indicating the terms and conditions required for a foreign corporate fiduciary to serve as a fiduciary in Texas. Specifically, you mentioned possible application and fee requirements and any requirement to post a bond or pledge securities. This area of the law is currently in flux due to pending legislation, but I can describe current law and what the law will be if House Bill No. 2066 passes the 76th Texas Legislature and is signed into law, as appears likely.[1]

Current Law: §105A, Texas Probate Code

Under current law, a foreign corporate fiduciary may serve in Texas under the authority of §105A, Texas Probate Code. That section generally permits a foreign corporate fiduciary to be appointed to serve as trustee in this state in any fiduciary capacity, but only to the same extent as the home state of the foreign corporate fiduciary grants authority to serve in like fiduciary capacity to a Texas corporate fiduciary. However, a foreign corporate fiduciary may not establish a place of business in Texas, including a branch or agency office, or directly or indirectly solicit fiduciary business in this state.[2]

Before accepting an appointment as a fiduciary in Texas, §105A requires a foreign corporate fiduciary to file with the Texas Secretary of State (1) a copy of its current charter or articles of incorporation or association, as amended, certified by its corporate secretary under corporate seal; (2) a written, perpetual, and irrevocable appointment of the Secretary of State as agent for service of process with respect to any action or proceeding relating to a trust, estate, fund, or other matter arising in this state and in which the foreign corporate fiduciary is acting as a fiduciary; and (3) a written designation, subject to change by a new designation, specifying the name and address of the officer, agent or other person to whom notice or process is to be forwarded by the Secretary of State. No fee is charged for this filing. Service on the Secretary of State as agent for a foreign corporate fiduciary is conclusively presumed to equate to personal service within this state upon the foreign corporate fiduciary. Pursuant to §405.031(a)(4), Texas Government Code, the Secretary of State charges a fee for forwarding service of process of $40 per person or party served through the Secretary of State.

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[1] *H.B. 2066 was enacted. See Acts 1999, 76th Leg., ch. 344, §6.002, eff. Sept. 1, 1999.*

[2] *This statement of law is incorrect as of September 1, 1999, the effective date of H.B. 2066. See the subsequent discussion of the bill.*

A foreign corporate fiduciary acting in a fiduciary capacity in this state in strict accordance with the §105A is not considered to be "doing business" in this state within the meaning of Article 8.01, Texas Business Corporation Act, and therefore is not required to file an application for a certificate of authority to do business in Texas as a foreign corporation.

Violation of §105A is a misdemeanor offense, and a conviction can result in the foreign corporate fiduciary being prohibited from serving in this state in any fiduciary capacity in the future.

Texas does not impose any general corporate requirement on a foreign corporate fiduciary to post a bond or pledge securities. With regard to specific appointments, Texas law does not require a bond of a corporate fiduciary. Section 195(b), Texas Probate Code, provides that a "corporate fiduciary" is specifically exempted from bonding requirements otherwise applicable to the personal representative of a decedent's estate. The term "corporate fiduciary" is defined in §3(d), Texas Probate Code, as a trust company or bank having trust powers, whether domestic or foreign.[3] Section 113.058(a), Texas Property Code, provides that "[a] corporate trustee is not required to provide a bond to secure performance of its duties as trustee." The term is not defined in the Property Code and so must be taken in its ordinary meaning as a fiduciary that has a corporate form of organization. Because the term as used in the Property Code is not modified by terms indicating a locus of incorporation, my conclusion is that the term includes both domestic and foreign corporate fiduciaries.

Proposed Law: §105A, Texas Probate Code, as amended by House Bill No. 2066

Currently pending in the 76th Texas Legislature is House Bill No. 2066, relating among other matters to the authorization of interstate operations of financial institutions in accordance with the requirements of federal law. Section 6.002 of the bill would amend §105A, Texas Probate Code, to remove some of its current restrictions. If the bill becomes law, it will be effective on September 1, 1999. At this writing, passage appears likely. In addition, §3.001 of the bill will enact new statutes that will specifically authorize a foreign corporate fiduciary to open a trust office or a representative office in this state.

As proposed to be amended, §105A will limit the concept of a "foreign corporate fiduciary" to a foreign financial institution that does not have its main office or a branch office in this state. Thus, a financial institution that operates an interstate branch or trust office in Texas will not be subject to §105A and be treated as a domestic entity for purposes of laws governing corporate fiduciaries and will be entitled to solicit and accept fiduciary business in this state without limitation.

As proposed to be amended, §105A will continue to permit a "foreign corporate fiduciary" (as that term is re-defined) to serve as trustee in this state to the same extent as the home state of the foreign corporate fiduciary grants authority to serve in like fiduciary capacity to a Texas corporate fiduciary. The filing requirements with the Texas Secretary of State, fees for filing, the effect of such filing, and bonding requirements are not affected by the amendment. Violation of §105A will continue to be a misdemeanor offense, and a conviction can result in the foreign corporate fiduciary being prohibited from serving in this state in any fiduciary capacity in the future.

[3] *Acts 1999, 76th Leg., ch. 344, §6.001, expanded the definition of "corporate fiduciary" to include a bank, savings bank, savings and loan association, credit union, or trust company, both domestic and foreign, effective September 1, 1999.*

Opinion No. 99-15

Loans secured by real estate occupied by individual parishes but owned by the area Catholic Diocese must be aggregated to the Diocese even though loans are nonrecourse.

June 9, 1999
D'Ann Johnson, Assistant General Counsel

By letter dated May 5, 1999, you requested our opinion whether loans secured by real estate occupied by individual parishes but owned by the Catholic Diocese would be aggregated even though there is a non-liability agreement to seek recourse solely against the real estate. You have stated that the bank has obtained financial information from each of the parishes substantiating their ability to service the debt. We are of the opinion that the loans would be aggregated.

Total loans or extensions of credit to any person or legal entity are limited to 25% of the Bank's capital and certified surplus. TEX. FIN. CODE §34.201(a).[1] The definition of loans includes non-recourse or limited recourse loans or extensions of credit. 7 TAC §12.3(a)(8). After discussion with experts in canonical law, it is apparent that individual parishes have no separate legal existence from the Catholic Diocese. The Diocese is more than a guarantor, because it signs the loan as borrower and holds title to the real property and all assets used or accumulated by the individual parish. Consequently, the Diocese is the direct beneficiary of the loans and aggregation is required. The Bank's limitation on repayment or recourse does not exempt the Bank from legal lending limit requirements.

Opinion No. 99-16

A loan to a limited partnership is generally not attributable to limited partners, but may be attributed to limited partners that guarantee the loan to the extent of the guaranty and aggregated with direct loans of the guarantor for legal lending limit purposes.

August 3, 1999
Sharon Gillespie, Assistant General Counsel

By letter dated May 6, 1999, you have requested an opinion relating to the legal lending limits of your bank. At my request, additional information has been faxed to me, and I have had several telephone conversations with you and other bank personnel (collectively referred to as "you" in this opinion). According to this correspondence, you are inquiring as to the applicability of legal lending limits to a loan made to a limited partnership (a property development company) that would be jointly and severally guaranteed by three individuals who are limited partners.[2] In the alternative, you ask what the legal lending implications would be if these individuals each limit their separate guarantees of the proposed loan to one-third of the amount of that loan. You have represented that the bank will not be relying solely on the creditworthiness of the limited partnership for repayment of the proposed loan; instead, it will require the guarantees.

Currently, the limited partners jointly and severally guarantee outstanding loans from your bank to the limited partnership, and each singly guarantees loans to one of three different homebuilding companies that own in equal parts the limited liability company that is the general partner. In our telephone conversations, you have indicated that the proposed loan is intended to purchase land in a growth corridor for a second phase of subdivision development; you have further indicated that there will be considerable cash equity in this project, that the loan to cost ratio is 71.1%, and that the loan will pay off on sale of 47 of the 72 lots. Two of the homebuilding companies intend to build on some lots in the proposed subdivision; but together they will purchase no more than 35% of the lots in the development. Most of the lots will be sold to other builders.

You have indicated that you have had a long banking relationship with the homebuilding companies, each of which has always performed as agreed and has good credit. You have also told me that, although you require guaranties in the normal course of business on all interim construction loans to homebuilding companies, the bank is not relying primarily on the

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[1] *Effective September 1, 2001, this limitation is stated as "25% of the lesser of bank's capital and certified surplus or total equity." Act of May 22, 2001, 77th Leg., H.B. 2155, §12.*

[2] The general partner, which is also a limited partner holding a 1% interest in the limited partnership, would not be a guarantor.

creditworthiness of the guarantors to repay the loans to these companies; the bank is relying primarily on the financial strength of the companies and the collateral on their loans. Prior loans from the bank to the limited partnership used to fund phase one of this development have not exceeded legal lending limits when aggregated with other outstanding debt described in your inquiry.

Based on the facts you have provided, you ask whether you must attribute 100% of the proposed loan to each of the individuals who will serve as its guarantors. Although you have indicated there will be considerable cash equity in the development project, you have also indicated that you would not make the proposed loan to the limited partnership but for the guarantees; furthermore, you are confident through your knowledge of the guarantors that taking a one-third guarantee from each will protect the bank's interest in the loan's repayment.

Preliminary Issues

Before answering your questions, we observe that the relationships among the parties are numerous and complex. At the core, three individuals control all related business, but in capacities that permit identification of separate borrowers. Based solely on your representations, it would appear that the relationships of the limited partners as guarantors of the proposed loan to the partnership and as owners/guarantors of the homebuilding companies; and the homebuilding companies as owners/members of the limited liability general partner, as customers of the limited partnership, and as borrowers from the Bank, do not require attribution and aggregation of loans for legal lending limit purposes. However, we have not investigated these relationships for the purpose of expressing an opinion.

Further, the proposed loan will be fully attributable to the general partner. *See* Opinion No. 99-08 (April 27, 1999). You have not asked for our opinion, and we have not elaborated, whether a loan to a limited liability company must be attributed to the members. However, if the members have limited liability similar to a limited partner or shareholder, attribution would not be made.

Subject to these observations, we limit our opinion solely to the guaranty issue you have raised.

Opinion Regarding Guaranties

Under 7 TAC §12.9(f)(1), loans to a limited partnership are not attributable to limited partners who are not generally liable for debts of the limited partnership. However, if the individuals who are limited partners each agree to guarantee the full amount of the loan to the limited partnership, the proposed loan to the limited partnership is fully attributable to each guarantor under 7 TAC §12.9(g) for legal lending limit purposes, regardless of the guarantors' status as limited partners. Section 12.9(g) provides that a loan which is guaranteed by a guarantor is not aggregated with direct loans to the guarantor "*if the lending bank is relying primarily on the creditworthiness of the primary obligor and none of the tests set forth in this section are satisfied.*" Because the bank is not relying primarily on the creditworthiness of the limited partnership, the guaranteed loans to the limited partnership are attributed to each guarantor to the extent of the guaranty and will be aggregated with direct loans of such guarantors under this same analysis. However, if each of the guarantors contractually limits his separate guarantee of the proposed loan to one-third the amount of that loan, only the amount actually guaranteed, *i.e.*, one-third of the loan amount, would be attributed to each guarantor.

Our conclusions herein should not be construed as an endorsement of the advisability or quality of the proposed loan, a determination that must be made by the board of directors of the bank. The bank is cautioned that the purpose of the lending limit is to reduce risk by preventing one individual, or a relatively small group, from borrowing an unduly large amount of the state bank's funds. As a result, these types of loans will be closely scrutinized by an examiner.

This opinion is limited to the facts and circumstances stated in your written correspondence with the Department and any facts or assumptions set out herein. Any change in those facts, circumstances, assumptions, or parties to the transaction may result in a different opinion.

Opinion No. 99-17

An accounting increase dictated by GAAP in the carrying value of bank's investment in a leveraged lease cannot create a legal lending limit violation, provided the increase does not represent an additional investment by the bank or an additional contractual obligation by the bank to advance funds.

July 20, 1999
Sammie K. Glasco, Assistant General Counsel

This letter is in response to your letter of May 6, 1999. You supplemented your letter by submitting documents related to the transaction on June 22, 1999. In your letter, you asked whether an accounting increase in the carrying value of a bank's investment in a lease constitutes a legal lending limit violation when (a) the amount expended at the inception of the transaction was within the bank's legal lending limit, and (b) the increase in carrying value is required by generally accepted accounting principles ("GAAP"). We are of the opinion that adjustments in the carrying value of an investment in a leveraged lease dictated by GAAP cannot create a legal lending limit violation, provided the increase does not represent an additional investment by the Bank or an additional contractual obligation by the Bank to advance funds.

The transaction is as follows. On December 16, 1997, [***] State Bank ("Bank") entered into a leveraged lease transaction through an assignment and assumption agreement (the "Agreement") in which the Bank gained a beneficial interest in a Boeing 737-522 aircraft. While in some leveraged leasing transactions the bank involved acts only as an owner-trustee for a beneficiary, it appears from the Agreement that the Bank, in this instance, is considered a "true" lessor. The total contract price was $6,159,161. The total amount expended at the inception of the transaction was $6,917,862. The Bank's legal lending limit was $7,500,000 at the time and remains so today. The Bank believes that compliance with certain technical requirements of GAAP may on occasion require a book entry increase in the carrying value of the investment to an amount in excess of $7,500,000.

Accounting for leveraged leases is highly complex, and is generally governed by Financial Accounting Standards Board Statement No. 13 ("FAS-13"), although numerous subsequent pronouncements have been issued that explain, interpret, or amend FAS-13 in a variety of ways. According to the 1999 Miller GAAP Guide,[1] GAAP for leases include the largest number of authoritative accounting pronouncements of any single subject in accounting literature.

As we understand the accounting treatment of leveraged leases, changes in the carrying value of the lease investment can occur as a result of the manner in which the related debt is amortized, exclusive of deferred tax liabilities. By definition, a "leveraged lease" is characterized by several attributes, one of which is that once the lessor's net investment is completed, the carrying value of the investment generally declines in the early years and raises in the later years before being liquidated.[2]

Section 34.201, Texas Finance Code, provides that unless the banking commissioner approves otherwise "total loans and extensions of credit by a state bank to a person outstanding at one time may not exceed an amount equal to 25 percent of the bank's capital and certified surplus."[3] Lease financing transactions are considered loans and extensions pursuant to 7 TAC §12.7. More generally, according to 7 TAC §12.3(a)(2), a loan or an extension of credit includes any "contractual obligation to advance funds to or on behalf of a person." The amount chargeable to a bank's legal lending limit is established on the date the bank advances or is obligated to advance funds on a person's behalf. In this instance, the extension of credit is $6,917,862, which is below the Bank's legal lending limit. An increase in the carrying amount of this investment for accounting purposes does not increase the amount that the Bank has advanced or is obligated by contract to advance. The Department only considers the amount that is "at risk" by the Bank for legal lending purposes. The fact that

[1] Jan R. Williams, Miller GAAP Guide (1999), page 30.05.

[2] *Id.* at 30.60; FAS-13, ¶ 42.

[3] The rules in Chapter 12 of Title7, Texas Administrative Code (7 TAC ch. 12), clarify that this limit is more accurately stated as "25% of the lesser of the bank's capital and certified surplus or the bank's total equity capital," *see, e.g.*, 7 TAC §12.5(a). [*The more accurate statement is now codified in Finance Code §34.201, eff. Sept. 1, 2001. Act of May 22, 2001, 77th Leg., H.B. 2155, §12.*]

the accounting treatment of a leveraged lease may require a book entry that increases the carrying value in the investment does not alter this conclusion.

This opinion is limited to the facts and circumstances stated in your letter of May 6, 1999, and the supplemental documents provided on June 22, 1999. Any change in those facts or circumstances could result in a difference conclusion.

Opinion No. 99-18

Under Finance Code §34.304 and Property Code §113.057, a state bank may pledge its assets to secure trust funds on deposit with the bank and held pending investment, distribution, or payment of debts. However, Property Code §113.057 applies only to an *express* trust and does not authorize such a pledge based merely on the existence of a fiduciary duty imposed on the bank with respect to certain funds.

April 6, 1999
Jeffrey L. Schrader, Assistant General Counsel

Your letter dated March 9, 1999 regarding the examination of [XYZ] Bank, [Any City], Texas (the "Bank"), has been referred to me for a response. The Bank was cited for a violation of Finance Code §34.304, which provides that a state bank may not create a lien on its assets or secure the repayment of a deposit except as authorized or required by that section, rules adopted under Finance Code, Title 3, Subtitle A, or other law. The violation was cited due to the pledge of assets by the Bank to the deposits of a customer that originated through the Bank under an agency agreement.

You have argued that the deposits under the agency agreement are trust funds and that, therefore, the pledge is authorized by Property Code §113.057, which allows a corporate trustee to deposit with itself trust funds that are being held pending investment, distribution, or payment of debts if it maintains under control of its trust department as security for the deposit a separate fund of securities legal for trust investment. However, Property Code §111.003 provides that, for purposes of the Texas Trust Code (Property Code, Title 9, Subtitle B), a "trust" is an express trust only. The law on which you have relied as authority for the Bank to secure the deposits under the agency agreement, Property Code §113.057, is therefore only applicable to express trusts. But the agency agreement in question is not an express trust under Texas law. Therefore, the Bank is not authorized to pledge its assets to secure the deposits of its customer originated under the agency agreement, and is in violation of Finance Code §34.304.

An "express trust" is defined at Property Code §111.004(4) as a fiduciary relationship with respect to property which arises as a manifestation by the settlor of an intention to create the relationship and which subjects the person *holding title to the property* to equitable duties to deal with the property for the benefit of another person (emphasis added). In addition the courts have held that in order to show an express trust the controlling tests are that (1) the words of the settlor ought to be construed as imperative and thus imposing an obligation on the trustee, (2) the subject to which the obligation relates must be certain, and (3) the person intended to be the beneficiary must be certain.[1] An express devise of property to another as trustee for named beneficiaries is required for the creation of an express trust.[2] I have reviewed the agency agreement and it does not manifest an intention to create a trust or fiduciary relationship. Nor does it vest legal title of the deposit funds with the Bank. Rather, the agency agreement merely functions as a cash management tool for excess funds held in a deposit account.

In addition, your reliance on OCC Interpretive Letter No. 699 (1996) as authority for the Bank to secure the deposits under the agency agreement is misplaced. As you point out, the OCC states in that interpretive letter that the contractual relationship between a paying agent and the corporate customer, and other facts and circumstances, determine whether corporate trust or paying agent balances are held in a "fiduciary" capacity. However, the fundamental issue in that interpretive letter was whether a national bank may deposit fiduciary funds in an affiliate bank and pledge or have the affiliate bank pledge assets to secure those deposits. The OCC concluded that the national bank or affiliate bank may pledge assets to secure those deposits *to the same extent as other competing institutions are permitted or required to do so under state law*. As described above, a state bank may not create a lien on its assets or secure the repayment of a deposit under Finance Code §34.304.

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[1] *Unthank v. Rippstein*, 386 S.W.2d 134 (Tex. 1964); *Brelsford v. Scheltz*, 564 S.W.2d 404 (Tex.Civ.App.—Houston 1978).

[2] *Fitz-Gerald v. Hull*, 150 Tex. 39, 237 S.W.2d 256 (1951); *Humane Society of Austin and Travis County v. Austin National Bank*, 531 S.W.2d 574 (Tex. 1975).

Opinion No. 99-19

A trust company may not earn interest on the "float" in a pooled disbursement account owned by the trust company and maintained at a bank, comprised of trust funds subject to outstanding checks.

July 16, 1999
Jeffrey L. Schrader, Assistant General Counsel

This is in response to your letter dated May 20, 1999 asking the department to reconsider a violation of law cited in the Report of Examination of [***] Trust Company (the "Company"), dated [***]. In that report the examiner cited management for recognizing income on the uncollected funds, or "float", in a pooled disbursement account comprised of trust funds subject to outstanding checks. Pursuant to your request, the department has revisited this issue and concurs with the conclusion of the examiner that this practice violates Texas law.

The report indicates that since the last examination the Company entered into an agreement with a local bank to sweep disbursement account float balances in excess of $[***] into a mutual fund account. The disbursement account float represents checks that have been issued but which have not cleared the bank. The examiner noted that these funds arise out of the administration of trust accounts and clearly do not belong to the Company, and advised management that it is considered a conflict of interest for the Company to earn income on the float. As a basis for this determination the examiner relied on Property Code §114.001(a), which provides that a trustee is accountable to a beneficiary for the trust property and for any profit made by the trustee through or arising out of the administration of the trust, even though the profit does not result from a breach of trust.

In response to this examination report you have provided reasons why you believe this practice is permissible. First, you contend that administration of a trust ends, as it relates to a disbursement, when the disbursement check is issued to the payee and posted to the trust account. Second, you advised the department that the Company uses a local bank for its trust disbursement account, and you believe that any earnings on disbursement float arise out of the normal administration of the Company's banking affairs, and not administration of the trust. Finally, you believe that because banks with trust powers utilize disbursement accounts which contain check float until the disbursement checks are cleared, and receive an economic benefit from holding own-bank deposits, that it is permissible for a trust company to derive an economic benefit as well.

The department disagrees with your assertion that administration of a trust ends when the disbursement check is issued to the payee and posted to the trust account. Upon termination of a trust, Property Code §112.052 provides that the trustee may continue to exercise the powers of the trustee for the reasonable period of time required to wind up the affairs of the trust and to make distribution of its assets to the appropriate beneficiaries.[1] If a trustee's responsibilities and fiduciary duties continue upon termination of a trust through the winding up period, then they certainly continue until funds finally clear after the issuance of a disbursement check on an active trust.

The department also disagrees with your belief that earnings on disbursement float arise out of the normal administration of your Company's banking affairs, as distinguished from administration of the trust. That view misses the point raised in the examination report — that the profits the Company realizes through this practice are generated through the use of *others'* funds (discussed in more detail below).

[1] See also Restatement of (Second) Trusts §344 comment a (1959), which states: "The powers and duties of the trustee in the winding up of the trust are similar to the powers and duties of the trustee in administering the trust . . . except so far as they are modified because of the fact that the trust is in process of termination."

Finally, the department disagrees with the parity argument you advance. To the extent banks with trust powers derive some economic benefits when their trust departments place fiduciary funds in own-bank deposits, as you contend, those benefits are incidental to their deposit-taking powers.[2] Property Code §113.057(b) provides that a corporate trustee may deposit with itself trust funds that are being held pending investment, distribution, or payment of debts, but requires the maintenance of a separate fund as security for such deposits (see also Tex. Rev. Civ. Stat. art. 342a-5.401). Except for the limited circumstances in which a trust company is authorized to deposit trust funds with itself, discussed above, the acceptance of deposits requires depository powers, and your Company does not possess such powers.

In my opinion, the interest income generated through the sweep of float balances into a mutual fund account belongs to the trust beneficiaries. A trustee's profit from dealing with property of a trust is property of the beneficiaries, not the trustee. *Steves v. United Services Automobile Association*, 459 S.W.2d 930 (Tex. Civ. App.–Beaumont 1970, writ ref'd n.r.e.). The rule of law prohibiting a trustee from profiting from his own self-dealing with the corpus of the trust estate is set out in the case of *Merriman v. Russell*, 39 Tex. 278, 285 (1873), which states:

> The rule that a trustee shall not deal with the subject of the trust for his own benefit, is said to be absolute and universal. It is subject to no qualifications and no exceptions.
>
> An abuse of trust can confer no rights on the party abusing it, or those who claim in privity with him. It is a principle recognized at law in all cases, susceptible of being brought out as a ground of action or of defense in a suit of law, while its application in courts of equity is universally adopted.

The rule prohibiting a trustee from profiting from his own self-dealing with trust property is repeated in *Slay v. Burnett Trust*, 143 Tex. 621, 187 S.W.2d 377, 387 (1945), which provides:

> It is a well-settled rule that a trustee can make no profit out of his trust. The rule in such cases springs from his duty to protect the interests of the estate, and not to permit his personal interest to in any wise conflict with his duty in that respect. The intention is to provide against any possible selfish interest exercising an influence which can interfere with the faithful discharge of the duty which is owning in a fiduciary capacity. *Magruder v. Drury*, 235 U.S. 106, 356 S. Ct. 77, 82, 59 L.Ed. 151, 156.

The rule extends to every variety of circumstances and has often been applied when a trustee has collected a commission or bonus or has otherwise made a profit for himself out of the property or funds of the trust or in the performance of his duties as a fiduciary. A trustee who has made a profit for himself under such circumstances is required to account to his beneficiary for it; the profits so made belong to the trust. *Slay*, 187 S.W.2d at 388.

In addition to the prohibition on self-dealing by the trustee, the general rule that "interest follows principal" applies in Texas. *Sellers v. Harris County*, 483 S.W.2d 242 (Tex. 1972). In *Sellers*, the Texas Supreme Court held that the interest earned by a deposit of money owned by the parties to a lawsuit is "an increment that accrues to that money and to its owners." 483 S.W.2d at 243. The rule that "interest follows principal" has been established under English common law since at least the mid-1700's, and has become firmly embedded in the common law of the various States. *Beckford v. Tobin*, 1 Ves. Sen. 308, 310, 27 Eng. Rep. 1049, 1051 (Ch. 1749) ("Interest shall follow the principal, as the shadow the body"). A trustee is vested with legal title to, and the right of possession of, trust property, while equitable title is vested in the

[2] A bank employs deposits for its own lending and investment activities and can benefit from check float. However, banks with trust powers are urged to have written policies and procedures governing the use of own-bank deposits. For example, the FDIC's Trust Examination Manual provides as follows:

> Trust departments should have written policies governing the use of own-bank...demand and interest-bearing deposits. As with other own-bank related investments, the fiduciary bank should fully document its review of alternative investment vehicles, the competitiveness of interest rates, and its approval procedures with a view to protecting the interests of both the beneficiaries and the institution. (Section 8(E)(3)(a).)
>
> To properly manage the conflict of interest and self-dealing inherent in own-bank or affiliated bank demand deposits, the amount held in demand balances of each account should be restricted to the minimum necessary. There have been a number of beneficiary lawsuits in recent years that focus on the fiduciary's management of demand deposits and its concurrent use of the funds for lending and investments, together with the benefit of float gained by the bank. (Section 8(E)(3)(b).)

beneficiaries. *Becknal v. Atwood*, 518 S.W.2d 593 (Tex. Civ. App.–Amarillo 1975, no writ). Accordingly, it follows that the income generated by that trust property belongs to the beneficiaries, as well.

The United States Supreme Court recently considered a similar issue in *Phillips v. Washington Legal Foundation*, 524 U.S. 156, 118 S. Ct. 1925 (1998). The question in that case was whether a Texas requirement that the interest earned on client trust funds in IOLTA[3] accounts was a property interest of the client or lawyer. Under the IOLTA program, an attorney who received client trust funds was required to place them in a separate, interest-bearing account. The Supreme Court held that the interest income generated by client funds held in Texas IOLTA accounts belonged to the client, as owner of the principal, relying on the "interest follows principal" rule enunciated in *Webb's Fabulous Pharmacies, Inc. v. Beckwith*, 449 U.S. 155, 101 S. Ct. 446 (1980).[4] Because the interest income at issue is generated by trust property, those earnings belong to the trust beneficiaries under the "interest follows principal" rule.

In conclusion, the department confirms the violation of law cited in the examination report. Management should discontinue the sweep arrangement because the Company cannot, consistent with its fiduciary duty, deal with trust property for its own benefit by appropriating interest earned on the "float" in a pooled disbursement account comprised of trust funds subject to outstanding checks because such profits are generated with trust property and therefore belong to the trust beneficiaries.

Opinion No. 99-22

A trust company may employ a third party to provide ministerial or administrative services with respect to customer accounts, and the location of the servicer will not be considered a branch of the trust company, provided that the services do not include the exercise of fiduciary powers except as otherwise explicitly permitted by Texas law.

July 22, 1999
Loren E. Svor, Assistant General Counsel

By letter dated May 28, 1999, you described a proposed arrangement under which [***] Corporation (the "Service Corp.") would provide a variety of "back office" services related to custodial accounts maintained with [***] Trust Company (the "Company"). Service Corp. and the Company are affiliated through common ownership by the [****]. You have asked for our assurances that Service Corp. would not be deemed to be a branch of the Company by virtue of the proposed activities on behalf of the Company. It is our opinion that the Company may contract with Service Corp. to provide the indicated ministerial or administrative services related to custodial accounts without the location of Service Corp. being considered a branch of the Company because these activities do not constitute engaging in the "trust business."

As outlined in your letter, the Company desires to expand its services to customers who are heavily invested in mutual funds. This type of account is transaction intensive, and the existing volume of such business does not justify the level of in-house staffing necessary to maintain it. The Company wishes to contract with Service Corp., an affiliate already servicing such accounts as part of its business, to provide the back office support necessary to administer its existing accounts of this type, and to allow expanded activity in this area without the necessity of hiring personnel in-house, at least until the volume of business would justify such a resource allocation. The Company believes that the arrangement would be less costly than handling these functions in-house and that, in fact, it may not be possible to hire sufficient satisfactory personnel given the tight local labor market. The Company further believes that the proposed cost is similar to or less than what would be charged by a unrelated third-party servicer.

[3] An Interest on Lawyers Trust Account (IOLTA) Program. Under these programs, certain client funds held by an attorney in connection with the practice of law are deposited in bank accounts. The interest income generated by the funds is paid to foundations that finance legal services for low-income individuals.

[4] The Court left for consideration on remand the question whether IOLTA funds have been "taken" by the State of Texas, as well as the amount of "just compensation," if any, due respondents.

Analysis

A state trust company is required to obtain the acquiescence or approval of the Banking Commissioner for any additional offices at which it engages in the "trust business." *See* Texas Trust Company Act ("TCA") (V.T.C.S. Art. 342a-1.001 *et seq.)* §§3.201 and 3.203[1] [*now Finance Code §§182.201 and 182.203*]; *see also* 7 TAC §21.1(a)(2). "Trust business" is defined as "the business of a company holding itself out to the public as a fiduciary for hire or compensation to hold or administer accounts." TCA §1.002(a)(50)[2] [*now Finance Code §§181.002(a)(49)*]. The Texas Trust Code (TEX. PROP. CODE, Subtitle B) provides that a trustee may engage third-parties to provide certain services with respect to fiduciary accounts in the course of performing fiduciary duties. For example, a trustee may employ attorneys, accountants, agents and brokers as reasonably necessary to the administration of the trust estate. TEX. PROP. CODE §113.008. A state trust company that is serving as a trustee, or serving as a custodian of an IRA account, may employ an affiliate to provide "brokerage, investment, administrative, custodial, or other account services" with respect to a trust. TEX. PROP. CODE §13.053(f); *See* Opinion No. 98-15 (July 27, 1998), *citing Transamerican Leasing Co. v. Three Bears, Inc.*, 586 S.W.2d 472, 476 (Tex. 1979)(trustee may give authority to others to carry ministerial or administrative acts to effectuate discretionary decision).

Our understanding is that Service Corp. would provide the following services to the Company and its customers invested in mutual funds:

- Processing new accounts, withdrawals form the accounts, and customer investment directions (including account termination or transfer);
- Preparation of account and financial statements for customers;
- Reconciling accounts at the request of the Company or a customer, and otherwise responding to customer inquiries with respect to the accounts;
- Originating ACH /direct electronic debiting and crediting with respect to the accounts;
- Preparation of tax documents for the accounts;
- Communication and coordination with mutual fund and annuity providers that have sold investment to customers;
- The processing of checks from investment providers for credit to customer accounts;
- Providing clerical staff, services, and filing services which may be requested by the Company or which are necessary to perform these duties; and
- Other services of a similar nature.

Service Corp. may engage in activities authorized by law and in the scope of authority as an agent of a state trust company without being considered to be engaging in the trust business. TCA §3.022(1) [*now Finance Code §182.021(1)*]. It follows that the Company may designate Service Corp. as an agent to perform such activities without Service Corp.'s location becoming an additional office of the Company. All of the activities described can be permissibly delegated pursuant to applicable law. *See* Tex. Prop. Code §113.008.[3] Consequently, the proposed activities would not result in Service Corp.'s office being considered an additional office, or branch, of the Company.

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[1] The TCA was repealed, effective September 1, 1999, by the 76th Legislature in connection with its codification as Subtitle F of the Texas Finance Code. TCA §§3.201 and 3.203 became Finance Code §§182.201 and 182.203. In addition, the source law for TCA §3.201 was amended to authorize additional trust offices out-of-state, which modification will be given effect notwithstanding the repeal.

[2] Effective September 1, 1999, Tex. Fin. Code §181.002(a)(49).

[3] The general rule in Texas has been that a trustee could not delegate discretionary powers. *See Transamerican Leasing* at 476; Opinion No. 98-15. Effective September 1, 1999, this rule will be somewhat relaxed — the 76th Legislature in HB 1475 amended Tex. Prop. Code §113.018, and added §113.060, to permit the appointment of an investment agent with the authority to make investment decisions for a trust. New §113.060 states that the trustee remains responsible for the investment decisions, unless the trustee employs a fiduciary standard of care in selecting the agent, and certain other conditions are met.

Other matters.

Please note that 7 TAC §17.21 specifies the records that must be maintained by a state trust company, and further requires the prior approval of the Department if any of the records are maintained at a location other than the home office of the trust company. The rule should be reviewed to determine that all such records with respect to the accounts to be administered by Service Corp. either will be available at the Company's home office, or that prior approval for a deviation is obtained. We would also suggest that paragraph 2.02 of the proposed contract, which requires Service Corp. to provide only records adequate "to enable [the Company] to identify and monitor accounts and assets" be amended to require, in addition, any records required by rule, or by the Department for another reason.

A contract for the provision of incidental services such as described above should have, for safety and soundness and regulatory reasons, provisions covering indemnification, regulatory access to records, and immediate termination upon regulatory prohibition of the relationship. The contract you have submitted satisfactorily addresses these areas.

This opinion is limited to the factual situation which you presented and to the issue of whether Service Corp. would be considered a branch of the Company under the proposed contract. We presume that the Company has performed proper due diligence in the selection of the servicer and will provide the necessary oversight of the servicer's activities. Of course, any aspect of the relationship remains subject to criticism on safety and soundness grounds.

Opinion No. 99-24

If a safe deposit box is opened without the lessee being present, one bank employee must be present who is an officer and another bank employee must be present who is a notary public.

June 25, 1999
Loren E. Svor, Assistant General Counsel

By letter dated May 6, 1999, you requested our interpretation of the Texas statutory requirements for opening a safe deposit box when the lessee is not present. Specifically, you asked whether the requirement of TEX. FIN. CODE §59.109 that such an opening be done in the presence of two bank employees, "at least one of which is an officer. . . and at least one of which is a notary public" would be satisfied if two employees were present, but the officer present was also the notary public, i.e., the other employee present was neither an officer or a notary. It is our opinion that TEX. FIN. CODE §§59.107 and 59.109 require that when a safety deposit box is opened except in the presence of the lessee, its contents must be inventoried by one person acting in the capacity of an officer or manager of the safe deposit company, and another person acting in the capacity of a notary; the same person may not act in both capacities.

Analysis

There are two sections of the Finance Code (the "Code") that deal with the opening of safe deposit boxes when the lessee has not consented in writing and is not present. Section 59.107(e) addresses a relocation which requires an opening of the box. In pertinent part it reads:

> If during the relocation the box is opened and the lessee does not personally supervise the relocation or has not authorized the relocation in writing, two employees, at least one of whom is an officer or manager of the safe deposit company and at least one of whom is a notary public, shall inventory the contents of the box in detail. The safe deposit company shall notify each lessee of the new box number or location not later than the 30th day after the date of the relocation and shall include a signed and notarized copy of the inventory report.

Section 59.109(a) addresses the procedure to be followed if the box is opened because the rent is delinquent. In pertinent part, it reads:

> If the rent is not paid before the date specified in the notice, the safe deposit company may open the box in the presence of two employees, at least one of whom is an officer or manager of the safe deposit company and at least one of whom is a notary public. The safe deposit company shall inventory the

> contents of the box in detail as provided by the comptroller's reporting instructions and place the contents of the box in a sealed envelope or container bearing the name of the lessee.

Although the procedures with respect to opening a box for which the rent is delinquent do not require that a signed and notarized inventory report be prepared, as does the procedure for opening a box for relocation, in light of the identically worded observer requirement, the two statutory provisions must be interpreted identically with respect to the capacities in which the employees are present. As it pertains to your question, this means that the two employees must be present in capacities that would permit a signed and notarized inventory report to be prepared even though that action is not specifically required by section 59.109 of the Code.[1]

In essence, the issue is whether a notary public may function as a notary and simultaneously be involved in the transaction in another capacity. The general rule is that a notary may function as such with respect to a transaction provided that the notary is not financially or beneficially interested in the transaction. *Phillips v. Brazosport Savings and Loan Assoc.*, 366 S.W.2d 929, 931-932 (Tex. 1963). A notary is not "interested" in a transaction merely by being an employee of a party executing a document. *In re Bruno*, 974 S.W.2d 401 (Tex. App.–San Antonio 1998); *Creosoted Wood Block Paving Co. v. McKay*, 211 S.W. 822 (Tex. Civ. App.–Dallas 1919).[2] However, if a notary is acting as an agent for a party in the transaction, particularly if the notary actually signs the instrument as an agent for a party, interest is presumed. *Kutch v. Holley*, 14 S.W. 32 (Tex. 1890).

When a safe deposit box is inventoried, the bank officer is required to be present because the officer is an agent of the bank, legally empowered to bind the bank. The officer signs the inventory report as the agent for the bank, and therefore may not also act as the official that notarizes the document. *Id*. Additionally, in requiring that the notary actually be present at the opening of the box, the statute apparently contemplates that the notary will provide independent verification of the accuracy of the officer's statement, as well as administering the oath to the officer. It seems improbable that the legislature intended that this elaborate procedure to assure the accuracy of an inventory of the safe deposit box could be essentially nullified by allowing the same person simultaneously to perform the functions of preparing the inventory, swearing to its accuracy, administering the oath, and providing independent verification of its accuracy. *See Bridgestone/Firestone, Inc. v. Glyn-Jones*, 878 S.W.2d 132, 134 (Tex. 1994) (Statutory provision will not be construed to cause a result the Legislature almost certainly could not have intended). We thus construe the statute to preclude the same person acting both as an officer of the bank and the notary public.

Opinion No. 99-28

A federal savings bank may not serve as depository trustee of a Texas prepaid funeral trust if the bank has no office in Texas.

May 19, 2000
Everette D. Jobe, General Counsel

By letter received June 24, 1999, you ask several questions relating to whether [***] FSB (the "Bank"), a federal thrift institution chartered under the Home Owners' Loan Act, 12 U.S.C. §§1461 *et seq.* ("HOLA"), may serve as trustee under a Texas prepaid funeral benefits contract trust agreement governed by Texas Finance Code Chapter 154. Please accept my apologies for our delay in responding to your request. We were critically understaffed in the Legal Division a few months ago and are only now reducing the backlogged work that developed.

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[1] In your specific circumstances, the principle of parallel construction is not necessary because, as you indicated in a telephone conversation subsequent to your letter, your procedures do require an inventory report signed by the officer present at the opening and notarized by the notary present at the opening.

[2] With respect to banks, this principle is statutorily recognized. TEX. FIN. CODE §59.003 provides that "[a] notary public is not disqualified from taking an acknowledgment or proof of a written instrument . . . solely because of the person's ownership of stock or a participation interest in or employment by a bank that is an interested party to the underlying transaction."

Question Presented

You first ask whether a corporate trustee must be chartered in Texas to be eligible to serve as trustee under a Texas prepaid funeral benefits contract trust agreement governed by Finance Code Chapter 154. You also ask whether Texas law requires such a trustee to have depository powers, and whether an out-of-state corporate trustee may serve as trustee if all trust operations occur outside Texas.

Summary of Response

Your individual questions are answered in greater detail below. In general response to your inquiry, however, Texas law requires prepaid funeral benefits trust funds to initially be deposited with a financial institution that has its main office or a branch located in this state. Consequently, the Bank, as an out-of-state financial institution, may not serve as trustee for a Texas prepaid funeral benefits trust unless the Bank establishes a branch in Texas and complies with Texas Revised Civil Statutes art. 342a-9.004 [*now Finance Code §187.004*][1] and Finance Code §201.102.

Discussion

To answer your questions, we first examine the provisions of the Texas Finance Code relevant to the deposit of trust-funded prepaid funeral benefits. Finance Code §154.253(a), which governs the deposit of money paid or collected under a prepaid funeral benefits contract, provides that:

> Not later that the 30th day after the date of collection, the money, other than money retained as provided by §154.252, shall be deposited: (1) in a financial institution that has its main office or a branch *in this state* in an interest-bearing account insured by the federal government; or (2) in trust with a financial institution that has its main office or a branch *located in this state* and is authorized to act as a fiduciary in this state, to be invested by the financial institution as trustee in accordance with this subchapter. [Emphasis added.]

Texas law is thus clear: prepaid funeral benefits trust funds must initially be entrusted to a financial institution with its main office or a branch located in this state. The holder of a Texas prepaid funeral benefits permit who fails to deposit trust funds in a financial institution with its main office or a branch located in Texas violates Finance Code §154.253(a), and is subject to regulatory sanctions under Finance Code Chapter 154, including permit cancellation and the imposition of criminal penalties.[2] To be eligible to serve as a trustee of a prepaid funeral prepaid funeral benefits trust fund under Texas law, therefore, the Bank must have its main office or a branch located in this state.

According to your letter, the Bank's principal place of business is in New Jersey. Consequently, the Bank can satisfy the requirements of Finance Code §154.253(a) and serve as trustee only if it maintains a branch in Texas. Finance Code §31.002(a)(8) and Revised Civil Statutes art. 342a-9.001(a)(3) [*now Finance Code §187.001(a)(3)*] define "branch," with certain exceptions not relevant here, as a "location of a bank, other than the bank's main office, at which the bank engages in the business of banking." Further, for interstate banking and branching purposes, Finance Code §201.001(a)(8) provides that "branch" has the meaning assigned to the term "domestic branch" by section 3(o), Federal Deposit Insurance Act.[3] We have found no published judicial decisions under federal law, and no meaningful written guidance, interpreting the term "domestic branch." The section 3(o) definition of "domestic branch" is, however, in relevant part, identical to the definition of "branch" in the National Bank Act[4]. As used in the National Bank Act, the term has been extensively interpreted, both in case law and agency guidance.

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[1] *As codified by Act of May 22, 2001, 77th Leg., H.B. 2812, §6.001(a), eff. Sept. 1, 2001.*

[2] *See* Finance Code §154.109(a)(1) and §154.402(a)(1).

[3] 12 U.S.C. §1813(o).

[4] 12 U.S.C. §36(j).

The meaning of "branch" has been held to be open-ended, "to include" a bank facility "at which deposits are received, or checks paid, or money lent."[5] Engaging in one or more of these core banking functions is clearly one of the indicia of a branch,[6] but the absence of these functions does not necessarily mean that a national bank office is not a branch.[7]

You advise that the Bank intends to engage only in marketing activities in Texas. It does not propose to engage in any core banking functions in this state or conduct any fiduciary activities. Indeed, it does not even intend to establish a facility or physical location or presence in Texas. All of its trust operations will occur outside of this state. On the basis of the facts presented in your letter regarding the Bank's proposed activities, we conclude that the Bank would not be a financial institution with its main office or a branch located in this state, as required by Texas law.

We next consider whether the Bank may serve as trustee of a Texas prepaid funeral benefits trust under federal law, even though it does not meet the requirements of Texas law. The Bank is a federal thrift chartered under HOLA as a limited purpose trust institution without depository powers.[8] The scope of trust powers of a federal thrift is defined by HOLA section 5(n),[9] and is determined by the laws of the state in which the thrift is located. For purposes of HOLA section 5(n), the Office of Thrift Supervision ("OTS") considers a federal thrift to be "located"[10] in each state in which it either operates a brick and mortar trust office or maintains a fiduciary presence that is the functional equivalent of a brick and mortar office — a so-called "de facto trust office."[11] To determine whether a federal thrift operates or maintains an actual or de facto trust office, the OTS has examined the nature of the activities the thrift performs in the state,[12] and has concluded that marketing activities alone do not locate a thrift in a state for trust purposes.[13] Further, the OTS has determined that an association is not located in a state if, with respect to fiduciary activities, no documents will be executed on behalf of the association in the state, no investment advice will be provided, no investments will be made, and no new trust accounts will be approved.[14]

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[5] These activities have been collectively referred to as the "core banking functions." *Clarke v. Securities Industry Ass'n*, 479 U.S. 388 (1987); 12 U.S.C. §36(j).

[6] *First Nat'l Bank in Plant City v. Dickinson,* 396 U.S. 122 (1969)

[7] As the Court stated in *Clarke*, 479 U.S. 388, at 409: "We are not faced today with the need to decide whether there are core banking functions beyond those explicitly enumerated in [§36(j)]; it suffices, to decide this case, to hold that the operation of a discount brokerage service is not a core banking function." Significantly, a national bank trust office has been held to be a branch, even though no deposits were received, checks paid, or money lent at the office. *St. Louis County Nat. Bank v. Mercantile Trust Co. Nat. Ass'n*, 548 F.2d 716 (8th Cir. 1976), *cert. denied*, 433 U.S. 909 (1977); *accord, Boatmen's Nat. Bank of St. Louis v. Hughes*, 385 Ill. 431, 53 N.E.2d 403 (1944).

[8] Congress explicitly stated in HOLA §5(a) (12 U.S.C. §1464(a)) that it was providing for chartering of federal thrift institutions "for the deposit of funds and for the extension of credit for homes and other goods and services," and, further, that the lending and investment powers conferred by §5 were "intended to encourage such institutions to provide credit for housing safely and soundly." We question the logic underlying issuance of a federal thrift charter for a limited purpose trust institution without depository powers in light of this explicit Congressional statement of purpose; *cf.* 12 U.S.C. §27(a), as amended by Financial Institutions Regulatory and Interest Rate Control Act of 1978, Pub. L. No. 95-630, §1504, 92 Stat. 3713 (inserting a provision that a national bank is not illegally constituted solely because its operations are limited to those of a trust company and related activities). However, that inquiry is not germane to this opinion.

[9] 12 U.S.C. §1464(n).

[10] Pursuant to HOLA §5(n)(1), the extent of the fiduciary authority of a Federal savings association or savings bank is measured by the fiduciary capacities "in which State banks, trust companies, or other corporations which compete with Federal savings associations are permitted to act under the laws of the State in which the Federal savings association is *located*." [Emphasis added.]

[11] OTS Opinion Letters dated March 28, June 21, and August 8, 1996. Although not fundamental to the conclusion in this opinion, we do not subscribe to the position asserted by the OTS that a federal thrift can establish a fiduciary presence within a state through a "de facto office."

[12] OTS Opinion Letter dated June 21, 1996.

[13] OTS Opinion Letters dated June 21 and August 8, 1996, and July 1, 1998.

[14] OTS Opinion Letter dated June 13, 1994.

Because the Bank does not intend to engage in any fiduciary activities in this state, and all of its trust operations would occur outside Texas, the Bank would not be considered to be "located" in Texas within the meaning of HOLA section 5(n), according to OTS interpretation. The scope of the Bank's authority to market its fiduciary services in Texas would therefore be determined by the laws of New Jersey, the state in which the Bank is domiciled, and would depend to a large extent upon what fiduciary activities the State of New Jersey permits a Texas corporate fiduciary to conduct in New Jersey.[15] The Bank's authority to act in a fiduciary capacity is entirely derivative of and equivalent to the fiduciary capacities a New Jersey state bank, trust company or other corporate fiduciary may exercise under New Jersey law, the state in which the Bank is located.[16] New Jersey state banks, trust companies and other corporate fiduciaries may not serve as trustee of a Texas prepaid funeral benefits trust unless such an entity lawfully establishes a branch in the State of Texas. The Bank is likewise limited.

To summarize our response to your primary inquiry, we conclude that the Bank may not serve as trustee of a Texas prepaid funeral benefits trust unless it lawfully establishes a branch in the State of Texas,[17] subject to compliance with Finance Code §201.102.

We turn now to your remaining questions, whether a corporate trustee must be chartered in Texas to serve as a trustee of a Chapter 154 prepaid funeral benefits trust, and whether such a trustee must have depository powers. Finance Code §154.253(a) does not require a corporate trustee to be chartered in this state in order to serve as trustee of a prepaid funeral benefits trust. Nor does it necessarily require a corporate trustee to possess general depository powers to serve in that capacity. A permit holder is to deposit trust funds *either* "in an interest-bearing account insured by the federal government" under Finance Code §154.253(a)(1), *or* "in trust" under Finance Code §154.253(a)(2). The receiving institution is held to the standard of a fiduciary in both instances, whether it accepts the funds as a depository or as trustee.[18]

As discussed above, the OTS has issued opinion letters relating to the interstate trust activities of federal thrifts, including fiduciary activities related to prepaid funeral benefits contract trust services. Although the OTS has concluded that HOLA section 5(n) preempts state laws that impede federally authorized activities, including incidental trust activities of out-of-state thrifts, in our opinion such OTS determinations are incorrect and, in any event, are not relevant to this matter.

The OTS has recognized the complex interplay between federal and state regulations pertaining to interstate trust operations, and has acknowledged the applicability of state laws that further a vital state interest.[19] The provisions of Texas Finance Code Chapter 154 pertaining to the deposit of prepaid funeral benefits trust funds clearly do so. When the Texas Legislature enacted Chapter 154, it recognized not only the public need for an opportunity to arrange and pay for funerals in advance of death, but also the state's interest in and need to protect the public from the potential abuses inherent in prepaid arrangements. For that reason, the stated purposes of Chapter 154 specifically include limiting the manner in which a person may accept funds in prepayment of future funeral services, and providing all necessary safeguards to protect the prepaid funds and to assure that the funds will be available to pay for the prearranged services. Finance Code §154.001(1), (3).

As part of Texas' comprehensive statutory scheme for the authorization and regulation of prepaid funeral services, the legislature established trust-funded prepaid funeral benefits contracts as one method by which consumers could arrange and pay for funeral services in advance of death. In order to safeguard these statutorily created trust funds and ensure their availability to pay for the prearranged services at death, the legislature deemed it necessary to limit where a Texas prepaid funeral benefits contract permit holder could deposit them. The legislature wanted to make sure that prepaid funeral

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[15] *See* Texas Probate Code art. 105A, as amended by Acts 1999, 76th Leg., ch. 344, §6.002, eff. Sept. 1, 1999.

[16] *See* 12 C.F.R. §550.20.

[17] The ability of a federal thrift to establish an interstate branch is subject to satisfaction of HOLA §5(r) (12 U.S.C. §1464(r)).

[18] *See* Finance Code §154.255.

[19] *See, e.g.*, OTS Opinion Letter dated September 2, 1997, and 12 C.F.R. §545.2 [operations and licensing]; 12 C.F.R. §557.13 [deposits]; OTS Opinion Letter dated March 10, 1999, OTS Opinion Letter dated December 24, 1996, and 12 C.F.R. §560.2(c) [lending]; and OTS Opinion Letter dated January 15, 1999, and 12 C.F.R. §555.200 [electronic operations].

benefits trust funds collected from Texas citizens were initially trusted (or deposited under a trust arrangement) under a fiduciary agreement or deposit contract governed by Texas law, and that such funds were within reach of a Texas court. Finance Code §154.243(a) achieves these statutory objectives by requiring the trustee of a prepaid funeral benefits trust, whether based in Texas or elsewhere, to initiate or create the fiduciary relationship at an office or branch in this state. Section 154.243(a) thus furthers the state's interest in preserving and protecting prepaid funeral benefits trust funds and the accomplishment of the purposes for which Chapter 154 was enacted. The provision, which constitutes a key component of this state's statutory scheme for the regulation of prepaid funeral services, clearly serves a vital state interest.

Moreover, Finance Code §154.243(a) does not, in our opinion, impede the ability of the Bank to serve as a trustee in Texas or to engage in incidental trust activities. The Texas Legislature recently enacted legislation that permits out-of-state trust institutions, such as the Bank, to establish branch locations and to engage in fiduciary activities in this state. Accordingly, the Bank can serve as a trustee under prepaid funeral benefits contract trust agreements simply by establishing a branch in Texas.

Finally, as a general rule, the OTS addresses specific provisions of state law on a case by case basis when considering preemption questions. An OTS preemption ruling with respect to another state's statute relating to prepaid funeral benefits contract trust services does not compel the conclusion that Finance Code §154.243(a) is preempted as well.

This opinion is limited to the facts and circumstances set forth in your letter. Any change in those facts or circumstances may result in a different opinion.

I hope that this has been responsive to your inquiry. Please feel free to contact me if you have any additional questions or concerns.

Opinion No. 99-31

The Texas Business Combination Law applies to a business combination involving a state bank unless its application would interfere with regulatory resolution of a bank in hazardous condition.

July 28, 1999
Loren E. Svor, Assistant General Counsel

By fax dated July 21, 1999, you asked our opinion whether a proposal by several present stockholders (the "Organizers") of [***] State Bank of [City] (the "Bank") to acquire control of the Bank through a stock purchase pursuant to contract and tender offer, and thereafter arrange an exchange of all of the Bank shares for shares of [***] Bancshares (the "Holding Company"), a one-bank holding company now in organization, would be a transaction prohibited by the Texas Business Combination Law (Texas Business Corporation Act ("TBCA"), Part 13) ("TBCL"). Based on the facts as we understand them which are set forth below, it is our opinion that while the proposed acquisition of Bank stock by the Organizers is not prohibited by the TBCL, the subsequent share exchange of Bank stock for Holding Company stock would be subject to the TBCL and could not be done for three years after the Organizers became an "affiliated shareholder," as defined in the TBCL, unless approved by affirmative vote of two-thirds of the stock not beneficially owned by the Organizers.

Based on copies of the proposal submitted to the Federal Reserve Board by the organizers of the Holding Company, we understand the facts of the transaction, in pertinent detail, to be as follows:

- Five of the present officers and directors of the Bank (the "Organizers") will acquire at least two-thirds of the common stock of the Bank. The Organizers at present hold 12.45 percent of the outstanding common stock.

- The remainder of the target amount of stock will be acquired as follows:

    - *** shares (10.44 percent) will be purchased from the retiring President of the Bank pursuant to a negotiated contract which was entered into in November, 1998; and

    - Additional shares to equal two-thirds (*** shares or 43.8 percent) will be acquired through a tender offer to the other shareholders.

- Both the tender offer and the contract to purchase the President's shares are contingent upon the Organizers owning at least two-thirds of outstanding shares upon completion of the purchases.

- The tendering of shares pursuant to the offer conveys the right to vote the shares immediately upon acceptance of the offer by the Organizers for the purpose of exchanging the shares for shares of the Holding Company.

- After acceptance of the tender of the requisite number of shares (or more), the Bank will approve a share exchange of all the Bank shares for shares of the Holding Company, which, after resolving any dissenter claims, would result in the Holding Company owning 100 percent of the Bank stock.

Analysis

A. The TBCL applies to a business combination involving a state bank unless the business combination is undertaken to reorganize a bank in a hazardous condition.

The TBCL, as part of the TBCA, potentially applies to a state bank. Finance Code §32.008(a) and (b) state that the TBCA applies to a state bank "to the extent not inconsistent with this subtitle [Finance Code, Title 3, Subtitle A] or the proper business of a state bank. . . ." or rules[1] adopted to limit, refine, alter, or supplement the requirements of the TBCA as they may otherwise apply to a state bank. The Finance Code and related rules require the prior approval of the Banking Commissioner (the "Commissioner") before a state bank may undergo a change in control or other form of corporate reorganization. *See* Finance Code §33.001 (change of control), §32.401 (purchase of assets of another financial institution), §§34.405 and 36.101 and 7 Texas Administrative Code ("TAC") §15.106 (sale of all or substantially all assets), and §32.301 and 7 TAC §15.104 (merger or share exchange). In our opinion, application of the TBCL is not inconsistent with the requirement for prior approval of the Banking Commissioner for a business combination involving a state bank that meets the statutory definition of "issuing public corporation," except in the limited case of resolving a state bank that is in a hazardous condition through a forced merger or other reorganization.

In general terms, the Finance Code contemplates that the TBCA will apply in matters related to corporate structure or governance, subject to any required approval by the Commissioner prior to consummation of the transaction. For example, Finance Code §32.008(c) states that unless expressly excepted by statute or rule, a state bank wishing to take any action authorized by the TBCA with respect to its corporate status, capital structure, or corporate governance, and which would require a filing with the secretary of state if the bank were a business corporation, must make the filing with the Commissioner and obtain the Commissioner's approval. Finance Code §32.301 requires that a merger must be implemented by the parties and the approval of the board and shareholders of the parties obtained in accordance with the TBCA, and 7 TAC §15.104 requires authorization of a merger or share exchange by the board and shareholders in accordance with the TBCA. Pursuant to 7 TAC §15.106, a sale of all or substantially all assets when the bank intends to remain in business must be approved by the board and shareholders in accordance with the TBCA. Although the referenced actions also require the approval of the Commissioner, these provisions indicate that the required compliance with the TBCA is not inconsistent with the Finance Code, Title 3, Subtitle A, but is instead a prerequisite to Commissioner approval.

A further indication that the TBCL is not inconsistent with the Finance Code and related rules may be seen in the different focus of the respective statutory provisions. The TBCL was intended to protect the shareholders of a corporation from an involuntary alteration of their corporate rights when the action is or could be influenced by other shareholders with a specified level of control. The Finance Code and related rules, on the other hand, require Commissioner approval of the same acts in order to protect the public and the viability of the bank itself. Thus, a merger or share exchange will be approved by the Commissioner if the resulting state bank will be solvent and adequately capitalized, all liabilities of a state bank participating in the merger have been discharged or assumed, a resulting state bank will not be engaged in a business other than banking or a business incidental to banking, and the parties have complied with the laws of Texas, the only required findings stated in Finance Code §32.302 and 7 TAC §15.104. The absence of any stated concern for bank shareholders indicates that their interests in a corporate restructuring are sufficiently protected by the requirements of TBCA, including the potential exercise of dissenter's rights and any required vote of shareholders (including a required vote under the TBCL). Indeed, prior to August 26, 1985, a merger involving a state bank could only be approved if the

[1] Texas administrative rules are published in the Texas Administrative Code, or "TAC."

Commissioner concluded that the proposed merger was "to the best interest of the depositors, creditors and stockholders of the merging banks and of the public in general [and] that the distribution of the stock of the resulting bank is to be upon an equitable basis...." (Former art. 342-308 of the Texas Banking Code). These quoted requirements were deleted in 1985 in connection with the addition of dissenters' rights to the Texas Banking Code, determined with reference to the TBCA; Act of May 27, 1985, 69th Leg., ch. 639, §7, 1985 Tex. Gen. Laws 2366, 2368 (Vernon).

The Finance Code and its related rules clearly place the burden of protecting shareholder's rights on the TBCA[2] and, except for certain actions relating to banks that are insolvent or threatened with insolvency, require that TBCA requirements be satisfied. The TBCL presents the additional requirement that certain business combinations must be approved by holders of two-thirds of the shares held by unaffiliated shareholders, as well as by the holders of two-thirds of all shares as discussed above.[3] When an action involving a viable bank is involved, satisfaction of this requirement as a predicate to Commissioner approval of the action is entirely consistent with the plain text of the statutes requiring shareholder approval as specified in the TBCA, and the additional requirement is not inconsistent with any provision of the Finance Code or its related rules.

However, when the bank is insolvent, or where insolvency is threatened, a different situation is presented. In such cases, there is little or no shareholder value to protect, time is frequently of the essence and obtaining the shareholder approvals required by the TBCA, even if ultimately forthcoming, would only exacerbate an unsatisfactory situation. For example, even though the TBCA requires the holders of two-thirds of the shares to approve a sale of all or substantially all assets, Finance Code §32.405 explicitly authorizes the Commissioner to approve such a sale without shareholder approval upon a finding that the interests of depositors and creditors are jeopardized and that the sale is in their best interest. In this situation, a TBCA requirement for any type of shareholder approval is inconsistent with the Finance Code and is not applicable.[4]

The Bank is financially sound, and is not in conservatorship or receivership. Consequently, if the proposed transaction is a business combination as defined in the TBCL, the transaction is subject to the TBCL.

B. The proposed acquisition of 100 percent of the stock of the Bank by the Holding Company is a prohibited business combination under the TBCL.

The TBCL prohibits an "issuing public corporation" from engaging in a "business combination" with an "affiliated shareholder" (or an affiliate of an affiliated shareholder) for three years following the affiliated shareholder's share acquisition date unless (i) the business combination or the acquisition of shares is approved by the board of directors of the issuing public corporation before the acquisition date, or (ii) the business combination is approved by affirmative vote of at least two-thirds of the shares not owned by the affiliated shareholder at a meeting of the shareholders held not less than six months after the affiliated shareholder's share acquisition date. TBCA Art. 13.03. An "issuing public corporation" is a domestic corporation that has (i) 100 or more shareholders; (ii) any voting shares registered under the Securities Exchange Act of 1934; or (iii) has shares qualified for trading in a national market system. TBCA Art. 13.02.A.(6). We assume that the Bank, with *** [more than 100] shareholders, is an "issuing public corporation."

A "business combination" is defined, as pertinent to the subject transactions, as a "merger, share exchange, or conversion" of an issuing public corporation with (i) an affiliated shareholder, or (ii) a corporation that is, or after the transaction would be, an affiliate of the affiliated shareholder (i.e., controlled by the affiliated shareholder). TBCA Art. 13.02.A.(4). An "affiliated shareholder," in pertinent detail, is a "person" that is the beneficial owner of 20 percent or more of the outstanding voting shares of the issuing public corporation. TBCA Art. 13.02.A.(3). For purposes of this definition, "person" includes two or more persons acting as a partnership, limited partnership, syndicate, or other group under an agreement or understanding, whether or not in writing, to acquire, hold, vote, or dispose of shares of a corporation. TBCA Art. 13.02.A.(7). A beneficial interest in shares is not acquired pursuant to a tender of shares until the shares are accepted for purchase or exchange. TBCA Art. 13.02.A.(3)(b)(i). However, a person is a beneficial owner of shares if the person has

[2] *Cf.*, Department of Banking Opinion No. 96-15 (Bank freeze-out mergers are permissible under Texas law).

[3] Except in the case where there are no affiliated shareholders, in which case only the normal approvals of the board and the holders of two-thirds of the shares are required.

[4] *Cf.*, Government Code §2001.223(2); Finance Code §§32.005(f), 35.107(b), and 36.203(c).

the right to acquire the shares "whether the right may be exercised immediately, or only after the passage of time, pursuant to an agreement, arrangement, or understanding", TBCA Art. 13.02.A.(3)(i).

Under the facts and the foregoing definitions, the initial acquisition of voting shares by the Organizers, pursuant to voluntary transactions under the contract and tender offer, is not subject to the TBCL because the acquisition is not a result of a "merger, share exchange, or conversion." However, the second transaction — the exchange of the Bank's shares with those of the Holding Company (subject to dissenter's rights) — is subject to the TBCL. The Organizers become an "affiliated shareholder"on the date they acquire a beneficial ownership of 20 percent or more of the Bank's voting stock, no later than the date the tendered shares are accepted and purchased, if not earlier.[5] The share exchange would be a "business combination" with an entity that is an affiliate of the affiliated shareholder, namely the Holding Company. Consequently, this transaction could not take place until three years after the share acquisition date[6] unless the board of directors approved the share exchange prior to that date, which we understand did not happen, or unless two-thirds of the remaining shares not beneficially owned by the Organizers affirmatively vote to approve the combination at a duly called meeting for that purpose no sooner than six months after the share acquisition date.

In the event that the original proposal could not be completed in compliance with the TBCL, you asked our opinion regarding two alternative proposals by the Organizers set forth in a "Confidential Exhibit C" attached to your inquiry. In the first scenario, after completion of the tender offer the Organizers would exchange their shares for shares of the Holding Company and offer the remaining shareholders the opportunity to do likewise. After this voluntary exchange, the Holding Company would attempt to acquire the remaining shares through a share exchange with the Bank, which, as the Organizers acknowledge, would require the affirmative vote of two-thirds of the remaining shares. We see no impediment in the TBCL to the voluntary exchange of Bank shares for Holding Company shares by the Organizers or by an unaffiliated holder of Bank shares.[7] The final step to compel exchange of the remaining Bank shares is subject to the TBCL, as the Organizers appear to concede.

The second alternative would involve the withdrawal of the tender offer and the formation of a Holding Company subsidiary to engage in a merger transaction directly with the Bank. Because the subsidiary is controlled by Organizers through the Holding Company, the share exchange would be with an affiliate of the Organizers. If the Organizers constitute an "affiliated shareholder" prior to the date of the proposed transaction, the transaction would be a prohibited business combination unless first approved by the holders of two-thirds of the shares other than those beneficially owned by the Organizers. We do not express an opinion regarding whether the Organizers constitute an "affiliated shareholder" prior to the date of the proposed transaction. Such a determination rests on two alternate factors. If the Organizers constituted an affiliated shareholder at any time prior to the withdrawal of the tender offer, such as pursuant to beneficial ownership of the President's shares under contract, they will continue to be so classified under TBCA Art. 13.02.A.(2) as a result of having been an affiliated shareholder "within the preceding three-year period." If not, a determination must be made based on the manner in which the contract to acquire the President's shares is amended to address the new proposed transaction.

[5] The Organizers possibly became an affiliated shareholder on the date the contract with the President was executed, giving them the right to acquire his shares. If these shares under contract are added to those shares directly held, the Organizers held beneficial ownership of 22.89 percent of the stock as of the date of that contract. While an exception exists for share purchase rights subject to certain contingencies, we do not decide if the shares under the purchase contract are excluded from beneficial ownership as shares "tendered pursuant to a tender offer . . . until the tendered shares . . . are accepted for purchase . . . ." TBCL Art. 13.02.A.(3)(b)(i)(A). Resolution of this issue is not within our special expertise.

[6] The date the Organizers first became an affiliated shareholder.

[7] We note that the TBCA does not require the affirmative vote of the holders of two-thirds of the shares for a corporation or other entity to acquire all or a part of the shares of a domestic corporation through a "voluntary exchange or otherwise." TBCA Art. 5.02.E.

Opinion No. 99-34

In a liquidation of a foreign bank branch or agency [*or another regulated financial institution*], the banking commissioner would not seek to repudiate executory contracts to recover assets previously sold by the branch or agency [*or another regulated financial institution*] as part of an asset securitization transaction, or to hinder the restructuring of any servicing arrangements of which the branch or agency [*or another regulated financial institution*] was a part, provided that the original asset transfer was part of a "bona fide sale" for which fair and adequate consideration had been received.

October 25, 1999
Loren E. Svor, Assistant General Counsel

By letter dated August 3, 1999, you requested our concurrence with your opinion on certain matters related to the (hypothetical) liquidation of a Texas foreign bank branch or agency as such would affect a securitization of certain loan or lease assets of the agency or branch. Specifically, you have asked us to concur with your conclusions that:

1. Where a Texas state branch or agency (the "Texas Branch") of a foreign bank (the "Bank") has transferred, for fair and adequate consideration and without recourse to the Texas Branch, its rights to receive payments of principal and interest (the "Payment Obligations") on account of certain loans or advances (the "Eligible Loans") arising under certain commercial or industrial loan or lease agreements or facilities (the "Designated Loan Agreements") selected from a portfolio owned by it, and where the Texas Branch continues to service the loans as a subservicer for such Eligible Loans, the Payment Obligations would not be assets of the Texas Branch that would be available to the Banking Commissioner or a receiver (the "Commissioner") to satisfy claimants who had transactions with the Texas Branch; and

2. A court would not grant an order consolidating the assets and liabilities of the Funding Trust (as defined below) and the Texas Branch so as to deal with them as if such assets were held by, and the liabilities incurred by, a single entity.

In addition you have requested our agreement that:

1. The Commissioner would not seek to prevent the appointment of any substitute subservicer pursuant to the subservicer agreement with the Servicer (as defined below) relating to the proposed transaction in the event the Commissioner were to take possession and control of the Texas Branch and its business and property; and

2. The Commissioner would not seek, pursuant to TEX. FIN. CODE §204.120, to "stop or limit" the Texas Branch's remittance of principal, interest, or fees under the Eligible Loans to the Funding Trust as subservicer of the Eligible Loans by any means, including repudiation of the grant by the Texas Branch of a power of attorney to the trustee of the Master Trust described below (the "Trustee") that allows the Trustee, following the Commissioner's taking possession and control of the Texas Branch, to direct the obligors on the Eligible Loans to send payments directly to an account held by the Trustee.

Description of Proposed Transaction

The Financing Program. The transaction involves the securitization of the Payment Obligations owned by the Texas Branch, as well as Payment Obligations owned by out-of-state branches of the same parent foreign bank (the "Sellers"). Sellers have established a special purpose Delaware business trust (the "Funding Trust") pursuant to an agreement between the Sellers and an independent trustee. The Sellers, excluding the Texas Branch, will hold the equity interests in the Funding Trust which will be evidenced by Funding Trust certificates (the "Funding Trust Certificates"). The Texas Branch may also hold Funding Trust Certificates if the investment is subsequently approved by the Commissioner.

The trustee of the Funding Trust will not be affiliated with Sellers or the Bank, and will conduct the Funding Trust's operations separately from the Sellers or the Bank. Each Seller will sell a 100 percent participation interest in the Payment Obligations owned by it, either through origination or transferred from other U.S. branches or agencies of the Bank, to the Funding Trust, pursuant to separate agreements between each Seller and the Funding Trust (the "Participation Agreements"). The Participation Agreements will clearly express the intention of each party that the transaction is a sale rather than a secured borrowing, and will not provide, nor will any other agreement with respect to the transaction provide that the Seller is obligated to repurchase the transferred assets or compensate the Funding Trust in any way should the underlying Eligible Loan(s) default. As a result, the Payment Obligations of the Texas Branch in which the participation interest is sold will no longer appear as assets on the books of the Texas Branch.

The Funding Trust will sell to another Delaware business trust (the “Master Trust”) a 100 percent subparticipation interest in its 100 percent participation interest in the Payment Obligations acquired from the Sellers. The Master Trust will issue notes secured by the assets of the Master Trust (the “Notes”), along with certificates (the “Certificates,” and collectively with the Notes, the “Securities”). The Certificates, along with a Transferor Certificate, which represents any portion of the beneficial interest ownership interest in the Master Trust not represented by the Securities, are retained by the Funding Trust. The Master Trust will deliver the net proceeds of any sales of the Notes to the Funding Trust as payment for the subparticipation agreement received from the Funding Trust (in addition to the Certificates and the Transferor Certificate).

Servicing. An out-of-state branch or agency of the Bank (the “Servicer”) will service all of the Eligible Loans relating to the Payment Obligations, including those owned by the Texas Branch, pursuant to an agreement between and among the Indenture Trustee, the Master Trust, and the out-of-state branch or agency (the “Servicing Agreement”). In exchange for a fee (the “Servicing Fee”), the Servicer will collect the payments and remit them to a collection account established by the Servicer at an unaffiliated bank in the name of the Trustee. The Servicer may appoint subservicers to subservice the Eligible Loans. An out-of-state branch or agency of the Bank will, and upon any necessary approval by the Commissioner, the Texas Branch will, subservice, or appoint a subservicer for, the Eligible Loans originated by or transferred to the Texas Branch and for which the Payment Obligations were sold to the Funding Trust. Pursuant to the Servicing Agreement, the Servicer may, but will not be required to, advance to the Master Trust scheduled payments of interest due on the Payment Obligations but not received by the applicable due date.[1]

Analysis

Pursuant to Finance Code, §204.120(b), the liquidation of a Texas branch or agency of a foreign bank is governed by Finance Code, ch. 36, as if the entity were a state bank.[2] Among the powers of a receiver under chapter 36 is the repudiation of executory contracts pursuant to TEX. FIN. CODE §36.215. Because a securitization transaction is completely structured pursuant to contract, the possibility exists that the Commissioner’s power to repudiate such contracts of a Texas Branch in liquidation and, perhaps, thereby attempt to reach the transferred assets could impair the satisfaction of the “legal isolation” requirement of Statement of Financial Standards No. 125, as promulgated by the Financial Accounting Standards Board, which is necessary in order for the asset transfer to be treated as a sale in accordance with generally accepted accounting principles (“GAAP”).

The purpose of giving the Commissioner or a receiver the power to terminate contracts is to prevent continuing obligations and duties imposed on the Texas Branch by such contracts from burdening the liquidating estate or its administration. We do not believe that it was the intent of Finance Code, §36.215, to provide a means for the Commissioner or receiver to recover assets which have been transferred by the Texas Branch in a bona fide sale, and for which fair and adequate compensation was received at the time of the transfer. We consider a bona fide sale to exist when:

1. The transaction meets all of the requirements for sale accounting under GAAP, with the exception of “legal isolation” only as it may be adversely affected because of the power of the Commissioner or receiver to terminate contracts as discussed above;

2. The contracts and other documents effecting the transfer clearly reflect the intention of the parties to treat the transaction for accounting purposes as a sale and not a secured borrowing;

3. The transfer is without recourse, meaning that it is not subject to an agreement that the seller repurchase the buyer’s interest or otherwise compensate the buyer upon the default on the underlying obligation; and

[1] The transaction will include certain credit enhancements, including a cash collateral account and an interest rate swap. We do not address these features in detail because they are not pertinent to the issues raised herein.

[2] In the liquidation of a foreign bank branch or agency, the liquidation provisions of chapter 36, Finance Code, are superceded by any contrary provisions set forth in chapter 204. The deviations, primarily in payout priorities, are not at issue here.

4. The transaction is with an entity with a distinct standing at law separate from the Texas Branch, and which is primarily engaged in acquiring and holding financial assets for the purpose of issuing securities representing beneficial interests in the assets, or in transferring such assets to another such special purpose entity for that purpose, and activities incidental to such purpose.

Based upon your representation of the facts of the transaction to be engaged in by Texas Branch, as set forth in your letter and subsequent telephone conversations, and as described above, it appears that these requirements will be met. Consequently, we concur with your conclusions that:

1. Under the represented facts, the Payment Obligations would not be considered assets of the liquidating Texas Branch available to the Commissioner to satisfy claimants who had transactions with the Texas Branch; and

2. The Commissioner would not seek, nor would a court grant an order consolidating the assets and liabilities of the Funding Trust and the Texas Branch so as to deal with them as if the assets were held by, and liabilities incurred by a single entity.

With respect to the two propositions on which you have requested our agreement, the Department's position is:

1. To the extent that the subservicing rights have value, and given that the right to appoint an alternate subservicer would be granted to the Texas Branch, the designation of the alternate subservicer would be an asset of the liquidating Texas Branch and the Commissioner would reserve the right to dispose of it in a manner that would provide the greatest benefit to the liquidating estate. Subject to that reservation, the Commissioner would not unreasonably obstruct designation of an alternative subservicer by the Servicer, nor would the Commissioner designate an alternate subservicer as successor to the Texas Branch's authority to do so over the reasonable objections of the Servicer; and

2. We agree that the Commissioner would not seek to "stop or limit" the normal remittance of payments under the Eligible Loans by any means, including repudiation of the power of attorney granted by the Texas Branch to the Trustee that allows the Trustee to direct the obligors on the Eligible Loans to send payments directly to an account held by the Trustee.

Other considerations. The opinions expressed herein are limited to the facts as represented and the law as it presently exists; a change in either could result in a different opinion with respect to a subsequent transactional circumstance. Consequently, this opinion should not be interpreted as a general statement controlling the Commissioner's administration of the liquidation of a foreign bank branch or agency when a securitization or participation transaction is involved. Rather, each such situation will be dealt with on a case-by-case basis. Finally, the opinions expressed above do not constitute a waiver of the Commissioner's right to avoid a transfer pursuant to TEX. FIN. CODE §36.216, or any other applicable law dealing with fraudulent transfers, nor do they, except as expressly stated, constitute a limitation of the Commissioner's or receiver's power to terminate executory contracts.

Opinion No. 99-36

A state bank offering mortgage loans through a loan production office may use an assumed name to identify a loan production office if use of the name does not create significant potential for confusing or misleading the public.

August 20, 1999
Randall S. James, Acting Banking Commissioner

This letter is in response to your letter of August 12, 1999. In your letter, you asked whether the Texas Department of Banking ("Department") had any objection to the proposal of [ABC] Bank, [City], Texas ("Bank"), to use the assumed name of "[XYZ] Mortgage," to identify its proposed new mortgage banking business at a location other than Bank's home office or an approved branch facility. Also, your letter served as notice of intent to operate "[XYZ] Mortgage," as a loan production office under the provisions of Texas Finance Code, §32.204 ("Code"). Finally, you asked that the 30-day waiting period for establishing a loan production office be waived or shortened pursuant to §32.204 and 7 T.A.C. §3.91(a). You supplemented this request by letter dated August 18, 1999, explaining that an opportunity to obtain the offices and employees of a former mortgage company had recently become available and time was of the essence.

Your first question is whether the Department has any objection to the use of the assumed name "[XYZ] Mortgage" by Bank. According to your letter, the assumed name would be used on all signage, brochures and other advertising, both as a marketing tool and to discourage Bank customers from attempting to deposit funds at the proposed facility. Also, according to the representations in your letter, Bank will comply with Texas Business and Commerce Code §36.01, et seq., and, to the extent applicable, will also comply with Interagency Statement FIL-46-98, "Guidance of the Use of Trade Names" (May 1, 1998).

The Department has in the past approved the use of an assumed name by a bank under certain circumstances.[1] Thus, the Department has no general prohibition against the use of assumed names by state banks. Our primary concern in these matters is whether a bank's use of an assumed name has the potential to confuse or mislead the public. Because no lending or depository services will be offered or available at the proposed location, we do not believe any potential exists for confusion. Therefore, based on your representations regarding compliance with Texas Business and Commerce Code §36.01 et. seq. and with FIL-46-98, we have no objection to this use of the name "[XYZ] Mortgage" by [ABC] Bank.

Additionally, the Department has no objection to the proposed establishment of a loan production office using the name "[XYZ] Mortgage" as long as the requirements of the Code are adhered to and no banking activities are conducted. The activities of a loan production office, under Finance Code §32.204, are strictly limited to "soliciting loans, accepting loan applications, and performing ministerial duties related to consummating a granted loan, such as execution of loan documents and the dispensation of loan proceeds by check or other draft . . . but not by cash."

Your request for a waiver of the 30-day waiting period is also granted. You may establish a loan production office at 8004 Quaker Avenue, Suite A, Lubbock, Texas 79424, at any time after August 27, 1999. If Bank plans to move from this location, notice of the relocation must be given pursuant to 7 T.A.C.§3.91(b).

[1] See Opinion No. 94-17, dated July 12, 1994.

<u>Opinion No. 99-38</u>

A "deputy" granted a right of access to a safe deposit box retains that right upon the death or incapacity of the lessee except to the extent the lease agreement explicitly provides otherwise.

November 29, 1999
Loren E. Svor, Assistant General Counsel

By letter dated September 6, 1999, you have asked us to address several questions to clarify the meaning of Finance Code, §59.106, concerning access to a safe deposit box by more than one person. Your questions generally concern the extent to which a contract can vary the rights of access of persons other than the lessee from those set forth in §59.106. As we will discuss in more detail below, we generally view §59.106 as setting forth default provisions which control only if they are not addressed in the contract. Consequently, any provisions of §59.106 can be modified by an appropriately worded contract.

Analysis

Finance Code, §59.106 reads:

> (a) If a safe deposit box is leased in the name of two or more persons jointly or if a person other than the lessee is designated in the lease agreement as having a right of access to the box, each of those persons is entitled to have access to the box and to remove its contents in the absence of a contract to the contrary. This right of access and removal is not affected by the death or incapacity of another person who is lessee or otherwise entitled to have access to the box.
>
> (b) A safe deposit company is not responsible for damage arising from access to safe deposit box or removal of its contents by a person with a right of access to the box.

By its terms, §59.106 states that a lessee (lessees), or other persons which may be designated by the lessee(s) in the lease agreement, each have an absolute right to access the box and remove its contents, unless the lease agreement explicitly states otherwise. This right is unaffected by the death of any other person with a right of access. However, we believe that the provision in the first sentence of §59.106(a) relating to varying the right of access by contract also applies to the second sentence, and that an explicit contractual term providing for termination of access rights of a person upon the death of another person is consistent with the statute.

Given this, your specific questions may be answered as follows:

1. *Does the phrase "people other than the lessee designated in the lease agreement" refer to a deputy appointed on a safe deposit rental lease?*

   Yes. My understanding of the term is that a "deputy" is a person designated to have an access right as a matter of convenience to the lessee(s) or in the event of incapacity of the lessee(s); perhaps a relative. A "deputy" in this context is conceptually similar to a "cosigner" on a convenience deposit account, conveying a right of access to the account but no ownership rights. *See* TEX. PROBATE CODE §438A. Since a "deputy" is given a right of access to the box by the terms of the lease agreement, the deputy would be a person, other than the lessee, who is designated in the lease agreement as having a right of access.

2. *Does the law state that this appointed deputy would have access to the box after the renter dies or becomes incapacitated unless there is a contract to the contrary?*

   Yes. Since a "deputy" is a person with a right of access, the plain terms of the statute provide that the access right is unaffected by the death or incapacity of a lessee, unless the contract provides otherwise.

3. *Please define and/or provide an example of a "contract to the contrary."*

   We will leave the precise wording to your attorney. However, a simple statement in the lease agreement, in the section relating to the appointment of the deputy, that any right of access of that person terminates upon the death (or incapacity, if desired) of the lessee (or of a joint lessee) should suffice. I would suggest that care be exercised in drafting such a provision, however, because of the liability which could follow from allowing a deputy access to a box subsequent to the death of a lessee, but of which the bank has no knowledge. This problem is compounded in that, in contrast to the situation discussed in question 6, below, the deputy probably will not be motivated to provide evidence of the lessee's death.

4. *If an existing lease now states that a deputy's power ceases upon the death of a renter, should this language be changed?*

   Nothing in §59.106 would compel such a change. However, the issue discussed in the previous answer should be considered.

5. *Should a rental lease have two sections: One to appoint a deputy and another to designate a person on a lease?*

   Section 59.106 is silent on the form of the contract; this is a matter for the drafting attorney. However, the question seems to imply a distinction which does not exist under the statute. A "deputy" is "a person on a lease." Other than the lessee, the access rights of any other person can be altered by the terms of the contract. A distinction between a "deputy" and a lessee is necessary, but not between a "deputy" and any other person given a right of access only by the terms of the agreement.

6. *Does this law permit a renter to set up a "payable on death" clause on the lease that will name an individual to have access to the box only after the renter's death?*

   Assuming that the reference to "payable on death" is meant only as an illustration of a right which arises only upon the death of the person granting the right, there is nothing in §59.106 which would preclude such a provision in a lease agreement. If such a provision is included, I would suggest that the agreement be very specific concerning the evidence of the death of the lessee that will be required before access is granted to the designee.

7. *If this law does not appear in a bank's safe deposit rental lease, should it be added?*

   Again, this is matter of form to be determined by the drafting attorney. I know of no reason why the statute would need to be included in the lease.

8. *If the bank decides not to permit the renter to designate a person to have access to the box, other than the lessee, are they in violation of this law?*

   Section 59.106 does not require that a person be designated to have access to the box. This is purely a contractual matter between the bank and the lessee. As a party to the contract, the bank may negotiate whatever terms it desires, including that only the lessee will have access to the box.

Opinion No. 99-39

A change in control of a holding company that owns a state trust company requires the prior approval of the banking commissioner.

November 24, 1999
Loren E. Svor, Assistant General Counsel

In an October 22, 1999, letter to Acting Banking Commissioner Randall S. James, you requested our concurrence with your conclusion that a proposed corporate acquisition involving [***], Inc. (“Holding Company”), resulting in a single shareholder beneficially owning 19.6% of Holding Company, would not require the approval of the Banking Commissioner (the “Commissioner”), pursuant to Finance Code, chapter 183, as a change in control of [***] (“Trust Company”), a Texas state-chartered trust company and wholly-owned subsidiary of Holding Company. For the reasons set forth below, we cannot concur with your conclusion. In our opinion, the proposed transaction involves a change in control of a state trust company, and requires the prior approval of the Commissioner pursuant to Finance Code, Chapter 183.

Background

As set forth in your letter, the pertinent facts relating to the proposed transaction are as follows:

- Trust Company is presently a wholly-owned subsidiary of Holding Company and will remain so after the proposed transaction.
- Holding Company is proposing to acquire [***], Inc. (“XYZ”), a [State]-based investment banking firm. The acquisition will involve the exchange of the *** outstanding shares of XYZ common stock for a like amount of Holding Company. These shares of Holding Company will be additions to the existing common capitalization of Holding Company of *** shares.
- Before the acquisition, the largest single shareholder of Holding Company beneficially owns 4.7% of voting stock; after the acquisition, the single largest shareholder will beneficially own 19.6% of voting stock.

Analysis

Finance Code §183.001(a) requires the prior written approval of the Commissioner before a person directly or indirectly acquires a legal or beneficial interest in voting securities in a state trust company or a corporation owning the voting securities in a state trust company if after the acquisition the person would control the state trust company. “Control” is defined in TEX. FIN. CODE §181.002(a)(13), which reads, in pertinent part:

> (A) the ownership of or ability or power to vote, directly, acting through one or more other persons, or otherwise indirectly, 25 percent or more of the outstanding shares of a class of voting securities of a stat trust company or other company;
>
> (B) the ability to control the election of a majority of the board of the state trust company or other company; [or]
>
> (C) the power to exercise, directly or indirectly, a controlling influence over the management or policies of the state trust company or other company as determined by the banking commissioner after notice and an opportunity for hearing . . . .

Additionally, for the purposes of Subchapter A, Chapter 183 (relating to Transfer of Ownership Interest), a “principal shareholder” is considered to control the company if the shareholder “directly or indirectly owns or has the power to vote a greater percentage of voting securities of the state trust company than any other shareholder,” TEX. FIN. CODE §181.002(b). A “principal shareholder” is a person “who owns or has the ability or power to vote, directly, acting through one or more other persons, or otherwise indirectly, 10 percent or more of the outstanding shares or participation shares of any class of voting securities of a state trust company or other company.” TEX. FIN. CODE §181.002(a)(38).

“Control” of a state trust company can therefore take place at any level of stock ownership if a shareholder has the ability to control the election of a majority of the board or exercises a controlling influence over the management or policies of the trust company. This constitutes actual or *de facto* control. Alternatively, “control” can result from the direct or indirect ownership of 25 percent or more of the voting shares of the trust company or other company, regardless of whether the shareholder is the largest shareholder, and from the ownership of 10 to 25 percent of voting shares if no other shareholder has a greater interest. This constitutes *de jure* control, or control as a matter of law, and exists without regard to whether such a shareholder exercises actual control over the trust company.

It is important to recognize that ownership of the stated percentages of the voting stock of a company, such as Holding Company, which owns the voting shares of a state trust company, also results in *de jure* control of the trust company. TEX. FIN. CODE §183.001(a) explicitly states that acquisition of control includes acquiring, directly or indirectly, a beneficial, as well as a legal interest in the voting shares of a trust company, or of a company owning voting securities in a state trust company. *See also* 7 TEX. ADMIN. CODE §21.51(a). The statutory definitions of "control" quoted above also refer to interests owned indirectly, as well as directly. Share ownership in a company that owns stock in a state trust company results in an indirect or beneficial ownership by the parent company shareholders of stock in the trust company. In the case of a company that owns 100 percent of the voting securities of a state trust company, such as Holding Company, control of the company, as defined above, is control of the trust company.

Before the acquisition of XYZ, Holding Company has no principal shareholders, and therefore no shareholders that would be considered to control Trust Company (assuming that none of the other indices of control set forth in TEX. FIN. CODE §181.002(a)(13) exist). However, after the proposed acquisition, the largest shareholder would own or control 19.6 percent of Holding Company, and thus would indirectly own 19.6 percent of Trust Company. Notwithstanding your argument that no actual change of control would take place — presumably because Holding Company's current officers and directors beneficially own over 25 percent of Holding Company (although this percentage would increase to over 49 percent) and management would be essentially the same — the statute, not practical considerations, determines when a *de jure* change of control has taken place. The situation you describe will result in a change of control of Trust Company, a state trust company, and the acquisition requires the prior written approval of the Commissioner. TEX. FIN. CODE §183.001. If Holding Company desires to proceed with this transaction, it will be necessary for the transferee (the proposed principal shareholder) to file with the Department of Banking an application which meets the requirements of TEX. FIN. CODE §183.003, and to publish the notice specified in that section (unless waived by the Commissioner).

Before closing, I will briefly to comment on your argument that the statutory change of control procedures are not reasonably manageable when applied to a publicly-traded company. In making this argument, you used as a hypothetical a situation in which the largest shareholder of a company owns 0.5 percent of the company. You then argue that if any other shareholder were to acquire just one share more than 0.5 percent of the company, a change of control application would be required, even though an ownership amount of that size could not result in actual control. The flaw in your argument is your belief that the largest shareholder, however small the amount, is the "principal shareholder." As set forth above, a "principal shareholder" is one that owns at least 10 percent of the voting stock. Therefore, in your hypothetical, no change of control issues would arise until a shareholder acquired at least 10 percent of voting shares, not one share over 0.5 percent as you argue. In a corporation with millions of shares and thousands of shareholders, it is not unreasonable to expect that a single shareholder concentration of that magnitude could convey effective control, as I believe most experts on modern corporate governance would agree. However, as discussed above, regardless of whether actual control results, the statute establishes an irrebuttable presumption of control at certain stock ownership levels, as well as establishing circumstances that constitute actual control regardless of the amount of stock owned.

Opinion No. 99-40

The portion of a properly made and documented loan that is unconditionally guaranteed by the Texas Film Industry Administrative Fund is exempt from the legal lending limit.

January 25, 2000
Steve Martin, Assistant General Counsel

By letter dated October 27, 1999, you requested our opinion as to whether the portion of a loan guaranteed by the Texas Film Industry Administrative Fund (Fund) is counted toward a bank's legal lending limit. Please accept our apologies for the long delay in responding to your request. Due to circumstances beyond our control, the Legal Division of the Department of Banking has been seriously understaffed since August, and has only recently achieved full staffing through the hiring of additional attorneys.

Analysis

Pursuant to §34.201(a) of the Texas Finance Code, the total loans and extensions of credit outstanding at any time by a state bank to one borrower may not exceed 25% of the bank's capital and certified surplus.[1] However, this limitation does not apply to "the portion of an indebtedness that this state, an agency or political subdivision of this state, the United States, or an instrumentality of the United States has unconditionally agreed to purchase, insure, or guarantee." TEX FIN. CODE §34.201(a)(8).[2]

To determine if the exemption created by §34.201(a)(8) applies in the instant case, we look, first, to discern whether the loan is guaranteed by one of the described governmental entities and, second, whether such guarantee is unconditional. The Fund was created by the Texas Film Industry Development Loan Guarantee Program Act, codified as Subchapter N of Chapter 403 of the Government Code (Act). The Fund is described as "a state program of loan guarantees to promote the film industry in this state." The Act further provides that the Fund "is an account in the general revenue fund." TEX. GOV'T CODE §403.323(a). The program and Fund are administered by the state Comptroller. *Id.* at §403.324. All indications of the Act point to the loan guarantee program being guaranteed by the State.

We previously reviewed the characteristics of an unconditional guarantee in Opinion 97-12 (October 14, 1997). In that opinion, we analyzed §34.201(a) of the Texas Finance Code and concluded that most programs of the guarantor, the Export-Import Bank of the United States, did fall within the exemption language as "unconditionally guaranteed." The Banking Department addresses this requirement of the guarantee being unconditional in 7 TAC §12.6(f) which provides, in pertinent part:

> A takeout commitment, insurance, or guarantee is considered unconditional if the protection afforded the bank is not substantially diminished or impaired if the loss should result from factors beyond the bank's control. Protection against loss is not materially diminished or impaired by procedural requirements such as an agreement to take over only in the event of default, including default over a specific period of time, a requirement that notification of default be given within a specific period of time, a requirement that notification of default be given within a specific period after its occurrence, or a requirement of good faith on the part of the bank.

We have found nothing in the Act which would cause a loan made pursuant to the Act to be anything other than "unconditional" as above defined.

The rule also provides that a guarantee is not considered unconditional unless the commitment or guarantee is payable only in cash or its equivalent within 60 days after demand for payment is made. Neither the Act nor the rules promulgated under the Act by the Comptroller (34 TAC §§1.330-332) address procedures for a bank seeking to enforce or secure payment on a loan agreement. Further, we have been provided no facts pertaining to this issue. We assume for purposes of this opinion that this requirement of 7 TAC §12.6(f) is met.

Conclusion

Subject to our assumptions, we conclude that the legal lending limit of §34.201(a) of the Texas Finance Code would not apply to that portion of a properly made and documented loan that is guaranteed by the Texas Film Industry Administrative Fund.

Our conclusion should not be construed as an endorsement of the proposed loan. A bank must heed the underlying purpose of the legal lending limit, reduction of risk by preventing one individual, or a relatively small group, from borrowing an unduly large amount of the state bank's funds. Further, while a bank is clearly empowered to make loans as described in

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[1] *Effective September 1, 2001, this limit is stated as "25% of the lesser of bank's capital and certified surplus or total equity." Act of May 22, 2001, 77th Leg., H.B. 2155, §12.*

[2] *Effective September 1, 2001, Finance Code §34.201(a)(8) exempts "the portion of an indebtedness that this state, an agency or political subdivision of this state, the United States, or an instrumentality of the United States has unconditionally agreed to repay, purchase, insure, or guarantee." Act of May 22, 2001, 77th Leg., H.B. 2155, §12.*

this opinion in an amount well in excess of the bank's legal lending limit, the bank in question must have the ability, capacity, and commitment to appropriately evaluate and manage the risks inherent in such lending activities. Thus, these types of loans will be closely scrutinized by an examiner to monitor the bank's adherence to its policies and procedures and to ensure that the bank is administering such loans in a manner that is consistent with safe and sound banking practices.

Finally, this opinion is limited to the facts and circumstances set forth in your letter of October 27, 1999. Any change in those facts, circumstances, or the stated assumptions underlying our opinion may result in a different opinion.

Opinion No. 00-01

A state bank may help customer businesses establish their own websites, include advertisements on the bank's website for other businesses, provide hypertext links to the other websites, and charge reasonable fees for such services, including a transaction fee for purchases resulting from the bank's links. A state bank may also provide website hosting and hypertext services to non-customers for a fee.

June 22, 2000
Sarah Shirley, Assistant General Counsel

By letter dated November 23, 1999 to Everette Jobe, you ask several questions about the authority of a state bank to engage in certain website-related activities. You believe that Opinion No. 98-18 answers many of your questions, but request clarification with respect to several matters that are not specifically addressed in that opinion.

Questions Presented

You ask whether a state bank may help local businesses establish their own websites, include advertisements on the bank's website for other businesses, provide links to the other websites, and charge a transaction fee for purchases resulting from the bank's hypertext links. You also ask whether you may provide these services to businesses that are not customers of the bank.

Summary of Response

A state bank may help customer businesses establish their own websites, include advertisements on the bank's website for other businesses, provide hypertext links to the other websites, and charge reasonable fees for such services, including a transaction fee for purchases resulting from the bank's links. A state bank may also provide website hosting and hypertext services to non-customers for a fee. We do not have sufficient information, however, to determine in this opinion whether a state bank may provide website design consulting services to businesses that are not bank customers.

Facts

It appears from your letter that American Bank of Commerce (Bank) currently operates a Bank webpage. The Bank would like to help its customers establish their own websites and offer them the ability to advertise on and link their services from the Bank's home page. The Bank proposes to charge each business a set-up fee and a monthly maintenance fee for these services, and also a referral or transaction fee for each purchase initiated through the links from the Bank's website. Although the Bank intends to initially offer these services only to its customers, the Bank may wish at some point to offer them to non-customers as well.

Discussion

A state bank may engage in any activity authorized by the Texas Finance Code (the Code) or rules adopted thereunder, or determined by the Banking Commissioner to be closely related to banking. TEX. FIN. CODE §32.001(b)(4) [*now in substance §32.001(b)(6), pertaining to activities financial in nature, and (b)(7)*]. Additionally, a state bank may exercise incidental powers necessary to carry on the business of banking. TEX. FIN. CODE §32.001(b)(1). The Bank may therefore engage in the subject activities if they constitute or are incidental to the business of banking, or if the Commissioner determines that they are closely related to banking. Otherwise, the Bank will be precluded from engaging in these activities by §34.107, which prohibits a bank from investing funds in trade or commerce by selling or otherwise dealing in goods or owning or operating a business that is not part of the business of banking.

We first consider whether the Bank may provide the proposed services to its business customers. The Department has previously addressed whether certain internet or technology related activities performed for a bank's customers constitute or are incidental to the business of banking and therefore do not violate the prohibition of §34.107. In Opinion No. 95-72, we concluded that a bank that had in good faith acquired excess internet capacity for its own business purposes could sell the excess capacity to its customers. We reasoned that the sale of its excess capacity was incidental to the bank's own use of its internet capacity, which was itself incidental to the business of banking. Thereafter, in Opinion No. 98-18, we similarly determined that providing internet capacity for itself and its business customers was incidental to the business of banking and that, accordingly, a state bank could help its business customers design their own webpages and could also offer them the ability to link their services from the bank's homepage. These prior opinions lead us to conclude that, assuming the Bank has acquired its excess capacity in good faith,[1] the Bank may help its business customers with webpage design and provide hosting and hypertext link services without violating §34.107. In addition, to the extent the Bank provides banking services to facilitate electronic commerce transactions directly through business customers' websites, such as through processing of credit card transactions,[2] webpage design, web site hosting services, and hypertext link services are directly incidental to banking and may be offered without being limited to existing excess capacity.

We believe that 7 T.A.C. §11.83(d) provides further, and independent, authority for our conclusion that the Bank may offer the proposed services to its customers. Section 11.83(d) permits a state bank, upon request, to act as "finder" in bringing together a buyer and a seller where the bank's activity is limited to the introduction and the bank takes no part in the negotiations. Acting as finder thus constitutes the business of banking. When the Bank offers and provides the proposed website hosting and hypertext services, it provides information to prospective buyers about the goods and services offered by prospective sellers, and in so doing helps bring the parties together for a transaction that they themselves then negotiate and consummate. The Bank acts as finder, and merely uses new technology to conduct the finder activities authorized pursuant to §11.83(d). *See* Opinion No. 99-11 (acting as finder is part of the business of banking).[3] Additionally, §11.83(d) specifically permits a bank to accept a fee for the provision of finder services. We therefore conclude that the Bank may not only provide website hosting and hypertext services for its customers, but may also collect a referral fee for resulting purchase or sale transactions.

We next consider whether the Bank may provide the proposed website related services to businesses that are not current bank customers. Section 11.83(d) does not limit the potential buyers and sellers for whom a bank may act as finder; there is no requirement that finder services be provided only to the bank's customers. Accordingly, we conclude that the Bank may provide website hosting and hypertext services to both customers and non-customers and charge a reasonable fee for therefor.

Whether the Bank may provide website design consulting services for non-customers poses a more difficult question. We recognize that evolving technology and the expanding definition of financial activity and the role of banks in commerce require us to constantly re-evaluate what constitutes or is incidental to the business of banking. An argument can be made that offering website design assistance to non-customers is merely incidental to the Bank's authority to act as finder, is a form of advertising to attract customers, or simply enables the Bank to make use of the excess software, hardware and expertise it has acquired for its own purposes or to better serve its customers. However, acting generally as a website design consultant neither constitutes nor is incidental to the business of banking, and we are concerned that the active marketing of website design services to non-customers may be an independent commercial activity of the sort that section 34.107 is intended to prohibit. Moreover, we question whether the Bank, as a byproduct of providing web-based banking services and retail website hosting services, is likely to have sufficient website design excess capacity to justify the offering of design services to non-customers.

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[1] *See* Opinion No. 98-02 (factors relevant to determination that excess capacity acquired in good faith.).

[2] *Cf.* OCC Interpretive Letter No. 875 (October 31, 1999)(national banks may operate "virtual mall" under finder authority).

[3] The Office of the Comptroller of the Currency has similarly interpreted 12 CFR §7.1002, which authorizes a national bank to act as finder in bringing together a buyer and a seller, and, unless otherwise prohibited by law, to advertise and accept a fee for such service . *See* OCC Conditional Approval Letter No. 221 (December 4,1996), OCC Interpretive Letter No. 856 (March 5, 1999) and OCC Corporate Decision No. 99-35 (November 1999).

We find that we do not have sufficient information regarding the Bank's proposal to offer website design consulting services to non-customers to answer that aspect of your question. If you wish us to determine whether the Bank may provide such services to non-customers, please provide in writing the details of how the services will be offered and rendered. The information you furnish should also include a description of the hardware, software and staffing you currently devote to or have available for website design, the purposes for which it was acquired, and the purposes for which it is presently used. Additionally, please describe any restrictions contained in your website design software licensing agreement regarding its use by third parties. Once we receive this information, we can fully evaluate the Bank's proposal and address the concerns we have identified above.

With respect to those activities we have determined to be authorized, safety and soundness must be considered. The security of the Bank's computer system must remain inviolate and thoughtful precautions should therefore be taken to ensure that the system is insulated from viruses and unauthorized access to information. In addition, the Bank should carefully analyze the risks presented by the proposed activities, particularly compliance and reputation risks, and take appropriate steps to minimize and manage such risks. For example, consideration should be given to the Bank's and the third-party vendors' compliance with the various federal and state statutes and regulations that may apply to the linked services and products, such as Regulations Z and DD.[4]

Additionally, the Bank should consider the need for disclosures to make clear when non-banking services are being offered by third parties and not by the Bank. The Bank should exercise prudence in the manner of presenting web-based advertising or linkage to avoid any perception that it endorses or guarantees or is in any way responsible for any third party vendor product or service, or that the products offered are insured by the FDIC. The Bank should also exercise appropriate controls and engage in the subject activities pursuant to written agreements, including web linking agreements, that define the obligations of the parties and appropriately allocate risk. Complete files of the activities should be maintained for examination purposes. We also recommend that the Bank notify its bonding company of the new services it intends to provide. We further suggest that the Bank review the Comptroller of the Currency's Handbook, Other Income Producing Activities, Internet Banking (October 1999), which provides guidance to national banks that are conducting or considering internet banking activities, available on the OCC's website at http://www.occ.treas.gov.

Finally, we note that the Texas Comptroller of Public Accounts has stated in recent letter rulings that any charge for providing advertising space on a website is subject to Texas sales tax.[5] It thus appears that a bank that sells such space on its website must collect the Texas sales tax from the advertising customer and remit it to the Comptroller. During the last legislative session, the Texas Legislature enacted Senate Bill 441,[6] portions of which address the extent to which taxes for internet related services, including website advertising, must be collected and remitted. The relevant provisions are codified in Chapter 151 of the Texas Tax Code. Pursuant to SB 441, eighty percent (80%) of the value of the advertising space is subject to the Texas sales tax. Pursuant to other provisions of Chapter 151, a Texas sales tax need not be collected if the customer seeking to advertise on the webpage is located outside of the State of Texas. If the customer has business locations both within and outside the state, however, the customer must issue to the bank an exemption certificate asserting a multi-state benefit and reporting and paying the tax on the portion of the advertising charge that will benefit the Texas location. We urge you to carefully review the relevant provisions of Chapter 151 to ensure that the Bank complies with Texas sales tax law in connection with its website hosting and advertising activities.

This opinion is limited to the facts and circumstances described in your letter. Any changes could result in a different conclusion.

[4] Codified at 12 C.F.R. Parts 226 and 230, respectively.

[5] The Comptroller's rulings may be found at http://aixtcp.cpa.state.tx.us/star/.

[6] Acts 1999, 76th Leg., ch.394, eff. Oct. 1, 1999.

Opinion No. 00-02

A state bank is not required to possess trust powers to act as custodian of brokered certificates of deposit.

March 10, 2000
Sarah J. Shirley, Assistant General Counsel

I write in response to your letter to Everette Jobe, dated November 29, 1999, in which you seek our advice on behalf of your client, [***] Bank, [City] (Bank).

Question Presented

You ask whether the Bank must possess trust powers to act as custodian of brokered certificates of deposit.

Summary Response

The Bank is not required to possess trust powers in order to provide the custodial services specified in the agreement entered into between the bank and its customers with respect to brokered certificates of deposit.

Facts

As background, you explain that when the Bank was chartered in 1983, its articles of incorporation included "trust powers" as an enumerated power. Thereafter, in 1992, at the insistence of the Federal Deposit Insurance Corporation, the Bank obtained regulatory approval to activate its trust powers in order to provide certain services in connection with an inter-governmental investment pool. Although the Bank ceased providing these services in 1995, it did not seek to terminate its trust powers. In 1996, the Bank purchased a trust company that had acted as custodian for brokered certificates of deposit, and began operating this business out of its "trust" division. The Bank desires to transfer this custodial function to its commercial banking department, disband its trust division, and deactivate its trust powers. You believe that the Bank's service as custodian is not a traditional fiduciary activity of the sort that requires the Bank to possess trust powers, and ask us to confirm that the Bank may continue to provide the subject services if it deactivates its trust powers.

You have submitted for our review the standard "Custodian Agreement" (Agreement) the Bank requires be executed in order to establish an account (Account) for the servicing of the brokered certificate of deposits (Deposits). Under the Agreement, the person or entity that has an interest in the Deposits ("Customer") appoints the Bank to act as custodian of the Deposits and to receive principal and interest payments on the Customer's behalf and remit them to the Customer in accordance with the terms of the Agreement. In addition to receiving and remitting payments, the Bank agrees to perform certain ministerial and recordkeeping duties with respect to the Account, such as providing the Customer with detailed account statements on a periodic basis. The Customer specifically acknowledges that the Bank acts only as custodian, has no discretionary powers, and provides no advice regarding the Deposits. The Agreement also limits the duties, responsibilities and liabilities of the Bank to those expressly set out therein.

You represent that, consistent with the terms of the Agreement, the Bank exercises no discretion, provides no advice, and "does not act in a traditional fiduciary capacity with respect to the brokered CDS." It appears that the Bank's activities are limited to safely maintaining, preserving and accounting for the Account assets and performing certain ministerial acts in accordance with and as required by the Agreement.

Discussion

In order to answer your question, we must examine the nature of the relationship between the Bank and its Customers with respect to the Deposits. We first consider whether it is an express trust or a similar trust-type relationship. If it is, then the Bank must possess trust powers to provide the custodian services in question. The term "trust" is generally considered to mean a fiduciary relationship with respect to property that arises as a result of a manifestation by the settlor of an intention to create the relationship and that subjects the person holding title to the property to equitable duties to deal with it for the benefit of another person.[1] Thus, for a trust to exist, the settlor must manifest an intention to create, on behalf of a beneficiary, a beneficial interest in the property that is the subject of the trust. While no particular words are necessary to create the trust, the settlor must fairly evidence his or her intention to do so. Additionally, the legal and equitable titles to the trust property must be separated. The legal title passes from the settlor to the trustee, and the beneficial or equitable interest to the beneficiary. Moreover, the trustee must be subject to an equitable obligation to manage and use the trust property for the benefit of the trust beneficiary. Implicit in the relationship is the trustee's duty and authority to act and exercise discretion on behalf of the beneficiary with respect to the trust property and matters coming withing the trust relationship.

We have reviewed the Agreement and considered your representations concerning the activities undertaken by the Bank pursuant to the Agreement, and have determined that no express trust or similar relationship exists between the Bank and its Customers in connection with the Account or the Deposits. Nothing in the Agreement suggests that the Customer intends to create a trust. The Bank has no substantive ownership interest in the Account assets or in the Deposits[2] and, as a result, the requisite separation of ownership is absent. Moreover, the Agreement neither authorizes nor requires the Bank to exercise any discretion with respect to the Account or the Deposits. Accordingly, we conclude that the Bank does not act as a trustee when it provides the custodian services in question and need not possess the fiduciary powers of a trustee to do so.

We believe that the relationship between the Bank and its Customers is most appropriately characterized as a bailment coupled with an agency. As a general rule, when a customer deposits property with a bank for safekeeping and gives the bank possession of the property, but not title, the Bank holds the property as bailee. The extent of the bank's duties regarding the property entrusted to it depends upon the agreement between the bank and the customer. Typically, the bank owes its customer the duty to use proper care to keep the property safely and to return it unharmed upon the customer's order. The bank may, however, assume further duties in addition to simply holding the property, in which event it serves as the customer's agent as well as bailee. With respect to securities held by a bank for its customers, for example, the bank may agree to act as the customer's agent to do such things as receive and issue receipts for the securities, collect principal and interest payments and disburse them according to the customer's directions, report all collections and disbursements to the customer, and execute the necessary papers required for income tax purposes. As agent, the bank's actions are directed and controlled by the customer through the terms of the contract between the bank and the customer.[3]

The relationship between the Bank and its Customers has characteristics of both a bailment and an agency. The Customers have entrusted the Bank with their property for safekeeping and preservation. As noted previously, the Bank has no legal or equitable ownership interest in or right to the principal and interest payments that comprise the Account assets and, to the extent it holds legal title to the Deposits, the Bank does so only as its Customers' nominee. Pursuant to the Agreement, the Bank has also assumed certain additional duties and serves as the Customers' agent to facilitate the collection and distribution of income from the Deposits and to perform certain ministerial or recordkeeping duties. The Bank acts for and on behalf of its Customers and, through the Agreement, is subject to their control; the Bank performs no acts that are not specifically required or authorized by the Agreement. The actual Account maintained by the Bank is best described as a typical custody or agency account, in which the agent is charged by the principal in the governing agreement with specific duties for the assets held in the account. These duties do not involve management or investment responsibilities and do not require the agent to exercise discretion, but are instead limited to keeping the property safe and performing ministerial acts as directed by the principal.

[1] 1 WILLIAM FRATCHER, SCOTT ON TRUSTS §2.3 (4th ed. 1987)[hereafter SCOTT ON TRUSTS]; *see also* TEX. PROP. CODE §111.004(4)(definition of "express trust").

[2] To the extent the Bank holds legal title to the Deposits, it does so only as its Customers' nominee.

[3] *See generally* SCOTT ON TRUSTS §§5.1, 8.1.

Having determined that the Bank does not act as a trustee when it provides the custodian services in question, and that it therefore need not possess the trust powers required of trustees, we now consider whether the Bank must have trust powers to act as bailee or agent. It is generally agreed that a bailment relationship is not one of a fiduciary nature.[4] Accordingly, the Bank need not possess trust powers when it acts as bailee under the Agreement. Nor do we believe that the Bank must have trust powers to provide the limited agency services specified in the Agreement. While it is true that the relationship of agent and principal is a formal fiduciary relationship[5], that fact alone does not compel the conclusion that the Bank must have trust powers to provide the custodian services in question. Indeed, as a general rule, an agency is not considered to be a trust.[6] To determine whether trust powers are in fact necessary, we again look at the scope of the agency and the nature and extent of the duties imposed upon and undertaken by the Bank pursuant to the Agreement.

As stated previously, the Bank has no investment or managerial responsibility and exercises no discretion with respect to the Accounts or the Deposits. The Bank offers no advice. Its duties and responsibilities are strictly confined to safely maintaining, preserving and accounting for the Deposits and the Account assets and performing specified ministerial and recordkeeping acts. The Customer, through the Agreement, directs and controls the Bank's actions. Given the limited nature of its authority and responsibility, we conclude that the Bank, although party to the formal fiduciary relationship that exists as a matter of law between any agent and its principal, need not possess trust powers to act as custodian of the brokered certificates of deposit. The Bank may render the services the Agreement authorizes and requires it to perform pursuant to its incidental banking powers.[7]

There may well be instances in which the scope of a particular agency is such that an agent would act both as agent and trustee, and would be required to have trust powers to provide the services or engage in the activities called for in the agency agreement. For example, an agent might need trust powers if the agreement authorizes him to exercise broad discretion on behalf of his principal. We do not undertake in this opinion, however, to identify all the various activities that might require an agent to have trust powers. Our answer is limited to the Agreement between the Bank and its Customers and the Bank's specific duties, responsibilities and liabilities thereunder.

As you know, the Bank's current articles of association authorize it to exercise the full range of trust powers permitted by law, and we assume that the Bank will amend its articles to reflect the "deactivation" of its trust powers. We caution you, however, that even if the Bank's trust department is disbanded and its trust powers deactivated, our examiners will continue to carefully scrutinize the Accounts and Deposits to ensure not only that the Bank is properly handling them, but also that the Bank's duties, responsibilities and liabilities and the actual activities undertaken in connection therewith do not exceed those specified in the Agreement.

We further caution you that our determination that the Bank need not possess trust powers to provide custodial services in connection with brokered certificates of deposit is based upon the facts and circumstances set out in your correspondence with the Department and your telephone conversations with Department staff, and the specific terms of the Custodial Agreement submitted for our review. Any change in those facts or circumstances, or in the terms of the Agreement, may result in a different conclusion.

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[4] *See* BOGERT, THE LAW OF TRUSTS AND TRUSTEES §11 (rev. 2nd ed. 1984).

[5] RESTATEMENT (SECOND) OF TRUSTS §2 cmt. b (1959).

[6] *See generally* SCOTT ON TRUSTS §8.

[7] The Comptroller of the Currency has held that "agency services arrangements that do not involve the exercise of discretion or similar fiduciary responsibilities, such as escrow, safekeeping and custody, may be performed by a bank under the incidental powers of banking without trust powers." Comptroller's Handbook for National Trust Examiners, Precedent and Opinion ¶ 9.2600, June, 1986. Although the OCC's determinations represent an analysis of the law of a specific state and are not binding upon the Department, we agree with its opinion on this issue.

Opinion No. 00-03

A state bank may sell title insurance directly or through an operating subsidiary if the selling entity is appropriately licensed as a title insurance agent under state law.

Originally issued March 6, 2000; revised August 22, 2000
Loren E. Svor, Assistant General Counsel

By letter dated November 19, 1999, you asked whether a Texas state-chartered bank (a "state bank") may sell title insurance as an agent, either directly or through a subsidiary. As you point out, the answer to this question is important for nationally-chartered banks, as well as state-chartered banks, as a result of the passage of the Gramm-Leach-Bliley Act ("GLBA"), effective November 12, 1999, which reversed the long-standing position of the Office of the Comptroller of the Currency ("OCC") permitting such activity. GLBA prohibits this activity for a national bank, or national bank subsidiary, unless it was engaged in the activity prior to the enactment of GLBA, or unless, and only to the extent that, a state bank could engage in the activity. In our opinion, pursuant to Texas banking law governing the powers and permissible activities of a state bank or operating subsidiary, Finance Code §§32.001 and 34.103, a state bank may sell title insurance directly, or through an operating subsidiary, if either is appropriately licensed by the Texas Department of Insurance.

Background

GLBA established a federally-mandated framework that both allows and encourages the convergence of the banking, insurance and securities industries. Legal barriers that have separated the industries (securities from banking since the Depression, and insurance from banking since bank holding company regulation began in the 1950s) are dissolved or significantly modified at the national level, and most contrary provisions at the state level are preempted. As a result, even though banks have for some time engaged in securities activities to a limited extent, they now may do so through a financial holding company relatively free from limitations on the scope of those activities. *See* GLBA, §103 (adding subsection (k) to 12 U.S.C. §1843). Further, most state insurance laws, rules, or interpretations that limit a bank's ability to sell, solicit, or cross-market insurance products are rendered ineffective, subject to specifically delineated and nondiscriminatory consumer protection measures which are statutorily protected from preemption. *See* GLBA §104 (c) and (d) [*15 U.S.C. §6701(c) and (d)*].

GLBA makes clear that the responsibility for functional regulation of securities and insurance activities will remain with the authority that has traditionally regulated the activity. Thus, insurance activities conducted by banks are subject to state insurance licensing requirements, provided that these requirements do not prevent or significantly interfere with the ability of an insured depository institution to engage in such activities or acquire functionally-regulated affiliates, as permitted by GLBA. *See* GLBA, §104(b) [*15 U.S.C. §6701(b)*]. For the most part, regulation of the functional aspects of the insurance business entails only minor rearrangement of traditional lines of regulatory responsibility, although it will be necessary for bank regulators to be aware of the impact of such regulation on the safety and soundness of their regulated entities. However, it is likely that clearly delineated areas of responsibility will not always pertain. For example, if an insurance law or regulation applicable to an insured depository institution is potentially subject to preemption under GLBA, the Department of Insurance will bear primary responsibility for the analysis, but the Department of Banking will also have a responsibility to address the issue to ensure non-discriminatory treatment of state banks and their affiliates.

This opinion addresses your question on insurance activities from the banking perspective, including our opinion on the applicability of related aspects of GLBA.

Analysis

A corporation may plainly be licensed as a title insurance agent. Title insurance is governed by the Texas Title Insurance Act (Chapter 9 of the Insurance Code), which specifies, at Article 9.36-1(a), that a "person, firm, association, or corporation" may be licensed as a title insurance agent. As a corporation authorized to transact business in Texas, a bank's operating subsidiary would therefore clearly be eligible for a license, provided other applicable regulatory requirements are satisfied.[1] However, at this point direct agent licensing of a bank may present novel and complex questions that the Texas Department of Insurance must first address before we can conclusively state that a state bank may directly act as a title insurance agent.

Assuming the Insurance Code would permit a state bank to be licensed as a title insurance agent, an issue that must first be resolved by the Texas Department of Insurance,[2] in our opinion no impediment exists in Texas banking law to a state bank directly selling title insurance as agent. A state bank is expressly authorized to "act as an agent . . . ." Finance Code §32.001(b)(2).[3] In our opinion, this explicit agency authority fully empowers a state bank to act as an agent in all matters relating to financial activities, including insurance activities.

Further (again assuming the Insurance Code would permit a state bank to be licensed as a title insurance agent), in our view acting as a title insurance agent is incidental to the business of banking and additionally authorized by Finance Code §32.001(b)(1). As a matter of prudent lending, title insurance is frequently required to protect the lender (as well as the borrower) from the prospect of economic loss resulting from a defect in the title to the property. The ability to obtain necessary title insurance from an "in-house" source increases the ability of the bank to efficiently and capably make such loans, while generating additional revenue for the bank.

Because "a state bank may conduct any activity . . . through an operating subsidiary that a state bank or a bank holding company is authorized to conduct under the laws of this state if the operating subsidiary is adequately empowered and appropriately licensed to conduct its business," Finance Code §34.103(a),[4] a state bank operating subsidiary may also sell title insurance as agent. Whether the activity is engaged in directly or through an operating subsidiary, a license must first be obtained from the Texas Department of Insurance. *See* GLBA §104(b).

A state bank that chooses to conduct title insurance agency activities directly through the bank may expect close scrutiny from the Department of Banking to assure that the bank's safety and soundness are not impaired by the activity.

Opinion No. 00-06

An out-of-state bank with lawfully operating Texas branches may establish additional branches on the same basis as if it were a Texas state-chartered bank, including de novo, through purchase of a branch of another bank, or through the acquisition of an existing bank, regardless of age.

February 7, 2000
Loren E. Svor, Assistant General Counsel

[1] See, for example, TEX. INS. CODE Art. 9.09, which states that a title insurance agent cannot sell any other type of insurance.

[2] *The Texas Commissioner of Insurance has since opined that a state bank may be licensed directly as a title insurance agent.*

[3] *Effective September 1, 2001, Finance Code §32.001(b)(2) provides that a state bank may "act as agent, or in a substantially similar capacity, with respect to a financial activity or an activity incidental or complementary to a financial activity."*

[4] *Effective September 1, 2001, Finance Code §34.103(a) provides that "a state bank may conduct any activity or make any investment through an operating subsidiary that a state bank or a bank holding company, including a financial holding company, is authorized to conduct or make under state or federal law if the operating subsidiary is adequately empowered and appropriately licensed to conduct its business."*

I have been asked to respond to your request for an opinion on the above referenced issue. In your original letter of December 23, 1999, you indicated that you represent [***] Bank ("[***]" or the "Bank") an Alabama state-chartered bank which is a wholly-owned subsidiary of [***], Inc., a registered bank holding company (the "holding company") headquartered in [City], Alabama. The Bank currently operates three branches in Texas, resulting from two 1998 mergers with Texas banks pursuant to the Riegle-Neal Interstate Banking and Branching Efficiency Act (12 U.S.C. §1831u) ("Riegle-Neal"). Your specific question is whether the normal requirement that a bank which is acquired by an out-of-state bank have been in continuous existence for at least five years applies to an acquiring bank, such as [***], that already has operating Texas branches. It is our opinion that an out-of-state bank with lawfully operating Texas branches may establish additional branches on the same basis as if it were a Texas state-chartered bank, including *de novo*, through purchase of a branch of another bank, or through the acquisition of an existing bank, regardless of age.

Riegle-Neal provided a framework for interstate branching of state and national banks. In general, Riegle-Neal provided that after June 1, 1997, the responsible federal regulator could approve a merger transaction between insured banks with different home states pursuant to 12 U.S.C. §1828(c), notwithstanding a statute of a home state prohibiting such a transaction. 12 U.S.C. §1831u(a)(1). This authority was subject to two limitations: (1) a state could "opt out" of interstate branching by enacting a law after September 29, 1994, and before June 1, 1997, prohibiting merger transactions involving all out-of-state banks; and (2) the merger is subject to meeting any state age requirements for the entity being acquired, up to a maximum of five years. 12 U.S.C. §§1831u(a)(2)(A) and (a)(5)(A). Texas attempted to opt out, but the statutory language failed to meet the requirements of Riegle-Neal in that the prohibition did not apply to out-of-state state savings banks, and consequently did not apply to all banks. *See* Opinion No. 98-27 (July 30, 1998). With it no longer possible to enact an "opt out" statute, Texas enacted, effective September 1, 1999, a comprehensive interstate branching framework as Chapters 201-204, Finance Code.

Finance Code, §203.005(a) provides that:

> An out-of-state bank may not acquire a Texas bank in an interstate merger transaction if the Texas bank has not been in existence and in continuous operation for at least five years as of the effective date of the interstate merger transaction. However, this section does not apply if the acquiring out-of-state bank could establish a de novo branch in this state pursuant to Section 203.002.[1]

Although there is nothing in the wording of §203.005 to so indicate, Finance Code §203.006 makes clear that §203.005 applies only to the initial acquisition of a Texas bank by providing that:

> An out-of-state bank that has established or acquired a branch in this state under this chapter may establish or acquire additional branches in this state to the same extent that a Texas state bank may establish or acquire a branch in this state under applicable state and federal law.

See also 12 U.S.C. 1831u(d)(2) (following the consummation of an interstate merger transaction, the resulting bank may establish or acquire a branch anywhere any of the banks involved in the transaction could have done so if they had not merged). Because a Texas state bank can acquire an existing bank through merger or purchase of all or substantially all of the existing bank's assets, without regard for the age of the bank being acquired, an out-of-state bank with a lawfully operating branch in Texas would be accorded the same privilege. *See* TEX. FIN. CODE §§32.203, 32.301, & 32.401.[2]

In summary, the requirement of Finance Code, §203.005, that an out-of-state bank may acquire by merger or purchase a Texas bank only if the Texas bank has been in existence and continuous operation for five years or more applies only to the first of such acquisitions; an out-of-state bank with a branch in Texas may branch under the same terms and limitations which apply to a Texas state bank.

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[1] An "interstate merger transaction" includes the purchase of all or substantially all of the assets of a bank by a bank with a different home state. *See* TEX. FIN. CODE §201.002(a)(27).

[2] However, acquisition of a Texas bank by an out-of-state bank holding company is always subject to the five year age limitation, even if the holding company has an existing Texas bank subsidiary. TEX. FIN. CODE §202.003.

Opinion No. 00-07

A state bank investment in FNMA adjustable rate preferred stock is not limited by statute, but the investment amount must be consistent with the financial capacity of the bank to safely bear the risks associated with the investment.

May 16, 2000
Loren E. Svor, Assistant General Counsel

By letters dated March 14 and 15, 2000, you have asked whether floating rate preferred stock issued by the Federal National Mortgage Association ("FNMA") is a permissible investment for Texas state banks, and if so, whether it is subject to a limitation with respect to the amount in which a state bank may invest. As discussed in detail below, in our opinion, a state bank investment in FNMA adjustable rate preferred stock is not limited by statute, but the investment amount must be consistent with the financial capacity of the bank to safely bear the risks associated with the investment.

Facts

The subject of your inquiry is FNMA perpetual preferred stock with a dividend rate that adjusts every two years to an (expected) 10-15 basis points below the two year treasury bill rate (the "Securities"). The Securities carry no voting rights and are callable on each adjustment date. The dividend is non-cumulative but must be paid before a common stock dividend may be paid. The Securities will be rated investment-grade, and will be traded on the New York Stock Exchange. Income from the Securities will be treated as dividends for federal tax purposes, and will be eligible for the 70% exemption allowed for dividends under the tax code.

Discussion

A state bank may invest without limitation in "investment securities issued or guaranteed by the Federal Home Loan Mortgage Corporation, the Federal National Mortgage Association, the Government National Mortgage Association, the Federal Agricultural Mortgage Company, or the Federal Farm Credit Banks Funding Corporation . . . ." Finance Code §34.101(e)(5) [*now §34.101(d)(5)-(7)*]. FNMA is authorized by its enabling legislation to issue preferred stock. *See* 12 U.S.C. §1718(a). The Securities are one such issue, and if they are "investment securities," are exempt from the investment limitations of the Finance Code.

Preferred stock has traditionally been considered an equity issue and as such would not be a permissible investment for a state bank. *See* Finance Code §34.101(c) [*now §34.101(b)(2)*]. However, in recent years entities seeking to minimize their financing costs have issued various securities that, while denominated as preferred stock, are intended to attract investors that otherwise would purchase traditional debt securities (such as, e.g., bonds). These "debt-like" issues reduce the issuer's financing costs because 70 percent of the "dividends" paid, unlike interest, are not taxed for a corporate investor. The issuer can therefore offer a lower rate than for a pure debt issue (given equal credit risk factors) because the dividend exclusion results in a higher effective rate to the corporate purchaser.

For regulatory purposes, the existence of these "hybrid" securities mandates a functional analysis rather than a strict reliance on denomination to determine whether they are "debt" or "equity." The Securities have many of the characteristics of debt. In particular, they convey no voting rights, do not share in the profits of the issuer, and do not change in value in relation to changes in the valuation of the issuer (although, like debt, their value can diminish if a decline in the credit-worthiness of the issuer raises doubts that the dividend can be paid). The Securities are rated investment grade, unlike equity securities which typically are not rated, and trade on a national exchange, which assures liquidity. We are of the opinion that the Securities are investment securities issued by the Federal National Mortgage Association ("FNMA"). Consequently they are subject to the exemption from normal investment limits pursuant to Finance Code [*§34.101(d)(5)*].

We are also of the opinion that Finance Code §34.101(h) [*now §34.101(f)*], which imposes a separate limit on an investment in adjustable rate preferred stock, does not apply to the Securities. This limitation directly conflicts with Finance Code [*§34.101(d)(5)*], which provides that investment security issues of FNMA are not subject to an investment limit. As matter of statutory interpretation, we are required to interpret the conflicting provisions such that both are given effect, if possible. Government Code §311.026(a). When that cannot be done, as it cannot here, a special provision is to be treated as an exception to a general provision. Government Code §311.026(b). Finance Code [*§34.101(f)*] is a provision which deals generally with adjustable rate preferred stock, which is issued by general business corporations as well as quasi-governmental entities like FNMA. Finance Code [*§34.101(d)(5)*], on the other hand, is concerned specifically with issues of quasi-governmental corporations such as FNMA. Section [*34.101(d)(5)*], providing for no investment limitation on such issues, therefore controls over the general limitation of [*§34.101(f)*]. The Securities may purchased by a state bank without statutory limitation.[1]

While a state bank may legally invest in the Securities without limit, a bank must recognize that, as with any traded security, there are market risks associated with an investment in the Securities. Share prices may decline due to changes in interest rates, the issuer's financial condition, or government tax policies. Therefore, the Department of Banking will expect that a state bank limit its investment in the Securities to an amount that reasonably relates to the amount of earnings and capital that it is prudent to place at risk.

Finally, while we conclude that a state bank may invest in the Securities subject to the considerations discussed above, this opinion is not an endorsement of a state bank investment in the Securities.

<u>Opinion No. 00-10</u>

The portion of a loan that is guaranteed by the United States Agency for International Development is exempt from the legal lending limit.

November 1, 2000
Steve Martin, Assistant General Counsel

By letter dated October 6, 2000, to J.W. Holt, Regional Director of the Department of Banking, you ask whether the portion of a loan guaranteed by the United States Agency for International Development (USAID) is counted toward a bank's legal lending limit. We conclude that such loans are exempt from the legal lending limit established in Texas Finance Code Section 34.201(a).

<u>Analysis</u>

Pursuant to §34.201(a) of the Texas Finance Code, the total loans and extensions of credit outstanding at any time by a state bank to one borrower may not exceed 25% of the bank's capital and certified surplus.[1] This limitation does not apply, however, to "the portion of an indebtedness that this state, an agency or political subdivision of this state, the United States, or an instrumentality of the United States has unconditionally agreed to purchase, insure, or guarantee." Tex Fin. Code §34.201(a)(8).[2]

To determine if the exemption created by §34.201(a)(8) applies, we look, first, to discern whether the loan is guaranteed by one of the described governmental entities and, second, whether such guarantee is unconditional. USAID is an independent

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[1] Although not necessary for our analysis, there is another principle of statutory construction that supports it: the legislature is presumed to enact a statute with full knowledge of the state of the law and with reference to it. *City of Ingleside v. Johnson*, 537 S.W.2d 145, 153 (Tex. Civ. App.–Corpus Christi 1976, no writ). What are now Finance Code, §§34.101(e)(5) and (h) [*now §§34.101(d)(5)-(7) and (f)*], were originally part of the Texas Banking Act of 1995. At the time of enactment, a portion of the Secondary Mortgage Market Enhancement Act of 1984, codified as 15 U.S.C. §77r-1, provided that "securities issued or guaranteed by the Federal Home Loan Mortgage Corporation or the Federal National Mortgage Association . . ." could be purchased and held by any person or entity subject only to any restrictions with respect to such person that would apply to an investment issued or guaranteed by the United States Government, and expressly preempting any contrary state laws (subject to an opt-out provision which was not exercised). 15 U.S.C. §77r-1(a)(1) and (b). An interpretation of Finance Code [*§34.101(f)*] restricting an investment in FNMA preferred stock while investment in direct United States Government issues is unrestricted would consequently be subject to preemption, a result that the legislature could not have intended.

[1] *Effective September 1, 2001, this limit is stated as "25% of the lesser of bank's capital and certified surplus or total equity." Act of May 22, 2001, 77th Leg., H.B. 2155, §12.*

[2] *Effective September 1, 2001, Finance Code §34.201(a)(8) exempts "the portion of an indebtedness that this state, an agency or political subdivision of this state, the United States, or an instrumentality of the United States has unconditionally agreed to <u>repay,</u> purchase, insure, or guarantee." Act of May 22, 2001, 77th Leg., H.B. 2155, §12.*

federal government agency established in the Executive Branch of the United States Government. 22 U.S.C. §6563; *see also* 5 U.S.C. §104. USAID is responsible for administering international development and foreign policy goals of the federal government. The agency is funded by the federal government through the general appropriations process. The Loan Agreement describes the loan guarantee as a USAID-issued guarantee backed by the "full faith and credit of the U.S. Government." All indications point to the USAID loan guarantee program being guaranteed by the United States.

The Department of Banking addresses the requirement of the guarantee being unconditional in 7 TAC §12.6(f) which provides, in pertinent part:

> A takeout commitment, insurance, or guarantee is considered unconditional if the protection afforded the bank is not substantially diminished or impaired if the loss should result from factors beyond the bank's control. Protection against loss is not materially diminished or impaired by procedural requirements such as an agreement to take over only in the event of default, including default over a specific period of time, a requirement that notification of default be given within a specific period of time, a requirement that notification of default be given within a specific period after its occurrence, or a requirement of good faith on the part of the bank.

We have reviewed the materials you provided, as well as the proposed Loan Guarantee Agreement, and communicated with USAID staff. The terms and conditions of the Loan Guarantee Agreement are consistent with the requirements of 7 TAC §12.6(f). USAID agrees to pay the Bank an amount equal to fifty per cent (50%) of its net loss of principal arising from default or other non-performance. The requirements for submitting, and receiving payment on, a claim are also consistent with 7 TAC §12.6(f). Based on our review, we have found no reason to believe that a loan made pursuant to USAID's authority would be anything other than "unconditional" as above defined.

The rule also provides that a guarantee is not considered unconditional unless the commitment or guarantee is payable only in cash or its equivalent within 60 days after demand for payment is made. The Loan Guarantee Agreement provides that upon approval of a claim, USAID will "promptly" pay the Bank. USAID has represented that it may be possible to provide for a 60-day payment period in the loan guarantee between USAID and the Bank. We assume for the purposes of this opinion that such requirement would be included.

Conclusion

Subject to our assumptions, we conclude that the legal lending limit of §34.201(a) of the Texas Finance Code would not apply to that portion of a properly made and documented loan that is guaranteed by the United States Agency for International Development.

Our conclusion should not be construed as an endorsement of the proposed loan. A bank must heed the underlying purpose of the legal lending limit, reduction of risk by preventing one individual, or a relatively small group, from borrowing an unduly large amount of the state bank's funds. Further, while a bank is clearly empowered to make loans as described in this opinion in an amount well in excess of the bank's legal lending limit, the bank in question must have the ability, capacity, and commitment to appropriately evaluate and manage the risks inherent in such lending activities. Thus, these types of loans will be closely scrutinized by an examiner to monitor the bank's adherence to its policies and procedures and to ensure that the bank is administering such loans in a manner that is consistent with safe and sound banking practices.

Finally, this opinion is limited to the facts and circumstances set forth in your letter of October 6, 2000, the accompanying materials, and the representations of USAID. Any change in those facts, circumstances, or the stated assumptions underlying our opinion may result in a different opinion.

Opinion No. 00-12

Permanent residential mortgage loans originated and underwritten by a state bank, acting as a direct endorsement lender for FHA and VA, are not exempt from the legal lending limit because the take-out commitment extends to the home buyer and not the home builder and key protections afforded the bank by the commitments are not unconditional.

November 16, 2000
Steve Martin, Assistant General Counsel

By letter dated March 6, 2000, you ask whether an interim construction contract house loan guaranteed by FannieMae (FNMA), Federal Housing Administration (FHA), or Department of Veteran Affairs (VA) is counted toward a bank's legal lending limit. You additionally seek clarification of Opinion No. 91-2 (April 19, 1991). As discussed more fully below, we conclude that such a loan is subject to the legal lending limit established in Texas Finance Code Section 34.201(a) because the take-out commitment extends to the home buyer and not the home builder, and key protections afforded the bank by the commitments are not unconditional.

Background

[****] Bank (the "Bank"), through its subsidiary [****] Mortgage [Company], is a direct endorsement lender for FHA and VA and a designated underwriter for FNMA and is thus qualified to originate and underwrite permanent residential mortgage loans. You represent that a part of the Bank's lending activity includes interim construction financing. You state that in reliance on Opinion No. 91-2, the Bank has been operating under the premise that interim construction loans to a home builder supported by a permanent funding takeout commitment from an approved FNMA, FHA, or VA direct endorsement lender are not subject to bank lending limits. Opinion No. 91-2 determined that certain interim construction loans subject to the purchase obligation of Farmers Home Administration (FmHA) were excluded from legal lending limit requirements.

Analysis

Pursuant to §34.201(a) of the Texas Finance Code, the total loans and extensions of credit outstanding at any time by a state bank to one borrower may not exceed 25% of the bank's capital and certified surplus.[1] The underlying purposes of this limitation are to protect the safety and soundness of state-chartered banks by preventing excessive loans to one person, and to promote diversification of loans to reduce portfolio and credit risk. *See* 7 TAC §12.1(a). This limitation does not apply, however, to "the portion of an indebtedness that this state, an agency or political subdivision of this state, the United States, or an instrumentality of the United States has unconditionally agreed to purchase, insure, or guarantee." TEX. FIN. CODE §34.201(a)(8).[2]

To determine if the exemption created by §34.201(a)(8) applies, we normally look, first, to discern whether the loan is guaranteed by one of the described governmental entities and, second, whether such guarantee is unconditional. In this case, however, because of the underlying purposes of the statutory lending limit, we must additionally consider on whose behalf the guarantee is extended.

Whether the Loan Is Guaranteed by One of the Described Governmental Entities

[1] *Effective September 1, 2001, this limit is stated as "25% of the lesser of bank's capital and certified surplus or total equity." Act of May 22, 2001, 77th Leg., H.B. 2155, §12.*

[2] *Effective September 1, 2001, Finance Code §34.201(a)(8) exempts "the portion of an indebtedness that this state, an agency or political subdivision of this state, the United States, or an instrumentality of the United States has unconditionally agreed to repay, purchase, insure, or guarantee." Act of May 22, 2001, 77th Leg., H.B. 2155, §12.*

FNMA is a private, shareholder-owned company and receives no government funding. *See* 12 U.S.C. §§1716 *et seq*. As such, FNMA is not an agency or instrumentality of the federal government and, consequently, does not come within the exception of §34.201(a)(8). The Federal Housing Administration is a department within the Department of Housing and Urban Development. 42 U.S.C. §3533(b). Both the Department of Housing and Urban Development and the Department of Veterans Affairs are departments within the Executive Branch of the United States Government. 5 U.S.C. §101. Both Departments are funded by the general appropriations of the United States Government. All indications point to the FHA and VA loan guarantee programs being guaranteed by agencies of the United States as contemplated by §34.201(a)(8).

On Whose Behalf the Guarantee Is Extended

The facts of the instant case are distinguishable from the facts and holding of Opinion No. 91-2 concerning on whose behalf the guarantee is issued. In that opinion, a general partnership secured interim financing to construct rental property. The underlying facts of that opinion involved a take-out commitment to one particular builder for a particular project. FmHA had specifically approved the project involving a commercial building and issued its guarantee. In the instant case, no commitment or guarantee extends from the federal agencies to the Bank for the interim construction loan made to the builder. The take-out commitment as evidenced by the documentation you submitted is issued to the buyer and not to the builder. Consequently, no protection is afforded to the Bank if the builder defaults and the safety and soundness of the bank are at risk.

Whether the Guarantee is "Unconditional"

The facts of the present case are also distinguishable from Opinion No. 91-2 in regard to the requirement that the guarantee be unconditional. In the circumstances involved in Opinion No. 91-2, final drawings, specifications, and all other contract documents had been approved by FmHA. FmHA had determined that the conditions of loan closing could be met. FmHA further indicated that the funds had been obligated to purchase from the bank and provide permanent financing for the approved loans. Based on these facts, the Department of Banking determined the underlying interim loan could be excluded from the legal lending limit requirement. We noted in Opinion No. 91-2 that since the FmHA is obligated to purchase from the bank and provide permanent financing for approved loans subject to certain conditions, these interim construction loans may be excluded from the limitations of Texas Finance Code 34.201(a)(8).

It is apparent from a review of the facts in the present case that the loan guarantees are conditional in nature under the terms of Section 34.201(a). The Department of Banking addresses this requirement of the guarantee being unconditional in 7 TAC §12.6(f) which provides, in pertinent part:

> A takeout commitment, insurance, or guarantee is considered unconditional if the protection afforded the bank is not substantially diminished or impaired if the loss should result from factors beyond the bank's control. Protection against loss is not materially diminished or impaired by procedural requirements such as an agreement to take over only in the event of default, including default over a specific period of time, a requirement that notification of default be given within a specific period of time, a requirement that notification of default be given within a specific period after its occurrence, or a requirement of good faith on the part of the bank.

In the present case, numerous substantive conditions must be met prior to the time that the guarantee becomes effective. These include, but are not limited to, final inspection, acceptable appraisal, approved sewer and water systems, title insurance policy, hazard insurance policy, and continuation of all conditions set forth in the application and supporting papers. The protection the guarantee affords the bank may be substantially diminished or impaired if a loss should result from factors beyond the bank's control. Consequently, the guarantee is not "unconditional" as that term has been explained in 7 TAC §12.6(f).

Conclusion

Subject to our assumptions and for the reasons stated above, we conclude that the interim construction contract house loans guaranteed by FannieMae, Federal Housing Administration, and the Department of Veteran Affairs do not qualify for the exception of §34.201(a)(8) of the Finance Code. Consequently, the legal lending limit established by §34.201(a) of the Texas Finance Code does apply to these loans.

This opinion is limited to the facts and circumstances set forth in your letter of March 6, 2000. Any change in those facts, circumstances, or the stated assumptions underlying our opinion may result in a different opinion.

Opinion No. 00-13

A vendor conducting ATM site safety evaluations may be required to register as a private security consultant with the Texas Commission on Private Security.

September 15, 2000
Steve Martin, Assistant General Counsel

I am responding to your letter of August 11, 2000, to Everette D. Jobe, General Counsel of the Texas Department of Banking. As I explained in our conversation of today, there are no licensure requirements of the Texas Department of Banking or Texas Finance Commission for performing ATM site safety evaluations to assist state banks in determining their level of compliance with Sections 59.301-59.310 of the Texas Finance Code. The conduct of your business as described in your letter does not implicate any licensing requirements of the Department or Commission.

As I also mentioned in our telephone conversation, it is possible that you may be required to register as a private security consultant with the Texas Commission on Private Security. An individual acts as a private security consultant if the person offers advice or services in the field of private security. Texas Occupations Code, Section 1702.226. "Private security consultant" is defined to mean a person who "consults, advises, trains, or specifies or recommends products, services, methods, or procedures in the security loss prevention industry." Texas Occupations Code, Section 1702.002(28). I have enclosed pertinent portions of the law relating to private security consultants. I suggest you contact the Commission on Private Security to ascertain if any licensing or registration requirements exist for the conduct of your business.

Opinion No. 01-01

Whether a state bank's loans to two companies must be aggregated for legal lending purposes, if the 50% owner of one company guarantees a loan to the other company and pledges collateral to support the guaranty, is a question of fact that must be resolved with regard for specific circumstances.

February 1, 2001
Steve Martin, Assistant General Counsel

By letter dated November 6, 2000, to Everette Jobe, General Counsel, Department of Banking, you ask whether a state bank's loans to two companies must be aggregated if the 50% owner of one company guarantees a loan to the other company, and pledges collateral to support the guaranty. We conclude that such loans need not be aggregated.

Factual Background

[***] Bank (Bank) has a lending relationship with two companies, [Company A] and [Company B]. You state that while there is common ownership between the two companies, they operate independently of one another. Company A is a vending service and Company B is a business management and consultant company. You additionally state that the proceeds of the loans to one company do not benefit the other and that the sources of repayment are not the same. However, one of the guarantors has pledged personal assets, shares listed on the New York Stock Exchange, as collateral to partially secure a letter of credit for which Company A, Inc. is the beneficiary. Further, this guarantor owns 50% of Company B and 12.5% of Company A.

Analysis

Pursuant to §34.201(a) of the Texas Finance Code, the total loans and extensions of credit outstanding at any time by a state bank to one borrower may not exceed 25% of the bank's capital and certified surplus.[1] Generally, for the purposes of computing the legal lending limit, a loan or extension of credit to one borrower is attributed to another person and each person will be considered a borrower if (1) proceeds of the loan or extension of credit are to be used for the direct benefit of the other person, (2) a common enterprise is deemed to exist between the two persons, or (3) the expected source of repayment for each loan or extension of credit is the same for each person. 7 TAC §12.9(a).

You represent that the proceeds of the loans to each of the companies do not benefit the other company and, further, that the sources of repayment for the loans are not the same. That leaves the question as to whether under the facts a common enterprise exists. A common enterprise exists if loans are made to affiliated borrowers, and the borrowers are financially interdependent. 7 TAC §12.9(c). Borrowers are affiliated if "one borrower directly or indirectly controls, is controlled by, or is under common control with another borrower." 7 TAC §12.9(c)(2). Based on your representations, there is no common control among the borrowers, therefore they are not "affiliated," and a common enterprise does not exist.

The pledge of collateral by the guarantor as described above may often indicate that the bank is relying primarily on the guarantor for repayment of the loan. Under 7 TAC §12.9(g), the derivative obligation of a guarantor is not required to be aggregated with direct loans or extensions of credit to the guarantor only if the lending bank is relying primarily on the creditworthiness of the primary obligor. You have represented that the bank is relying primarily on Company A and Company B, respectively, for repayment and not the personal guarantee of the guarantor. Consequently, the indebtedness of the two companies need not be aggregated with each other on that basis. The reliance of the lending bank on the primary obligor must be evidenced by the certification of an officer of the bank that the bank is, on stated facts, relying primarily on the responsibility and financial condition of the primary obligor for payment of the loan or extension of credit and not on the guarantee of the guarantor. Assuming evidence exists in the Bank's files to reasonably support its determination that Company A and Company B each have the ability and capacity to repay their respective loans and that the decision to fund each loan was based upon such determination, and assuming each loan file contains the requisite Bank officer certification, the requirements of 7 TAC §12.9(g) are satisfied.

While is it not necessary for resolution of this matter to consider the guarantor's pledge of readily marketable collateral pursuant to 7 TAC §12.5(d), loans or extensions of credit to one borrower may exceed the bank's lending limit by an additional 15% to the extent that the amount that exceeds the bank's lending limit is fully secured by readily marketable collateral. The bank is required to properly perfect its security interest in the collateral and the collateral at all times must have a market value of at least 100% of the amount of the loan or extension of credit that exceeds the bank's lending limit. 7 TAC §12.5(d).

Conclusion

Subject to your representations and our assumptions, we conclude that a state bank's loans to two companies are not required to be aggregated where the 50% owner of one company guarantees a loan to the other company, and pledges collateral to support the guaranty, as long as the lending bank is relying primarily on the creditworthiness of the primary obligor.

Our conclusion should not be construed as an endorsement of the proposed loan. A bank must heed the underlying purpose of the legal lending limit, reduction of risk by preventing one individual, or a relatively small group, from borrowing an unduly large amount of the state bank's funds. Further, while a bank is clearly empowered to make loans as described in this opinion, the bank in question must have the ability, capacity, and commitment to appropriately evaluate and manage the risks inherent in such lending activities.

Finally, this opinion is limited to the facts and circumstances set forth in your letter of November 6, 2000, the accompanying information, and our telephone conversations. Any change in those facts, circumstances, or the stated assumptions underlying our opinion may result in a different opinion.

[1] *Effective September 1, 2001, this limit is stated as "25% of the lesser of bank's capital and certified surplus or total equity." Act of May 22, 2001, 77th Leg., H.B. 2155, §12.*

<u>Opinion No. 01-04</u>

An out-of-state, federal savings bank with trust powers may engage in fiduciary activities in this state with respect to perpetual care cemetery trusts and prepaid funeral benefit trusts created under Texas law if the bank establishes a physical Texas presence through a branch or representative trust office.

Sarah Shirley, Assistant General Counsel
May 30, 2001

By letter dated January 5, 2001, you ask the Department of Banking (the "Department") to grant [****] Bank (the "Bank") a "variance" from Health & Safety Code §712.021(a) and Finance Code §154.253, which require the trustee of a perpetual care cemetery trust to be located in Texas and a trustee of a prepaid funeral benefit trust to have its main office or a branch in Texas, respectively.

Summary of Opinion

An out-of-state, federal savings bank with trust powers may engage in fiduciary activities in this state with respect to perpetual care cemetery trusts and prepaid funeral benefit trusts created under Texas law if the bank establishes a physical Texas presence through a branch or representative trust office.

Background

In your letter, you advise the Department that a Texas perpetual care cemetery corporation has approached you "to see if the Bank could assist his company in setting up a perpetual care trust." Apparently, the corporation wishes to transfer its perpetual care cemetery trust funds from the current trustee to the Bank. You have provided additional details about the proposed trust activities during our several telephone conversations. Although your letter mentions only activities as trustee of a perpetual care cemetery trust, you advise that the Bank also wishes to serve as the trustee of prepaid funeral benefit trusts. You also advise that the Bank has its principal office in [City], [State], and does not currently have an office in Texas.

Analysis

In our opinion, an out-of-state, federal savings bank with trust powers may engage in fiduciary activities in this state without qualification in all but a few circumstances. With respect to acting as a fiduciary for prepaid funeral benefits and perpetual care trust funds under Texas law, fiduciary relationships that would not exist but for Texas law, an out-of-state federal savings bank may only do so if it establishes a physical Texas presence through a branch or representative trust office.[1]

Health & Safety Code §712.021(a), pertaining to perpetual care trust funds, requires a corporation that operates a perpetual care cemetery in Texas to have a trust fund established with a trust company or bank with trust powers that is located in this state. Health & Safety Code §712.028 requires that the cemetery corporation "deposit" specific amounts collected from the sale of perpetual care property into the trust fund, and §712.029 establishes requirements pertaining to the timing of and accounting for "deposits."

Finance Code §154.253 requires that money paid or collected on prepaid funeral benefits contracts be "deposited" into either an insured, interest bearing account with a financial institution that has its main office or a branch in Texas, or in trust with a financial institution that has its main office or a branch located in this state and is authorized to act as a fiduciary in Texas.

Health & Safety Code §712.021(a) and Finance Code §154.253 are not banking statutes. In the context of these statutes, the word "deposit" is not used in the same manner as in banking statutes because the term includes a contribution to a trust, which is not a "deposit" transaction. Finance Code §154.253 permits either a deposit account or a trust account, and refers to both forms of account as "deposits." Similarly, we believe the terms "located," "main office," and "branch" are not used

[1] In this respect, we disagree with the Office of Thrift Supervision and its view that such state law requirements are preempted by federal law. *See* Department Opinion No. 99-28 (May 18, 2000).

in the same manner as in banking statutes when referring to trust accounts, but simply require that the funds be received by the fiduciary institution in Texas subject to Texas law. A physical Texas location, such as a branch or representative trust office, will therefore satisfy the requirements of Health & Safety Code §§712.021, 712.028, and 712.029, and Finance Code §154.253. We believe this interpretation accomplishes the purposes for which the office location requirements were enacted – to ensure that Texas-based perpetual care trust funds and prepaid funeral benefit trust funds are received and receipted for in Texas and are subject to and dealt with in accordance with Texas law.

Accordingly, the Bank may act as trustee of perpetual care cemetery trust funds or prepaid funeral benefit trust funds in Texas if it establishes a branch or representative office in this state to engage in prepaid funeral benefits and perpetual care cemetery-related fiduciary activities, and complies with applicable provisions of Texas law and the Department's rules. Certain Texas laws impose minimal requirements. Specifically, the Bank must register with the Texas Secretary of State, pursuant to Finance Code §201.102, and, if establishing a representative trust office, must comply with the requirements of [*Finance Code §187.202*].

Once the required registrations have been completed with the Secretary of State and the Savings and Loan Commissioner, any Texas perpetual care cemetery corporation or prepaid funeral benefits contract seller that desires to use the Bank as trustee should contact Ms. Sheila Armstrong of the Department's Special Audits Division for specific instructions regarding how to proceed with the deposit or transfer of trust funds, inasmuch as the requirements vary somewhat depending upon whether the funds in question are prepaid funeral benefits funds or perpetual care funds. In either event, the Department will require that the Bank, prior to receiving any of these trust funds, execute and return to the Department an acknowledgment affirming its agreement to, among other things, receive and provide a receipt for trust funds at its Texas branch or representative trust office, and comply with and be bound in all respects by the requirements of Health & Safety Code Chapter 712 and Finance Code Chapter 154 applicable to fiduciaries, specifically including those pertaining to the protection of perpetual care cemetery funds and prepaid funeral benefits funds.

Opinion No. 01-05

A Texas state-chartered trust company may market its services in states other than Texas, and accept referrals from and pay referral fees to affiliates and non-affiliated third parties relating to potential customers located in states other than Texas, if permitted by the laws of such other states.

May 31, 2001
Shannon Phillips Jr., Assistant General Counsel

This letter is in response to your letter dated May 2, 2001, addressed to Randall S. James, Commissioner of the Texas Department of Banking. Your letter requests confirmation that a Texas state-chartered trust company under Texas law may, subject to satisfying any legal requirements in the applicable states, (a) market its services in states other than Texas, and/or (b) accept referrals from affiliates and non-affiliated third parties relating to potential customers located in states other than Texas and pay a referral fee for such referrals.

Summary of Opinion

A Texas state-chartered trust company satisfying the requirements of the Act may (a) market its services in states other than Texas, and (b) accept referrals from affiliates and non-affiliated third parties relating to potential customers located in states other than Texas and pay a referral fee for such referrals.

Background

In your letter, you advise the Department that a Texas state-chartered trust company (the "Company") is contemplating generating business from (a) referrals from employees of the company and other affiliates located in Texas and states other than Texas; (b) referrals from independent third parties, e.g., accountants, attorneys, and financial consultants, located in Texas and states other than Texas; and (c) direct marketing in states other than Texas. The Company's marketing and referrals will relate to activities that the company proposes to accept and perform in Texas using its powers as a Texas state-charted trust company, subject to satisfying any legal requirements in the applicable states.

Analysis

Texas Trust Company Act (the "Act"), Vernon's Texas Civil Statutes, Article 342a-9.003 [*now Finance Code §187.003*], provides that "subject to the approval of the banking commissioner pursuant to Section 3.203 [*now Finance Code §182.203*], a state trust company may engage in the trust business in another state or foreign country at a trust office or a trust representative office to the extent permitted by and subject to applicable laws of the state or foreign country." [*Finance Code §182.203*] allows a Texas state-chartered trust company to "establish and maintain additional offices by filing a written notice with the banking commissioner setting forth the name of the state trust company, the street address of the proposed additional office, a description of the activities proposed to be conducted at the additional office, and a copy of the resolution adopted by the board authorizing the additional office."

Based on the facts as presented, the methods the Company is contemplating to generate business in states other than Texas do not involve establishing and maintaining additional offices. It is the opinion of the Department that [*Finance Code §187.003*] does not require the Company to establish and maintain additional offices in the other states where it anticipates engaging in the activities contemplated.

This opinion is based strictly on Texas law and makes no conclusions as to any other state's licensing, registration or other requirements necessary to undertake the proposed activity in that other state. Further, this opinion is limited to the facts and circumstances set forth in your letters referenced above, and any change in those facts or circumstances may result in a different opinion.

Opinion No. 01-06

A state bank affiliated insurance agency may pay more that nominal, contingent referral fees to certain bank officers if the officers are appropriately licensed as insurance solicitors under state law.

June 7, 2001
Steve Martin, Assistant General Counsel

By letter dated March 14, 2001, you requested our opinion as to whether a state bank affiliated insurance agency may pay more than nominal referral fees, to be paid if the customer referral results in the sale of an insurance product by the agency, to certain of the bank's officers if the officers are appropriately licensed as solicitors under the Texas Insurance Code. Without interpreting or addressing the application of Texas insurance laws, we conclude that a state bank affiliated insurance agency may pay such referral fees.

Factual Background

As you explain in your letter, [****] Bank (Bank) has an insurance agency subsidiary, [****] Insurance Agency, Inc. (Agency). Agency maintains a general lines insurance license under the Texas Insurance Code and is a wholly-owned subsidiary of the Bank. The Bank and the Agency propose to establish a program whereby the Agency would pay referral fees to certain officers of the Bank when a customer referral from the officer results in the Agency's sale of an insurance product. The referral fee paid could be more than nominal in amount. You state that any officers who participate in this compensation program would be required to be licensed by the Texas Insurance Department as solicitors pursuant to Article 21.14 of the Texas Insurance Code. You also state that the Bank, its officers, and employees, would adhere to the consumer protection rules set forth in 12 C.F.R. Part 343.

Analysis

As a starting point, we note that there is no prohibition under the Texas Finance Code or the regulations promulgated thereunder regarding the payment of referral fees to the Bank's officers as above described. However, the Texas Department of Banking (the "Department") has issued two opinions that are instructive in considering your question. In Opinion No. 93-7 (September 30, 1993), the Department advised a Texas state bank that it had no objection to a proposed program whereby certain of the bank's employees would serve as dual employees of an insurance agency. However, that opinion cautioned the bank concerning possible confusion about the provision of deposit insurance and other consumer-related matters. In that regard, we note that you intend to comply with the insurance consumer protection rules set forth at 12 C.F.R. Part 343. In Opinion 95-55 (December 6, 1995), the Department advised a state bank that it had no objection to the receipt of a commission by a bank officer who was also a part-time real estate broker. That opinion observed that the state did not have a law similar to the federal bank bribery law, discussed below. While approving the proposed activity, Opinion No. 95-55 noted our concern about the possible application of federal laws and potential conflicts of interest.

Your question implicates 12 C.F.R. §343.50(b), a federal regulation that addresses the payment of referral fees to an employee "who accepts deposits from the public in an area where such transactions are routinely conducted in the bank . . ." The preamble to this regulation indicates that the provision is directed to bank tellers and the regulation has been interpreted accordingly. Upon review, we do not believe that this regulation applies to your proposal. Another federal law which must be considered is 18 U.S.C. §215, the so-called Bank Bribery Act. This section prohibits "corruptly" giving anything of value to a bank officer in connection with any business or transaction of the bank. It further prohibits a bank officer from "corruptly" accepting anything of value from any person intending to be influenced or rewarded in connection with any business or transaction of the bank. This section appears to target the prohibited activity in the context of the obtaining of loans. In fact, the section is entitled "Receipt of commissions or gifts for procuring loans." We have reviewed this section and conclude that it does not apply to the proposal contained in your letter.

In addition to the foregoing, we also base our opinion in this matter on your representations that the bank employees who may refer customers to the Agency, and who may in turn receive referral fees, will be licensed under the Texas Insurance Code as solicitors. It appears that a solicitor's license must be obtained in order to procure business for any insurance company and to receive valuable consideration for the referral. Texas Insurance Code Article 21.14, §4. However, we express no opinion on, or interpretation of, the Texas Insurance Code. We suggest you contact the Texas Department of Insurance for any questions you have regarding the application of the Texas Insurance Code.

Conclusion

Subject to your representations in your letter of March 14, 2001, and our assumptions noted above, we conclude that a state bank affiliated insurance agency may pay more than nominal referral fees, to be paid if the customer referral results in the sale of an insurance product by the agency, to certain of the bank's officers if the officers are appropriately licensed as solicitors under the Texas Insurance Code. This opinion is limited to the facts and circumstances set forth in your letter of March 14, 2001. Any change in those facts, circumstances, or the stated assumptions underlying our opinion may result in a different opinion.

Both the bank's documented procedures and actual practice in this matter should assure the board of directors and this office that there is neither an abuse of customers nor any safety and soundness risk to the bank through misplaced or inappropriate incentives.

<u>Opinion No. 01-07</u>

A Texas bank, acting as agent for an out-of-state bank that does not have a Texas office, may not accept deposits through ATMs from customers of the out-of-state bank in a manner that implies or allows the inference that the funds have been deposited in the customer's insured account prior to the time the customer's bank actually receives the funds.

Although Opinion No. 01-07 stands for the proposition stated above, the opinion specifically addresses the proposal of an ATM operator to accept deposits for Internet banks through ATMs in Texas. A more precise statement of the specific opinion is as follows:

> ***A Texas-licensed money transmitter is fully authorized to accept funds through an ATM it owns and operates in Texas for transmission to a customer's out-of-state bank that does not have a Texas office, but may not represent the receipt of funds at the ATM in such a manner as to imply or allow the inference that the funds have been deposited in the customer's bank prior to the time the bank actually receives the funds. Retention of a bank in Texas as agent does not alter this conclusion.***

June 15, 2001
Everette D. Jobe, General Counsel

By letter dated April 6, 2000, you asked for our concurrence that a proposed program to be offered through ATMs owned by [Company] is a permissible activity under Texas law.

Specifically [Company] proposes to utilize Texas depository institutions, as agents for other depository institutions, including those with no physical presence in Texas, to accept deposits on behalf of such depository institutions from their customers through [Company] ATMs. For convenience, we will refer to depository institutions as "banks" although we acknowledge that participating depository institutions could include savings banks, savings and loan associations, and credit unions, in addition to commercial banks.

Summary of Response

Because the program you describe does not establish the existence of a deposit until the customer's funds are actually received by the customer's bank, [Company] is fully authorized as a Texas-licensed money transmitter to accept funds through an ATM in Texas for transmission to a customer's bank, but may not represent the receipt of funds at the ATM in such a manner as to imply or allow the inference that the funds have been deposited in the customer's bank prior to the time the bank actually receives the funds.

The Proposal

[Company] desires to permit participating banks to accept customer deposits at [Company] ATMs in Texas, with an emphasis on serving customers of Internet banks. In recognition that [Company] is not itself authorized to accept deposits, [Company] proposes to facilitate an agency relationship between each participating bank and a Texas-based bank ("bank-agent") that will authorize the Texas bank-agent to nominally accept the funds for subsequent transfer to the customer's bank for deposit. No depository relationship will be created between the customer and the Texas bank-agent, and the "deposit" will not be recognized and acknowledged by the customer's bank until the bank credits the customer's account upon actual receipt of the funds.

Discussion

As we understand the [Company] proposal, a Texas bank-agent will not necessarily be required. As you have described the arrangement, the transaction is simply an undertaking to transmit money. [Company] is fully authorized by its license under Finance Code Chapter 152 to transmit funds from a Texas customer to a designated third party, including the customer's bank.

However, we believe the [Company] proposal as currently described potentially violates other Texas laws, including the Texas Deceptive Trade Practices-Consumer Protection Act, Business and Commerce Code §§17.41 *et seq.* The nature and insured status of funds accepted through a [Company] ATM for transmission to the customer's bank must not be misrepresented. In our view, an advertisement or representation to customers of this program that funds submitted through an ATM have been "deposited" would be potentially misleading or deceptive. Interposing a Texas bank-agent for [Company] as the money transmitter is insufficient to transform the transaction into a deposit.

Specifically, you indicate that no deposit relationship will be established by the customer with the Texas bank-agent, and the deposit will not be recognized by the customer's bank until the funds are actually received. Although the time elapsed from receipt at the ATM to receipt by the customer's bank could be short if the funds are comprised of cash and the Texas bank-agent performs efficiently, the same would not be true with respect to funds represented by a check. Further, even if the delay in receipt of the funds by the customer's bank is short, the receipts would still not be an insured deposit for a period of time during which the customer could reasonably assume the funds were insured.

At the moment customer funds are "deposited" in the customer's bank, as evidenced by the bank's deposit account records,[1] federal deposit insurance attaches. If the customer's bank were to acknowledge the receipt of funds via an [Company] ATM as an immediate deposit by an appropriate entry in its deposit account records, the ATM transaction could truthfully be represented as a deposit[2] if the transaction were otherwise authorized under Texas law. However, even if the program can be restructured in a way that encourages immediate recognition of funds tendered through an ATM as a deposit, a customer's bank that does not have authority to directly accept deposits in Texas may not accept such deposits at an ATM in Texas, whether or not a bank-agent is employed in Texas, as discussed further below.

Although not necessary to resolution of your request, we briefly address the ability of a Texas bank to act as agent for another bank. Section 18(r) of the Federal Deposit Insurance Act (12 U.S.C. §1828(r)) and Finance Code §59.005 explicitly authorize certain agency activities among affiliated, insured banks. The federal law is silent regarding the authority of a bank to act as agent for an unaffiliated bank or, as principal, to use an unaffiliated bank as agent, 12 U.S.C. §1828(r)(1). Further, a bank may not conduct an activity as agent if the bank lacks authority to conduct the same activity as principal under applicable federal or state law, or as principal, have an agent conduct an activity that the bank cannot conduct directly under applicable federal or state law, 12 U.S.C. §1828(r)(3).

A Texas state bank has explicit authority to act as agent for an unaffiliated bank under Finance Code §59.005 including, effective September 1, 2001, an out-of-state bank without a Texas presence.[3] As is the case under federal law, a state bank may not conduct an activity as agent if the bank lacks authority to conduct the same activity as principal under applicable federal or state law, or as principal, have an agent conduct an activity that the bank cannot conduct directly under applicable federal or state law, Finance Code §59.005(e).

[1] The term "deposit account records" is defined in 12 C.F.R. §330.1(e).

[2] We cannot conclude with certainty that a "deposit receivable" from a bank-agent is a "deposit" as defined by 12 U.S.C. §1813(l), although appropriate recordation in the deposit account records of the customer's bank would be required at a minimum. If resolution of this issue is important, the views of the Federal Deposit Insurance Corporation should be sought.

[3] Act of May 22, 2001, 77th Leg., H.B. 2155, §14 (authorizing a Texas financial institution to act as agent for another financial institution, regardless of location, with regard to the explicitly specified activities and limitations, effective September 1, 2001).

Neither the federal statute nor the state statute purport to fully occupy the field of the law of agency as applied in banking; the primary purpose of each statute is to create a “safe harbor” by declaring that engaging in explicitly authorized agency activities will not cause the bank-agent to be considered a “branch” of its principal.[4] Both the federal and state statutes expressly preserve the law of agency as such might be applied in other circumstances.[5] However, the statutory restriction that requires a bank to be adequately empowered to directly perform an action it seeks to perform as agent, or seeks an agent to perform, is at its core a fundamental principle of the law of agency and would continue to apply outside the parameters of these statutes.

Therefore, a customer’s bank that does not have authority to directly accept deposits in Texas may not accept deposits through an ATM in Texas, whether or not a bank-agent is employed in Texas. However, this conclusion does not dilute the force of our primary response to your question. Regardless of whether a customer’s bank has the authority to directly accept deposits in Texas, [Company] is fully authorized as a Texas-licensed money transmitter to accept funds tendered through ATMs in Texas by the bank’s customers for transmission to the bank, but must not represent the receipt of funds at the ATMs in such a manner as to imply or allow the inference that the funds have been deposited in the customer’s bank prior to the time the bank actually receives the funds.

Opinion No. 01-08

A state bank may purchase an insurance policy that covers repossession costs and any collection shortfall on a loan or lease that goes into default, subject to restrictions limiting pass-through of costs to consumer borrowers.

July 2, 2001
Everette D. Jobe, General Counsel

By letter dated March 16, 2001, you advise that your company, [****], Inc., serves as administrator for insurance programs insured by the [****] Group of Companies. You state that a number of Texas financial institutions are interested in purchasing “default shortfall” insurance, and ask whether Texas banking law would prohibit them from doing so.

Summary Response:

A Texas state bank may purchase “default shortfall” insurance for its own benefit incidental to its express power to lend money. However, a lender generally may not pass the cost for such insurance on to the borrower of a loan subject to Chapter 342, Finance Code (consumer loans).

Discussion:

[4] 12 U.S.C. §1828(r)(2) and Finance Code §59.005(g) (effective September 1, 2001, renumbered as §59.005(d)).

[5] 12 U.S.C. §1828(r)(4) and Finance Code §59.005(h) (effective September 1, 2001, renumbered as §59.005(e)). The cited subsection of Finance Code §59.005 provides as follows (edits effective September 1, 2001):

> <u>(e)</u> [~~(h)~~] This section does not affect:
> (1) authority under another law for a <u>financial</u> [~~depository~~] institution to act as an agent on behalf of another person or to act as a principal in employing another person as agent; or
> (2) whether an agent’s activities on behalf of a <u>financial</u> [~~depository~~] institution under another law would cause the agent to be considered a branch of the <u>financial</u> [~~depository~~] institution.

Similar language appears in 12 U.S.C. §1828(r)(4).

You explain that "default shortfall" coverage protects a financial institution in the event a loan or lease for which it has provided financing goes into default. The insurance covers the costs incurred by the institution to repossess the collateral securing the loan or lease and any "shortfall" on the balance owing after disposition of the collateral.[1] My understanding, based on discussions between my staff and [***], an independent insurance agent who has an exclusive agreement with [****] for the sale of the product in Texas, is that a financial institution would purchase the insurance in connection with its financing of commercial and consumer loans and leases for the purchase or lease of personal automobiles, truck tractors and trailers, recreational vehicles and motorcycles. I understand further from these discussions with Mr. [***], as reported to me, that you are interested only in whether a Texas financial institution may purchase default insurance for its own benefit, just as it might purchase liability or property insurance.

Finance Code §32.001(b)(1) authorizes a state bank to lend money and, further, to "exercise incidental powers as necessary to carry on the business of banking as provided by this subtitle." Incidental to its express power to lend money, a state bank has the power to purchase insurance against certain risks it assumes in the exercise of its express powers. We recognize the value of such insurance to the extent it relieves the bank of, among other costs and risks, the expense of repossession and the risk of loss in the event liquidation of the collateral fails to generate sufficient funds to pay off the remaining balance of the defaulted loan. However, a state bank should only purchase insurance that is written at lawful rates, in accordance with the Texas Insurance Code, and by a company authorized to do business in Texas.

Although you do not ask whether a state bank may pass on the cost of insurance to borrowers, these questions are of interest to state banks that may be considering participating in a specific insurance program. A state bank may, as a general matter, include the cost of insurance purchased for its own benefit as part of its operational overhead for purposes of calculating general loan fees.[2] In addition to purchasing insurance for its own benefit, a state bank may, as a general matter, offer insurance to a borrower and charge a separate or identifiable fee or charge for the coverage. As explained below, however, a state bank's authority to do so is limited with respect to certain consumer loans by relevant provisions of the Texas Credit Title, Finance Code §§301.001, *et seq*. (West Supp. 2001).

In general, the charges that may be assessed in connection with a consumer installment loan made by a state bank are governed by Finance Code Chapter 342. Chapter 342 applies to a loan extended primarily for personal, family or household use for which the annual interest rate exceeds ten percent. Finance Code §342.004(a), §342.005. Pursuant to Finance Code §342.502:

> (a) A lender may not directly or indirectly charge, contract for, or receive an amount that is not authorized under this chapter in connection with a loan to which this chapter applies, including any fee, compensation, bonus, commission, brokerage, discount, expense, and any other charge of any nature, whether or not listed by this subsection.
>
> (b) On a loan subject to Subchapter E[3] . . . a lender may assess and collect from the borrower an amount incurred by the lender for:
>
> . . .
>
> (6) a premium or an identifiable charge received in connection with the sale of insurance authorized under this chapter.

[1] Because you do not indicate that the default is triggered by any specific event, such as the borrower's disability or involuntary unemployment, we assume that the default shortfall insurance you describe provides protection against default generally.

[2] Finance Code §34.203; 7 TAC §12.32.

[3] Finance Code §§342.201 *et seq.* Subchapter E applies to a loan contract under Chapter 342 that is a regular transaction and is not secured by real property. Section 342.001(2) defines a "regular transaction" to mean a loan that is payable in installments that are consecutive, monthly and substantially equal in amount, and the first installment of which is due within one month and fifteen days of the date of the loan.

The types of insurance for which Chapter 342 authorizes a premium or identifiable charge are, depending upon the amount of the loan, hazard insurance on collateral securing the loan, credit life insurance, credit health and accident insurance, involuntary unemployment insurance, and non-filing insurance. Finance Code §§342.401, 342.402, 342.406. "Default shortfall" insurance is not a type of insurance authorized under Chapter 342.[4] Consequently, a state bank may not include the cost of such insurance in its overhead factor for general loan fees,[5] or assess and collect a premium or identifiable charge for such insurance sold to the borrower, in connection with a loan subject to Chapter 342 — an installment loan made by the bank to a borrower primarily for personal, family or household use with an interest rate in excess of ten percent per year.[6] A state bank may, however, under its incidental power, include the cost of such insurance in its overhead factor for general loan fees applicable to a commercial loan, or offer default shortfall insurance and charge a fee for the coverage on a commercial loan.[7]

In closing, we caution that a Texas state bank that offers and charges a fee to borrowers for default shortfall insurance must comply with all applicable federal and state laws and regulations, including the Texas Insurance Code and the regulations of the Texas Department of Insurance.

This letter does not constitute an endorsement of [****], Inc., the [****] Group of Companies, or any product or service offered by either. Please feel free to call me if you have any questions or comments.

Opinion No. 01-09

Unless the account documentation for a self-directed IRA directly states that a trust is created or indirectly does so by, for example, referring to the custodian as trustee or the assets as trust property, the IRA custodial account is not a trust and the custodian is not a trustee under state law, although the custodian is subject to applicable Internal Revenue Code provisions relevant to conflicts of interest and prohibited transactions between account holders and trustees or custodians.

July 2, 2001
Everette D. Jobe, General Counsel

By letter dated April 10, 2000, you ask several questions regarding permissible activities of [****] Trust Company ("Trust Company") as custodian of a self-directed, individual retirement account ("IRA custodial account"). Your questions pose novel legal issues that we have not previously considered and our response has required extensive research and analysis.

You first ask whether Property Code §113.053 prohibits a trust company that acts as custodian of an IRA custodial account from selling, upon the account holder's specific instruction, an account asset to a trust company officer or director. You also ask whether Property Code §113.054 prohibits the trust company from selling an asset in an IRA custodial account to another IRA custodial account for which the company serves as custodian if both the selling and purchasing IRA custodial account holders specifically direct the trust company to process the transaction.

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[4] We note that the Texas Credit Title also limits insurance charges that may be assessed in connection with retail installment sales contracts subject to Finance Code Chapter 345 and motor vehicle retail installment contracts subject to Finance Code Chapter 348. Neither Chapter 345 nor Chapter 348 authorizes the inclusion of a fee for default shortfall insurance.

[5] 7 TAC §12.32(a)(2). Rule 12.32 is in need of amendment in that it erroneously purports to permit such loan fees on a consumer loan with one installment while prohibiting the fee on a consumer loan with two or more installments. The Texas Credit Title has subsequently been amended to eliminate the distinction. *See* Finance Code §34.203(e).

[6] A state bank may offer default shortfall insurance and charge a fee for the coverage to a consumer if the installment loan bears an interest rate of ten percent or less. However, the bank should consider that the fee could become unauthorized if the fee is included in "interest" by a court and the inclusion causes the interest rate to exceed ten percent.

[7] Finance Code §306.001(5) defines "commercial loan" to mean "a loan that is made primarily for business, commercial, investment, agricultural, or similar purposes."

Summary Response:

Property Code §§113.053 and 113.054 apply only to an express trust. The custodian of a self-directed IRA is not the trustee of an express trust unless the account documentation directly states that a trust is created or indirectly does so by, for example, referring to the custodian as trustee or the assets as trust property. Therefore, a custodian of a properly structured IRA custodial account may:

- sell an IRA custodial account asset to an officer or director of the custodian upon the account holder's specific instruction, notwithstanding Property Code §113.053; and

- sell an asset in one IRA custodial account to another IRA custodial account if both the selling and purchasing IRA custodial account holders specifically direct the custodian to process the transaction, notwithstanding Property Code §113.054.

However, the custodian is subject to applicable Internal Revenue Code provisions relevant to conflicts of interest and prohibited transactions between account holders and trustees or custodians.

Facts and Representations:

You explain that Trust Company serves as custodian of IRA custodial accounts. As custodian, Trust Company invests account funds and sells account assets only upon and in accordance with the account holders' written instructions. Trust Company does not make investment decisions or otherwise exercise any discretion with respect to the accounts. Nor does Trust Company give investment advice or offer any investment products. You emphasize that Trust Company acts only as custodian and *does not* serve as trustee of the accounts.[1]

You further advise that many IRA custodial account holders direct that funds in their accounts be used to purchase church bonds and that Trust Company makes the purchases upon receipt of the account holders' written instructions.[2] Occasionally, an account holder advises Trust Company that he or she desires to sell an unmatured church bond. Trust Company advises the account holder that Trust Company may not buy or sell the bond for its own account, but that, if the account holder finds a purchaser, Trust Company will sell the bond upon receipt of the account holder's written instructions. At times, Trust Company gives information about the account holder's offer to sell to Trust Company officers and directors, who then purchase the bond in response to and upon the account holder's instructions to sell. In other instances, the IRA custodial account holder arranges to sell the bond to another IRA custodial account for which Trust Company also acts as custodian. The selling account holder directs Trust Company in writing to sell to a specific account holder at a specific price. The purchasing account holder directs Trust Company in writing to purchase the specific bond at a specific price from a specific account holder. Upon receipt of these written directions, Trust Company processes the transactions in accordance with their terms. Your questions arise because the Department's trust examiners have questioned whether the Texas Trust Code permits these sales to an Trust Company officer or director or from one IRA custodial account to another.

Discussion:

A. <u>Statutory Analysis</u>

Property Code, Title 9, Subtitle B, commonly referred to as the Texas Trust Code ("Trust Code"), governs the creation and administration of trusts in this state. Sections 113.053 and 113.054, the statutes about which you ask, are included within the Trust Code and pertain to trustee conflicts of interest. Section 113.053 generally prohibits a trustee from directly or indirectly buying or selling trust property from or to an employee, officer or director of the trustee. Section 113.054 prohibits the trustee of one trust from selling trust property to another trust for which it also serves as trustee unless the property is an obligation issued or fully guaranteed by the United States government. We note that if §113.053 and §113.054 do apply to the custodian of an IRA custodial account, only the §113.053 prohibition against the sale of an

[1] Further account documentation does not directly state that a trust is created, or indirectly do so by, for example, referring to Trust Company as trustee or the IRA assets as trust property.

[2] The bonds are registered to Trust Company in the capacity of IRA custodian for the name of the individual account holder.

account asset to an employee, officer or director of the trustee is problematic. Section 113.059(a) would permit an IRA custodial account holder, by means of a trust indenture provision, to remove the §113.054 restriction and authorize Trust Company to process the sale and purchase of account assets between different IRA custodial accounts for which Trust Company serves as custodian. Section 113.059(b), however, explicitly provides that a corporate trustee may not be relieved of the §113.053 prohibitions against self-dealing.[3]

By its terms, the Trust Code applies only to an express trust.[4] To answer your question, we must determine whether an IRA custodial account is an express trust to which the Trust Code, and, therefore, §113.053 and §113.054, apply. Before addressing that question, however, we believe it helpful to examine the nature of an IRA. Internal Revenue Code §408[5] authorizes the establishment of and provides tax benefits for a variety of individual retirement arrangements intended to encourage and provide a means for individuals to plan and save for their retirement. One such arrangement is the IRA, defined in Internal Revenue Code §408(a) as "a trust created or organized in the United States for the exclusive benefit of an individual or his beneficiaries." An IRA, which is established by written document and must satisfy certain statutory criteria,[6] is basically a tax deferment savings plan. The account holder contributes funds to his account for investment, and the income earned on account assets is not taxed until money is withdrawn after the account holder reaches a certain age, presumably when he is retired and may be in a lower income tax bracket. The account is subject to the absolute control of the depositor who may, subject to penalties, terminate the account or make early withdrawals from it at will.

Many IRAs are referred to as "self-directed," meaning the depositor makes all the decisions with respect to the investment and disposition of account assets. A self-directed IRA may be set up as either a trust or a custodial account.[7] If the depositor establishes his or her self-directed IRA as a trust, the trustee receives the funds in trust and deposits, invests and distributes them according to the depositor/settlor's instructions.[8] Many times the trustee also acts as the account custodian. If the depositor establishes his self-directed IRA as a custodial account, the custodian acts as the depositor's bailee and agent. As bailee, the custodian does not have legal title to the depositor's property, but rather has possession of and safekeeps the property under the custodial agreement. As agent, the custodian is subject to the control of the principal; he collects and pays out the income earned on the account assets, and buys, sells, receives and delivers the assets when instructed to do so by the depositor. Although the custodian owes a fiduciary duty to the principal with respect to matters within the scope of the agency, the relationship is not a trust.

Internal Revenue Code §408(a) provides that "the term 'individual retirement account' means a *trust* . . . ." Internal Revenue Code §408(h), however, deals specifically with custodial accounts and provides that:

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[3] *See also* Property Code §111.002(a), which provides that the terms of the trust control in the event of a conflict between the trust and subtitle B, except that the settlor may not relieve a corporate trustee from its duties, restrictions and liabilities under §113.053.

[4] Property Code §111.003.

[5] 26 U.S.C.A.§408 (1986).

[6] *Id*., §408(a). Section 408(a) specifies the qualifications of the trustee or custodian, limits the amount of allowable annual contributions and requires contributions to be in cash (except for rollovers), prohibits account funds from being used to buy life insurance, limits the combining of account assets with other property, and provides that the account holder's interest in the account balance is nonforfeitable.

[7] Whether the self-directed IRA is a trust or a custodial account depends upon the form of the account and the governing documentary language.

[8] Even though a self-directed IRA trust is *technically* a trust, the trustee's fiduciary duties are determined by and limited to the specific terms of the agreement establishing the IRA trust and related documents, and therefore may not encompass the broad range of legal rights, duties, and responsibilities typically imposed upon a trustee. *See Metz v. Independent Trust Corp*., 994 F.2d 395 (7th Cir. 1993) (trustee of self-directed IRA, as non-discretionary trustee, merely obligated to follow the directions of the settlor and, as a result, had no duty to disclose to settlor that particular loan was prohibited transaction under Internal Revenue Code); *Brown v. California Pension Administrators & Consultants, Inc*., 45 Cal.App.4th 333 (Cal. Ct. App. 1996) (duties and liabilities of trustee of self-directed IRAs limited to those expressly set out in the documents establishing the relationship among the parties and governing the IRA accounts and, because of limited nature of fiduciary relationship established by documents, trustee had no duty to notify IRA account holders that borrower of their funds had defaulted in payments to other account holders).

> *For purposes of this section*, a custodial account shall be treated as a trust . . . if the custodial account would, *except for the fact that it is not a trust*, constitute an individual retirement account described in subsection (a). *For purposes of this title*, in the case of a custodial account treated as a trust by reason of the preceding sentence, the custodian of such account shall be treated as the trustee thereof.

The express language of §408(h) confines the treatment of a custodial account as a trust, and the custodian as a trustee, to Internal Revenue Code §408. Section 408(h) thus evidences Congress' recognition that, although a custodial account will be treated as a trust in order to qualify as an IRA under §408(a) and receive the statute's tax benefits, a custodial IRA does not necessarily constitute a trust for any purpose other than income tax purposes.[9]

We do not believe that the characterization and treatment of an IRA custodial account as a trust for income tax purposes compels the conclusion that such an account is a trust under Texas law. The provisions of the Texas Trust Code, not the Internal Revenue Code, determine whether an IRA custodial account is a trust.

As stated previously, the Trust Code applies only to express trusts. Trust Code §111.004(4) defines an "express trust" as:

> A fiduciary relationship with respect to property which arises as a manifestation by the settlor of an intention to create the relationship and which subjects the person holding title to the property to equitable duties to deal with the property for the benefit of another person.

This definition establishes certain elements that must be present for the creation of an express trust. First, the settlor must demonstrate that he intends to create a trust — that he intends the trust property to be held in trust for his benefit or that of another, and that he intends the legal title to the trust property to pass to the trustee. Trust Code §112.002 specifically states that "a trust is created *only if* the settlor manifests an intention to create a trust." Thus, the settlor's intent ultimately determines whether a transaction creates a trust. Without a showing of the requisite intent, an express trust simply does not exist.[10] Although no particular words are necessary, the settlor's intent must be sufficiently expressed and shown with reasonable certainty, generally through an explicit declaration of trust in the attendant documents.[11] Other elements ordinarily required for the establishment of an express trust include the settlor's transfer of the legal and equitable ownership of the trust property. Legal title must immediately pass to the trustee, and the beneficial or equitable title to the beneficiary.[12]

We have reviewed the self-directed IRA custodial account application and other account-related documents you have submitted and considered your representations concerning the activities undertaken by Trust Company in connection with IRA custodial accounts for which Trust Company serves as custodian. Applying the requirements discussed above, we conclude that the IRA custodial accounts lack the requisite elements to constitute express trusts under Texas law. Nothing in the account documentation we reviewed suggests, directly or indirectly, that the account holder, the person who established the custodial account, intends to establish a trust. The documents refer to Trust Company as "custodian", the account holder as "depositor", and the account as a "custodial" account. Moreover, to establish the accounts, Trust Company and the depositor utilized IRS Form 5305-A, the custodial form, rather than IRS Form 5305, the trustee form. Additionally, Trust Company has no legal or equitable ownership interest in or right to the IRA custodial account assets; if it

[9] Texas law also recognizes that an IRA custodial account is different from an IRA trust and, further, that a custodial account may not be a trust under state law. Trust Code §111.004(20) defines an "individual retirement account" as a "trust, *custodial arrangement* or annuity under §408(a) or (b), Internal Revenue Code of 1954 (26 U.S.C.A. Sec. 408 (1986))." Moreover, §113.053(f) expressly excepts certain activity from the prohibition against self-dealing by an institution serving as custodian of an IRA "*regardless of whether the custodial account is, or would otherwise be, considered a trust for purposes of this subtitle* . . . ." This provision, which clarifies that certain activities are permissible even if a particular custodial account is also a trust, recognizes that a custodial account may not be a trust for purposes of the Trust Code.

[10] *Rippstein v. Unthank*, 380 S.W.2d. 155 (Tex. Civ. App.–Amarillo), *rev'd on other grounds*, 386 S.W.2d 134 (Tex. 1964).

[11] Conceivably, the requisite intent to form a trust may be inferred from more indirect documentary language such as, for example, identifying the custodian as trustee or the assets as trust property.

[12] *Cutrer v. Cutrer*, 334 S.W.2d 559, 605 (Tex. Civ. App.–San Antonio 1960).

holds "title" to the assets at all, it does so only as the account holder's nominee. The requisite transfer of legal title to a trustee is thus absent.[13]

Based upon the foregoing, we conclude that deposits into the self-directed IRA custodial accounts do not constitute trust property and that Trust Company, as custodian, is not a trustee. The arrangement is not an "express trust" within the meaning of the Trust Code.[14] As a matter of state law, the IRA custodial accounts instead appear to simply be custodial agency accounts in which Trust Company, as bailee, has the obligation to preserve and safekeep the property entrusted to the company by its principal, the IRA custodial account holder, and to deal with that property in accordance with the account holder's instructions and the terms of the custodial agreement. As agent, Trust Company's actions are directed and controlled by the account holder through the terms of the contract and Trust Company performs no acts that are not specifically required and authorized by the agreement.[15]

B. Texas Cases

In reaching our conclusion, we have reviewed Texas cases that address the substantive nature of an IRA. We have found no case that specifically considers whether a self-directed IRA established strictly as a custodial account is an express trust under the Trust Code. Several Texas cases do, however, consider self-directed IRAs set up as trusts where the trustee also serves as custodian. In *Lee v. Guitierrez,*[16] IRA depositors with accounts at a defunct savings and loan association contended that the funds in their IRA accounts were trust funds under Texas law, and claimed priority over the association's general depositors upon the institution's liquidation. The court recognized that the IRA was a trust under the Internal Revenue Code, but characterized it as a "unique" trust — the depositor who created it was both the settlor and primary beneficiary, and he, not the trustee, had the authority to decide how the account assets were to be invested. The court analogized the IRA account to a safe deposit box, and the account assets to the box's contents, and concluded that the assets were not held in trust and that the IRA account holders were therefore not entitled to the claimed status of trust beneficiaries.

In *Colvin v. Alta Mesa Resources, Inc.*,[17] an IRA account holder argued that he could not legally assign his interest in the account assets because the IRA was a "true" trust in which he merely had a beneficial interest; only the trustee bank, as owner of the legal title, had the authority to assign the account assets. The court rejected the account holder's argument, noting the unique nature of an IRA and repeating the *Lee* court's "safe deposit box/contents" analogy. The court held that the IRA depositor owned the assets in his account and could therefore assign those assets without the consent of the trustee bank.

We do not believe that *Lee* or *Colvin* should be read to mean that a self-directed IRA *set up strictly as a custodial account* constitutes an express trust under Texas law, or transforms the custodian into a trustee and the account assets into trust funds. Indeed, we believe the courts' holdings, and their use of the safe deposit box analogy, support our conclusion that the custodial accounts in question are simply bailments coupled with an agency.

[13] The account holder of an IRA custodial account does not transfer to the custodian legal title to the property the account holder contributes to the account or account assets; rather, the account technically owns the legal title and the account holder owns the account. No other person has a legal or equitable interest.

[14] Nor do we think that the Trust Company IRA custodial accounts constitute trusts under the common law, generally a civil remedy imposed to address demonstrated abuse or wrongdoing.

[15] *See generally* SCOTT ON TRUSTS §5.1, §8.1.

[16] 876 S.W.2d 382 (Tex. App.–Austin 1994, writ denied).

[17] 920 S.W.2d 688 (Tex. App.–Houston [1st Dist.] 1996, writ denied).

C. *Cases from Other Jurisdictions*

In addition to researching Texas case law, we have reviewed cases from other jurisdictions. Courts in several jurisdictions have analyzed custodial accounts as we have and concluded that a self-directed custodial IRA, although treated as a trust for federal income tax purposes, is not a trust for other purposes because the account does not satisfy state law requirements relating to the establishment of a trust.[18] These courts emphasize the absence of any manifestation, either through conduct or the documents creating the account, that the person establishing the account intends to create a trust. They also cite the fact that the custodian has no interest in the account assets and that the transfer and separation of titles required for the creation of a trust is therefore missing.

Admittedly, courts in several other jurisdictions have reached a contrary conclusion and have found that an IRA is a trust;[19] however, only a few of those cases dealt with an explicitly custodial arrangement. The cases have generally arisen in the context of a bankruptcy proceeding and/or have involved an attempt by a custodian bank to set off IRA account assets against a general indebtedness owed by the IRA account holder, an action courts have found impermissible for a variety of reasons. We find these cases either distinguishable, unpersuasive, or actually supportive of our conclusion. In those cases in which the court has concluded that a custodial account is a trust and therefore not subject to offset or creditors' claims, reliance has been placed upon the language of 408(a) that an IRA is a trust, as well as the section's provision that an account holder's interest in the account is nonforfeitable. Generally, no issue has been raised as to whether the account is a trust or whether the trustee holds legal title to the account assets. In cases in which the nature of an IRA as a "true" trust has been an issue, the courts have found a trust to exist because the documents establishing the custodial account refer to "trust", "trustee", "trust assets" and "trust investments".

D. *Federal Banking Agencies*

We further note that, although no federal banking regulatory agency appears to have addressed the issue directly, published regulatory materials of several agencies imply that they would concur in our conclusions. For example, federally regulated financial institutions that engage in retail securities brokerage must comply with the guidelines established by the "Interagency Statement on Retail Sales of Nondeposit Investment Products," dated February 15, 1994 (Interagency Statement).[20] The interagency statement establishes minimum operating standards for retail brokerage programs that help mitigate risks to both the financial institution and the consumer. However, these standards generally do not apply to fiduciary accounts administered by a depository institution, primarily because fiduciary accounts are governed by other standards of care and prudence, but do apply to accounts where the customer directs investments, such as IRA custodial accounts.[21]

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[18] *See, e.g.*, *In re Houck*, 181 B.R. 187, 191 (Bankr. E.D. Pa. 1995); *First Nat. Bank of Blue Island v. Philp*, 436 N.E.2d 15 (Ill. App. Ct. 1982); *Abrahams v. New York State Tax Comm'n*, 500 N.Y.S.2d 965, 966 (N.Y. Sup. Ct. 1986); *Estate of Davis*, 217 Cal.Rptr. 734, 736 (Cal. Ct. App. 1985); *also see* discussion of collected cases in *In re Fulton*, 240 B.R. 854, 865-868 (Bankr. W.D. Pa. 1999); *Cf. Hall v. Duncan Savings & Loan Assoc.*, 820 P.2d 1360 (Okla. Ct. App. 1991).

[19] *See, e.g.*, *In re Yuhas*, 104 F.3d 612, 614 (3rd Cir. 1997) (Stating custodial IRA is not necessarily an express trust unless *state law* makes it so); *In re Hipple*, 225 B.R. 808, 813 (Bankr. N.D. Ga. 1996) (Custodial IRA met *state law* test for formation of an express trust); *In re Estate of Davis*, 589 N.E.2d 154, 161-162 (Ill. App. Ct. 1992) (Stating custodial IRA is not an express trust, court found IRA at issue was explicitly formed as a trust); *McCarty v. State Bank of Fredonia*, 795 P.2d 940, 943-944 (Kan. Ct. App. 1990) (IRA at issue met *state law* test for formation of an express trust).

[20] Federal Deposit Insurance Corporation ("FDIC"), Financial Institution Letter 9-94 (Feb. 17, 1994). The Interagency Statement sets forth the collective views of the four federal banking agencies, each of which has published the Interagency Statement in its own regulatory materials. The four federal banking agencies are the Board of Governors of the Federal Reserve System ("FRB"), the FDIC, the Office of the Comptroller of the Currency ("OCC"), and the Office of Thrift Supervision ("OTS").

[21] *Id.*; *also see* FDIC Financial Institution Letters 80-98 (July 16, 1998) and 61-95 (Sept. 12, 1995). Additional supporting statements can be gleaned from other published materials. *See, e.g.*, FDIC Financial Institution Letter 48-97, page 13 (May 7, 1997) (A bank need not possess trust powers to offer self-directed custodial accounts); OCC Interpretive Letter No. 394 (Aug. 24, 1987) (A national bank must obtain trust powers prior to acting as trustee under Starker Trust agreements (used to facilitate a time-delayed, tax-free exchange of real property under Section 1031 of the Internal Revenue Code) even though its duties may be non-discretionary, because the arrangements appear to establish express trusts, unlike arrangements such as escrow, safekeeping and custody, including custodial, self-directed IRAs and Keogh plans).

Conclusion:

To summarize, we conclude that the IRA custodial accounts for which Trust Company serves as custodian are not express trusts under the Trust Code and are therefore not subject to §113.053 or §113.054. Accordingly, §113.053 does not prohibit Trust Company, as custodian of such accounts, from selling, upon the account holder's specific instruction, an account asset to a trust company officer or director. Nor does §113.054 prohibit Trust Company from selling an asset in one IRA custodial account to another IRA custodial account if both the selling and purchasing IRA custodial account holders specifically direct Trust Company to process the transaction.

We caution, however, that in our opinion the transactions in question carry substantial potential for abuse, particularly since no viable or established secondary market exists for IRA custodial account holders who wish or need to sell their church bonds prior to maturity. It is therefore essential that Trust Company strictly adhere to the policies and procedures set out in your letter in connection with these sales and purchases. We also caution that, even though the self-directed IRA custodial accounts are not trust accounts and Trust Company is not a trustee for purposes of state law under the Trust Code, *Trust Company is treated as a trustee for purposes of Section 408 of the Internal Revenue Code*. As such, Trust Company is subject to applicable Internal Revenue Code provisions relevant to conflicts of interest and prohibited transactions between account holders and trustees or custodians. Department examiners will continue to review Trust Company's activities for possible abuse.

Our determination is based upon the facts and circumstances set out in your correspondence with the Department and the specific terms of the Self-Directed IRA Custodial Agreement and other related documents submitted for our review. Any change in those facts or circumstances, or in the terms of the Agreement, may result in a different conclusion.

Opinion No. 01-10

A loan to a public junior college is exempt from the legal lending limit if it is a legally created general obligation of the public junior college and the lending bank has obtained an opinion of counsel that the loan or extension of credit is a valid and enforceable general obligation of the college.

July 13, 2001
Steve Martin, Assistant General Counsel

By letter dated June 5, 2001, you requested our opinion as to whether a loan or extension of credit to a public junior college is exempt from the legal lending limit. As discussed more fully below, a public junior college is exempt from the legal lending limit if the loan or extension of credit is a legally created general obligation of the public junior college and the lending bank has obtained an opinion of counsel that the loan or extension of credit is a valid and enforceable general obligation of the college.

Facts

You state that a Personal Property Finance Contract ("PPFC") currently exists between [***] Junior College ("College") and [Bank]. College is a public junior college located in [***], Texas. Bank regularly provides banking services for College. You state that a credit facility of the size of the PPFC , if considered part of the legal lending limit, would severely impact the availability of credit to College. Consequently you seek our opinion on whether the PPFC is covered by, or exempt from, the legal lending limit requirement.

Analysis

Pursuant to §34.201(a) of the Texas Finance Code, the total loans and extensions of credit outstanding at any time by a state bank may not exceed 25% of the bank's capital and certified surplus.[1] You have suggested in your letter that your inquiry is resolved by Finance Code §34.201(a)(8) which provides an exemption from the legal lending limit for "the portion of an indebtedness that this state, an agency or political subdivision of this state, the United States, or an instrumentality of the United States has unconditionally agreed to purchase, insure, or guarantee." However, §34.201(a)(8) does not apply to direct loans to a governmental entity.[2] The Department of Banking has issued several opinions discussing the application of this section. *See e.g.* Opinion No. 99-40 (January 19, 2000).
The issue in this case, however, is addressed by 7 TAC §12.6(c), which provides an exemption from the legal lending limit for "a loan or extension of credit to this state or an agency or political subdivision of this state . . . to the extent the loan or extension of credit constitutes a legally created general obligation of the borrower, if the lending bank has obtained an opinion of counsel that the loan or extension of credit is a valid and enforceable general obligation of the borrower." 7 TAC §12.6(c).

To determine if the exemption created by 7 TAC §12.6(c) applies in the instant case, we look, first, to discern whether the loan or credit is extended to this state or an agency or political subdivision of this state and, second, whether the loan or extension of credit constitutes a legally created general obligation of the borrower and the lending bank has obtained an opinion of counsel that the loan or extension of credit is a valid and enforceable general obligation of the borrower. College is a creature of state law with tax assessment and collection authority. Education Code §130.0011. College is also funded with legislative appropriations from the Texas Legislature. All indications point to College being a political subdivision of the State.

The loan must also be a legally created general obligation of the borrower. A general obligation is payable from general revenue rather than from a special fund. The PPFC provides that the final College budget of each fiscal year shall set aside and appropriate out of the limited tax and other revenues and funds lawfully available an amount sufficient to make payments for the PPFC. The PPFC also provides that the College has levied and the College agrees to assess and collect a continuing and direct ad valorem tax at a rate from year to year sufficient together with revenues and funds lawfully available to the College to make payments for the PPFC. (PPFC §111.1, page 7.) Based on a review of the PPFC, it appears that the loan represents a general obligation of the College. However, as noted above, 7 TAC §12.6(c) also requires an opinion from Bank's legal counsel to the effect that the loan or extension of credit is a valid and enforceable general obligation of the borrower. Such a letter has not been presented in the instant case. The bank would be required to have such an opinion letter in its possession in order to utilize the exemption from the legal lending limit provided by 7 TAC §12.6(c).

Conclusion

Subject to your representations, we conclude that a loan or extension of credit to a public junior college may be exempt from the legal lending limit under 7 TAC §12.6(c) if the loan or extension of credit is a legally created general obligation of the public junior college and the lending bank obtains an opinion of counsel that the loan or extension of credit is a valid and enforceable general obligation of the college.

Our conclusion should not be construed as an endorsement of the proposed loan. A bank must heed the underlying purpose of the legal lending limit, reduction of risk by preventing one individual, or a relatively small group, from borrowing an unduly large amount of the state bank's funds. Further, while a bank is clearly empowered to make loans as described in this opinion in an amount well in excess of the bank's legal lending limit, the bank in question must have the ability,

[1] *Effective September 1, 2001, this limitation is stated as "25% of the lesser of bank's capital and certified surplus or total equity." Act of May 22, 2001, 77th Leg., H.B. 2155, §12.*

[2] *Effective September 1, 2001, Finance Code §34.201(a)(8) exempts "the portion of an indebtedness that this state, an agency or political subdivision of this state, the United States, or an instrumentality of the United States has unconditionally agreed to repay, purchase, insure, or guarantee." Act of May 22, 2001, 77th Leg., H.B. 2155, §12, effectively including direct repayment obligations of the listed governmental entities within the exemption.*

capacity, and commitment to appropriately evaluate and manage the risks inherent in such lending activities. Thus, these types of loans will be closely scrutinized by the Department of Banking examiners to monitor the bank's adherence to its policies and procedures and to ensure that the bank is administering such loans in a manner that is consistent with safe and sound banking practices.

Finally, this opinion is limited to the facts and circumstances set forth in your letter of June 5, 2001. Any change in those facts, circumstances, or the stated assumptions underlying our opinion may result in a different opinion.

Opinion No. 01-12

A bank may accept 12b-1 fees in connection with investment of trust assets in the related mutual funds if the compensation is disclosed.

Robin Robinson, Assistant General Counsel
August 10, 2001

In your June 15, 2001 letter, you seek our opinion whether [Bank] may accept 12b-1 fees in connection with investment of trust assets in the related mutual funds. Bank may accept the 12b-1 fees if it discloses the compensation.

Background

The Securities and Exchange Commission issued Rule 12b-1 (12 C.F.R. §_270.12b-1) pursuant to 12(b) of the Investment Company Act of 1940 (15 U.S.C. §_80a-1, et seq.). The rule permits electing mutual funds (12b-1 funds) to use fund assets to sell or distribute fund shares and to compensate third parties in connection with the sale or distribution. Some bank fiduciaries invest trust assets in 12b-1 funds and receive 12b-1 "service" fees from the funds. The 12b-1 fees are generally calculated as a percentage of the amount of trust assets invested by the bank in the 12b-1 fund.

From time to time, Bank determines that the most appropriate investment for particular trust funds is a 12b-1 fund and it receives 12b-1 fees without correspondingly reducing its trust account compensation. Bank seeks an opinion on whether this is permissible. For the purpose of making this determination, Bank acknowledged its exacting fiduciary duty to make decisions concerning the investment of trust assets based exclusively on what is in the best interest of its trust customers. Bank also represented that it will acquit itself of this fiduciary duty fully, completely, and carefully and that it will always follow the exact terms of the governing instrument of the trust, the applicable law, and the prudent investor rule.

If we conclude that Bank's acceptance of the 12b-1 fees is permissible, Bank asks the following questions: (1) what are the disclosure requirements? and (2) can Bank use the 12b-1 fees it receives to pay for services that benefit trust clients?

Discussion

A conflict arises when a trustee accepts 12b-1 fees in connection with investment of trust assets in related mutual funds because the compensation has the potential to induce the trustee to invest in a 12b-1 fund even if better or more suitable investments are readily available in the marketplace. Nevertheless, the practice is specifically authorized in Texas Property Code §_113.053(g) if the compensation is disclosed. This statutory authorization, however, is subject to the trustee's fiduciary duty to appropriately manage the resulting conflict by applying a heightened level of scrutiny to determine whether investment in a 12b-1 fund best meets the purpose of the investing trust. Bank represented that it unqualifiedly fulfills this heightened level of responsibility. Therefore, we do not further address the issue in this discussion.

As to Bank's question on what disclosure is required for accepting 12b-1 fees, we believe initial disclosure should be made through authorization in governing instruments. We further believe that disclosure must be made in at least annual account statements showing the fees as a separate line item stated in dollars and cents and the total amount of fees attributed to the account since the previous statement.

Finally, if 12b-1 fees are authorized and appropriate, the fees charged become Bank property and may be used for any legitimate business expense, whether or not it is trust related.

Conclusion

Bank may accept 12b-1 fees in connection with investment of trust assets in related mutual funds if it discloses the compensation. This conclusion is based on the facts and representations in Bank's June 15, 2001 letter. Any change in those underlying facts or representations may result in a different opinion.

Opinion No. 01-14

A lender may modify a home equity loan by reducing its interest rate and changing the payment amounts and/or the number of monthly payments without going through all of the steps of a loan refinancing. The lender and a borrower may agree to a modification at any time, even if it is within a year of closing this or another home equity loan secured by the same homestead.

December 20, 2001
Randall S. James, Commissioner, Texas Department of Banking
Leslie Pettijohn, Commissioner, Office of Consumer Credit Commissioner
James L. Pledger, Commissioner, Texas Savings & Loan Department
Harold E. Feeney, Commissioner, Texas Credit Union Department

By letter to Everette D. Jobe, General Counsel of the Texas Department of Banking dated October 3, 2001, you asked whether it is permissible to modify, rather than refinance, a home equity loan to reduce the interest rate and change the payments accordingly.

Summary:

A lender may modify a home equity loan by reducing its interest rate and changing the payment amounts and/or the number of monthly payments without going through all of the steps of a loan refinancing. The lender and a borrower may agree to a modification at any time, even if it is within a year of closing this or another home equity loan secured by the same homestead.

May a home equity loan be modified?

A loan modification is a transaction where an existing note is modified, but the note is not cancelled. In a modification, a lender and a borrower may agree to extend the term of the loan, change the interest rate, change the monthly payments, etc. If the existing note is cancelled and a new note is signed to replace it, the transaction is generally considered a loan refinance. The permissibility of refinancing of home equity loans is discussed in the Regulatory Commentary on Equity Lending Procedures (October 7, 1998), jointly issued by the below-signed state regulatory agencies.

Section 50(a)(6) does not specifically allow or even mention modifications of home equity loans. Elsewhere, the constitution provides that a refinance secured by the homestead, any portion of which is a home equity loan, may not be secured by a valid lien against the homestead unless the refinance of the debt is a home equity loan.[3] Thus, while the framers of these provisions of the constitution did include restrictions on refinancing a home equity loan, the constitutional provisions on home equity loans are silent on the application of common mortgage industry practices, such as modifications.

Inherent in an issue as complex as home equity lending are details that simply cannot be fully addressed within the text of the constitutional amendment. Different statutes and constitutional provisions govern the various aspects of credit transactions, specifically loans, including home equity loans. The home equity lending constitutional amendment and other laws affecting mortgage lending, particularly the Texas Finance Code, are separate and distinct layers of regulation, which may all, to some degree, apply to one or more aspects of a home equity loan. In reviewing home equity lending, these agencies must consider and administer all of these laws, as applicable, and not merely any one distinct layer. Section 50 addresses the elements necessary to create a valid lien on a homestead and the consumer protections the framers deemed necessary. Some of these protections may limit the ability of a lender to do things otherwise permissible in the context of a

[3] Tex. Const. art. XVI, §50(f).

home loan that is not a home equity loan. To the extent that the provisions of the constitution can be reconciled with provisions of other Texas law applicable to mortgage lending, home equity lending will be governed by both.

A first or secondary home equity loan may be modified provided the modification is not contrary to any of the express requirements of the constitution. For instance, the loan may not be modified to give the lender recourse for personal liability against any owner or the spouse of any owner. A modification to increase the principal amount advanced would be prohibited because it would have the effect of turning the home equity loan into a line of credit, which is expressly prohibited. These are examples, and there may be other instances where terms of a modification would be in conflict with the constitution.
A lender may unilaterally modify a home equity loan to comply with a legal requirement, but if an owner rejects the modification, the borrower has the right to pay off the existing balance of the loan at the rate and over the time period in effect prior to the proposed modification. The lender may not accelerate the loan solely on the basis of the rejection of the modification.

This opinion does not address the appropriateness of charging fees associated with a modification.

May a home equity loan be modified within one year of its anniversary date?

A home equity loan in Texas must "not be closed before the first anniversary of the closing date of any other home equity loan secured by the same homestead property" TEX. CONST. art. XVI, § 50(a)(6)(M)(ii). Does this provision prohibit modifying a home equity loan prior to its one-year anniversary date?

The constitutional amendment requires that an equity loan may not be closed before the first anniversary of the closing date of any other equity loan secured by the same homestead property. This provision requires that a refinancing of an equity loan may not be closed before one year has elapsed since the closing date of any other equity loan secured by the same homestead property. However, because modification of a home equity loan does not involve a closing and is legally different from a refinancing, a home equity loan may be modified before the first anniversary of the closing date of any other equity loan secured by the same homestead property.

How does the requirement of substantially equal successive monthly installments affect modification?

A home equity loan must be scheduled "to be repaid in substantially equal successive monthly installments…each of which equals or exceeds the amount of accrued interest as of the date of the scheduled installment." TEX. CONST. art. XVI, § 50(a)(6)(L). However, in modifying a home equity loan, a lender may find it difficult to keep the monthly installments "substantially equal" to the loan's original monthly installments. In fact, a modified home equity loan with monthly installments substantially the same as originally contracted would likely circumvent the purposes and objectives of the Soldier's and Sailors Civil Relief Act of 1940(the "SSCRA").

Because variable rate loans, which often have changing installments, are specifically permitted under subsection (a)(6)(O), the framers and ratifiers apparently intended to allow reasonable variation from subsection (a)(6)(L) in limited situations. The below-signed regulators agree that a mutually agreed upon loan modification resulting in substantially equal post-modification monthly installments that differ from the pre-modification monthly installments would be acceptable.

Authority of Responding Agencies

Because the constitutional provision[4] for home equity lending provides no mechanism for agency interpretation, no state agency has authority to interpret it. This letter is not, therefore, an interpretation but a statement as to how the four agencies issuing this letter would, absent judicial precedent to the contrary, view home equity loan modifications.

[4]Tex. Const. art. XVI, §50(a)(6).

The consumer credit commissioner has the powers and performs all duties relating to the issuance of a license under Finance Code, Title, 4, Subtitle B and is responsible for the other administration of the subtitle except as provided by this Finance Code Chapter 341, Subchapter B.[5] The banking commissioner has enforcement authority relating to the regulation of a state bank operating under Finance Code, Title 4, Subtitle B.[6] Likewise, the savings and loan commissioner has enforcement authority relating to the regulation of state savings associations and state savings banks operating under Finance Code, Title 4, Subtitle B,[7] and the credit union commissioner has enforcement authority relating to the regulation of state credit unions operating under Finance Code, Title 4, Subtitle B.[8] The Comptroller of the Currency, the Office of Thrift Supervision, and the Supervisor of Federally Chartered Credit Unions may enforce Finance Code, Title 4, Subtitle B, relating respectively to the regulation of national banks,[9] federal credit savings associations,[10] and federal credit unions[11] operating under Subtitle B.

The below-signed state regulatory agencies believe it is important to provide this guidance with respect to home equity loans to facilitate regulated lenders and investor's efforts, consistent with the intent of the Legislature, to meet the need of Texas consumers. This guidance is particularly momentous during this time when, pursuant to the SSCRA,[12] lenders may need to modify the rates on home equity loans to persons called to active military duty.[13]

The position on loan modification presented in this letter is the opinion of each of the state administrative agencies responsible for regulating certain entities making these loans. Lenders must be aware however that a court may or may not defer to this letter in resolving a dispute between a borrower and a lender.

Opinion No. 02-01

Loans under Lessor's leasing program as proposed will be aggregated to Lessor and not considered loans to lessees because Lessor will control lessee relationships with Bank. Specifically, loan payments will be handled by Lessor and not made directly to Bank by lessees as required by 7 TAC §12.7(b)(5). Further, Lessor's negotiation and control of the lease payments extend beyond the activities permitted for a servicing agent.

February 14, 2002
Robin Robinson, Assistant General Counsel

This opinion is in response to your January 3, 2002 opinion request concerning whether loans from [a Texas state bank (Bank)] to [ABC] Leasing, Inc. (Lessor) will be considered loans to the lessees under 7 TAC §12.7(b).

Summary of Opinion:

A loan to fund leases of person property through a leasing company is not considered a loan to a lessee if the leasing company receives the lease payments, deposits or otherwise negotiates the payment checks, deducts expenses from these funds, and then forwards the remaining amount to the Bank, because this arrangement does not meet the requirements of 7

[5] Finance Code § 341.101

[6] Finance Code § 341.102(a).

[7] Finance Code § 341.103(a).

[8] Finance Code § 341.104(a).

[9] Finance Code § 341.102(b).

[10] Finance Code § 341.103(b).

[11] Finance Code § 341.104(b).

[12] 50 U.S.C. §§ 501 et seq.

[13] 50 U.S.C. § 526 applies to a loan made prior to the time the person entered the service (or prior to active duty in the case of reservists and National Guardsmen). A serviceman who obtains a loan while already in the service is bound by the contract terms. The Act applies to all persons on active duty in the Army, Navy, Air Force, Marines, Coast Guard, Public Health Service, as well as members of the Guard or the Reserves who have commenced active service.

TAC §12.7(b)(5) that lease payments must be paid by the lessee directly to the Bank. Further, Lessor's negotiation and control of the lease payments extend beyond the activities permitted for a servicing agent.

Facts:

Lessor proposes to offer its leasing program to Texas state-chartered banks. Under the program, participating banks perform an initial credit review and approve the extension of credit to an equipment lessee. Lessor works with the Bank to confirm the leasing transaction, the price and vendor for the equipment, and other pertinent details relating to the lease. Lessor also prepares the lease and other typical leasing documents that are executed by the Bank and lessee. The Bank sells the lease equipment and assigns the rights under the lease to Lessor. In turn, Lessor provides a non-recourse promissory note to the bank secured by the equipment and reassigns the lease to the Bank.

In the January 3, 2002 opinion request, payments on the note and lease are described as follows: "The monthly payments are made to a lock box for [Lessor], which deducts the monthly tax and remits the remaining payment to the Bank, which is applied as a reduction of the note and as payment of the Lease." We asked for additional information on this payment arrangement. On January 17, 2002, Lessor responded as follows:

> In connection with the execution of the leasing documents, [Lessor] receives the express authorization of the Bank to act as servicing agent with respect to lease payments made payable to the Bank by the Lessee and transmitted to a lock box administered by [Servicing Bank] on behalf of [Lessor]. [Lessor] accepts such payments as servicing agent for the Bank, and transmits the Bank's portion of the payment to the Bank immediately, within one (1) business day of receipt. A portion of each payment is retained by [Lessor] for payment of taxes directly to the relevant taxing authority.
>
> An ancillary issue that you raised relates to the fact that the coupon book given to the Lessee calls for payments under the lease to be made to the Bank. Accordingly, the actual instrument by which the payment is made is made payable to the Bank rather than [Lessor]. However, under the agreement that will be entered into between [Lessor] and each Bank, providing for [Lessor's] role as the servicer, the Bank will agree to and confirm that [Lessor] in the course of processing and servicing the leases, and collecting payments on them, may deposit, endorse, and otherwise deal with the check that is payable to the Bank.

Discussion:

Under 7 TAC §12.7(b), a loan to a leasing company for the purpose of purchasing equipment for lease is considered a loan to the lessee if the following conditions are met:

(1) the bank documents the basis for its reliance on the lessee as the primary source of repayment before the loan is extended to the leasing corporation,

(2) the loan is without recourse to the leasing corporation,

(3) the bank receives a security interest in the equipment and, in the event of default, may proceed directly against the equipment and the lessee for any deficiency resulting from the sale of the equipment,

(4) the leasing corporation assigns all of its rights under the lease to the bank,

(5) the lessee's payments are assigned and paid to the bank directly by the lessee, and

(6) the lease terms are subject to the same limitations that would apply to a state bank acting as a lessor under the Finance Code §34.204.

Lessor's program does not satisfy the condition in subsection (b)(5). Lessor receives the lease payments, deposits or otherwise negotiates the payments, deducts expenses from the resulting funds, and then forwards its own payment to the bank for the remaining funds, which is not a direct payment from the lessee to the Bank as the provision requires.

If subsection (b)(5) were otherwise met, the opinion request raises the issue of whether a leasing company could act as servicing agent for the Bank. As demonstrated in the cited OCC interpretive letter,[1] this is permissible when the activities of the leasing company are limited to collecting lease payments and submitting them to the Bank. Lessor's negotiation and control of lease payments are beyond these permitted activities and present the same safety and soundness concerns that disqualified consideration of the bank loans as loans to the lessees under 7 TAC §12.7(b)(5).

The remaining conditions in 7 TAC §12.7(b) appear to be satisfied under Lessor's program. Therefore, Lessor could restructure its lease payment arrangement to avoid being characterized as the borrower. An acceptable payment arrangement would require lessees to make payments directly to the Bank and send payments directly to the Bank or to a servicing agent whose activities are limited, as discussed. The Servicing Bank could act as the servicing agent.

Conclusion:

Loans under Lessor's leasing program will not be considered loans to lessees because the loan payments are not paid by lessees directly to the Bank as required by 7 TAC §12.7(b)(5).

Opinion No. 02-02
See Supervisory Memorandum 1010 regarding bank owned life insurance.

Opinion No. 02-03
A proposed loan will be aggregated under 7 TEX. ADMIN. CODE §12.9(g) with other loans to a borrower if the bank is relying on the borrower's guarantee and not primarily on the responsibility and financial condition of the obligor.

August 5, 2002
Robin Robinson, Assistant General Counsel

This letter is in response to your June 21, 2002 letter, on behalf of [***] Bank (the "Bank"), in which you ask about the applicability of the legal lending limit provisions of the Texas Finance Code and related regulations to certain of the Bank's existing and proposed loans.

Question Presented:

You ask us to determine the effect of 7 TEX. ADM. CODE §12.9 as applied to two existing loans and three proposed loans, with respect to an individual customer ("Borrower"). The Borrower is a co-borrower under and guarantor of the first existing loan and is the trustee of the trust-borrower under and guarantor of the second existing loan. The Borrower also controls each proposed borrower under the three proposed loans and proposes to guarantee each proposed loan.

Summary of Opinion:

Based on the facts as you have presented them, the first existing loan and one of the proposed loans must be attributed to the Borrower because the Borrower is or will be the expected source of repayment for each loan. Another of the proposed loans will be aggregated with other loans to the Borrower for purposes of legal lending limit analysis because the Bank is relying on the guaranty of the Borrower rather than the creditworthiness of the primary obligor.

Facts:

You provided the following facts in your letter and supporting documents:

[1] OCC Unpublished Interpretive Letter (October 21, 1987).

1. Existing Loan One for $221,775 was made to the Borrower and another individual. The Borrower is the primary source of repayment for the loan as well as guarantor of the loan.

2. Existing Loan Two for $52,656 was made to a trust for the Borrower's mother (the "Trust"). The Borrower is the trustee for the Trust and guarantor of the loan. You represent that the primary source of repayment for this loan is rental payments from tenants.

3. Proposed Loan One for $1,084,000 is proposed to be made to a corporation that owns two commercial warehouses leased to non-affiliated entities. The Borrower owns 50% of the corporation and proposes to be guarantor of Proposed Loan One. The purchase of the warehouses was financed by another bank and Proposed Loan One would refinance the prior notes and terminate the relationship between the corporation and the other bank. The stated primary source of repayment for Proposed Loan One is lease income. Two of five key points listed by the loan officer in recommending approval of this loan were: (1) financial strength and creditworthiness of the guarantors, and (2) banking relationships of guarantors and related entities. The corporation is a Subchapter S corporation and the shareholders have elected to withdraw all available cash flow from the corporation. The corporation's December 31, 2001, balance sheet reflects a negative net worth of $166,164, based on $1,191,110 in total assets and $1,357,274 in total liabilities.

4. Proposed Loan Two for $455,000 is proposed to be made to a limited liability company ("LLC-1") that owns an office building and parking lot. The Borrower owns 75% of LLC-1, owns and manages the title company that is the office building's primary tenant, and proposes to be guarantor of the Proposed Loan Two. The purchase of the building and lot was financed by another bank and Proposed Loan Two would refinance the prior note and terminate the relationship between LLC-1 and the other bank. The stated primary source of repayment for Proposed Loan Two is lease payments from the title company.

5. Proposed Loan Three for $195,000 is proposed to be made to another limited liability company ("LLC-2") that currently is the obligor under a promissory note with another bank. The Borrower is 50% owner of LLC-2 and proposes to be guarantor of Proposed Loan Three. Proposed Loan Three would refinance the existing note and terminate the relationship with the other bank. LLC-2 is the owner of a wraparound note from [***, Inc.] for the purchase of real property. The note will be collateral for Proposed Loan Three and it appears to be the only source of income for LLC-2.

6. The Bank's legal lending limit is $500,000.

Discussion:

Under Texas Finance Code §34.201(a), absent the prior written approval of the Banking Commissioner, the total loans and extensions of credit by a state bank outstanding at any one time to a person may not exceed 25% of the lesser of the bank's capital and certified surplus or the bank's total equity capital. The term "loans and extensions of credit" is defined in '31.002(a)(34) as "Ydirect or indirect advances of money by a state bank to a person that are conditioned on the obligation of the person to repay the money or that are repayable from specific property pledged by or on behalf of the person." You ask about the effect of these provisions on the existing and proposed loans described in your letter. Specifically, you ask whether the attribution and aggregation rules in 7 TEX. ADMIN. CODE §12.9 will cause the Bank to exceed the Texas Finance Code §34.201(a) legal lending limit with respect to these loans.

Under 7 TEX. ADMIN. CODE §12.9(a), a loan or extension of credit to one borrower is attributed to another person, and each person will be considered a borrower if: (1) proceeds of the loan or extension of credit are to be used for the direct benefit of the other person, (2) a common enterprise is deemed to exist between the persons, or (3) the expected source of repayment for each loan or extension of credit is the same for each person.

Under 7 TEX. ADMIN. CODE §12.9(g), the derivative obligation of a guarantor will be aggregated with the direct loans or extensions of credit of such guarantor if the lending bank is not relying primarily on the creditworthiness of the primary obligor. Specifically, an officer of the lending bank must certify in writing that the lending bank is, on stated facts, relying primarily on the responsibility and financial condition of the primary obligor for payment of the loans and not on the guarantor.

Based on the facts and information provided by you, we have determined that:

1. Existing Loan One is the Borrower's direct obligation. No analysis is required to conclude that the principal amount of $221,775 should be included in loans to the Borrower for purposes of applying the Bank's legal lending limit.

2. Based on your representations, Existing Loan Two does not appear to be attributable to the Borrower. However, the stated primary source of repayment on Existing Loan Two is rental payments from tenants. We assume for purposes of this opinion that the tenants do not include the Borrower, the Borrower's dependents, or companies controlled by the Borrower to any material degree. If this assumption is incorrect, Existing Loan Two of $52,656 may be attributable to the Borrower under 7 TEX. ADMIN. CODE §12.9(a)(3). Further, we assume the loan file for Existing Loan Two will contain written documentation demonstrating that the Bank is reasonably relying on the creditworthiness of the Trust for repayment of the loan, and not on the Borrower's guaranty. If this documentation does not exist, or if the Bank's reliance on the Trust for repayment of the loan is unreasonable in light of the stated facts, Existing Loan Two may be aggregated with other loans and extensions of credit to Borrower for purposes of applying the legal lending limit.

3. Proposed Loan One for $1,084,000 would by itself exceed the Bank's legal lending limit of $500,000, as we assume you recognize. The question at hand is whether the loan should be attributed to Borrower. Based on the information you furnished, an examiner could reasonably conclude that Proposed Loan One should be aggregated with other loans to the Borrower under 7 TEX. ADMIN. CODE §12.9(g). Bank records show that Bank is relying on the guaranty of Borrower to make Proposed Loan One. The insolvency of the proposed primary obligor also suggests that Proposed Loan One would not be made but for the Borrower's guaranty. No other controverting information was provided, such as certification by a Bank officer and supporting evidence demonstrating that the Bank is relying primarily on the responsibility and financial condition of the corporation for payment of the loan and not on the guaranty of Borrower.

4. Proposed Loan Two for $455,000 would likely be attributable to the Borrower under 7 TEX. ADMIN. CODE §12.9(a)(3), because the Borrower appears to be the primary source of repayment on Proposed Loan Two. The Borrower owns and manages the title company that is the principal tenant of the office building, and title company lease payments to LLC-1, the primary obligor, would appear to constitute the primary source of repayment for Proposed Loan Two.

5. We have insufficient information to conclude that Proposed Loan Three for $195,000 would be attributable to Borrower. However, Proposed Loan Three would be attributable to Borrower under 7 TEX. ADMIN. CODE §12.9(a)(3) if the relationship between Borrower and [***, Inc.] would make Borrower the primary source of repayment on the real estate note. Further, if an examiner determines that the Bank did not make the loan relying primarily on the creditworthiness of LLC-2, the primary obligor, but instead made the loan in reliance on Borrower's guaranty, Proposed Loan Three would be aggregated with other loans and extensions of credit to Borrower for purpose of applying the legal lending limit.

Conclusion:

Based solely on your letter of June 21, 2002, and accompanying information, we conclude that the Trust and LLC-2, borrower and proposed borrower under Existing Loan Two and Proposed Loan Three, would likely be viewed as independent of Borrower for purposes of applying the legal lending limits of Texas Finance Code §34.201(a). Conversely, Existing Loan One, Proposed Loan One, and Proposed Loan Two would likely be included as loans or extensions of credit to Borrower for legal lending limit purposes.

Our conclusion should not be construed as an endorsement of any proposed loan. A bank must heed the underlying purpose of the legal lending limit, reduction of risk by preventing one individual, or a relatively small group, from borrowing an unduly large amount of the state bank's funds. Further, while a bank may be empowered to make loans as described in this opinion that collectively aggregate more than the bank's legal lending limit, the bank in question must have the ability, capacity, and commitment to appropriately evaluate and manage the risks inherent in such lending activities. Thus, these types of loans will be closely scrutinized by an examiner to monitor the bank's adherence to its policies and procedures and to ensure that the bank is administering such loans in a manner that is consistent with safe and sound banking practices.

This opinion is limited to the facts and circumstances set forth in your letter of June 21, 2002, and accompanying information. Any change in those facts, circumstances, or the stated assumptions underlying our opinion may result in a different opinion.

Opinion No. 02-04

Assuming certain conditions are satisfied, the portfolio investments of affiliated mutual fund investment companies that, in the aggregate, total no more than 15 percent of the voting shares of a state bank will not cause the companies or their sponsor to be considered to have acquired "control" of the bank for purposes of the prior approval requirements of Texas Finance Code §33.001.

October 4, 2002
Shannon Phillips, Jr., Assistant General Counsel

I write in response to the letter you submitted last year to the Texas Department of Banking (Department), written on behalf of [***] and its related mutual fund investment companies and managed accounts (Fund or Funds). Please accept our apologies for the delay in response.

Questions Presented:

Finance Code, Chapter 33, Subchapter A imposes certain requirements in connection with the transfer of ownership interests in state-chartered banks. Under Finance Code, §33.001, a person must obtain the prior approval of the Texas Banking Commissioner (Commissioner) before acquiring an interest in the voting shares of a state bank if, after the acquisition, the person would control the bank. You ask whether the Department would aggregate the proposed investments of an individual Fund in a state bank with the proposed investments of another Fund in the bank so as to subject the investing Funds to the change of control provisions of Finance Code, §§33.001 *et seq*. If the Department concludes that the proposed investments would in fact implicate the statute, you ask the Commissioner to find that regulation of the investments is not necessary or appropriate to achieve the purposes of the statute and, impliedly, to exempt the transactions from the prior approval requirement. Additionally, you ask the Commissioner to defer to the Board of Governors of the Federal Reserve Board (Fed) should the agreement entered into between [***], the Funds and the Fed (Fed Agreement) under the Change in Bank Control Act, 12 U.S.C. §1817(CBCA), require clarification or modification.

Summary Conclusion:

The Department concludes that the proposed Funds investment transactions trigger the change of control provisions of Finance Code, §33.001, because [***], as the Funds' investment advisor, ultimately determines how the state bank shares held in individual Fund portfolios should be voted. However, the Commissioner believes that the purposes and objectives of Finance Code, §33.001, are achieved, and exempts [***] from the statute's prior approval requirements, if [***] and the Funds are organized as and adhere to the policies described in your letter, comply with the Fed Agreement, and operate within currently applicable federal and state laws. Additionally, [***] must enter into a separate agreement with the Department whereby [***] agrees to seek the Department's approval should the Fed Agreement be clarified or modified, or if any change occurs with respect to the laws, circumstances or facts set out in your letter of January 31, 2001.

Applicable Texas Statutes:

Finance Code, Chapter 33, Subchapter A, titled "Transfer of Ownership Interests," requires a person to apply for and obtain the Commissioner's approval before consummating a transaction that results in the person's acquisition of control of a Texas-chartered bank or a corporation or other entity that owns the voting securities of a Texas chartered-bank (State Bank or Bank). Section 33.001(a) provides as follows:

> **Sec. 33.001. Acquisition of Control.** (a) Except as otherwise expressly permitted by this subtitle, without the prior written approval of the banking commissioner a person may not directly or indirectly acquire a legal or beneficial interest in voting securities of a state bank or a corporation or other entity owning voting securities of a state bank if, after the acquisition, the person would *control* the bank.

Finance Code, §31.002(a)(13), defines "control" as:

(A) the ownership of or ability or power to vote, directly, acting through one or more other persons, or otherwise indirectly, 25 percent or more of the outstanding shares of a class of voting securities of a bank or other company;

(B) the ability to control the election of a majority of the board of a bank or other company;

(C) the power to exercise, directly or indirectly, a controlling influence over the management of policies of the bank or other company as determined by the banking commissioner . . .; or

(D) the conditioning of the transfer of 25 percent or more of the outstanding shares or participation shares of a class of voting securities of a bank or other company on the transfer of 25 percent or more of the outstanding shares of a class of voting securities of another bank or other company.

Finance Code, §33.001(b), modifies the Finance Code, §31.002(a)(13)(A), definition of "control" for purposes of the prior approval requirements by providing as follows:

(b) For purposes of this subchapter and except as otherwise provided by rules adopted under this subtitle, the principal shareholder or principal participant of a state bank that directly or indirectly owns or has the power to vote a greater percentage of voting securities of the bank than any other shareholder or participant is considered to control the bank.

A person who owns or has the ability or power to vote, directly or indirectly, at least 10 percent of the Bank's outstanding stock is considered to be a "principal shareholder."[2]

In summary, an acquisition transaction triggers §33.001(a) if, as a result of the acquisition, a person has the ability or power to vote or effect the transfer of 25 percent or more of the outstanding shares of a voting class of a State Bank's stock, the ability to control a majority of a Bank's board of directors, or the ability to exercise controlling influence over a Bank's policies. Finance Code, Section 33.001(a), is also invoked if, as a result of the acquisition, a person who directly or indirectly owns or has the ability or power to vote at least 10 percent of a class of a State Bank's outstanding stock owns or has the power to vote a greater percentage than any other shareholder. If any one of these circumstances would exist after the acquisition transaction, prior approval of the proposed transaction must be obtained unless the transaction is exempt under Finance Code, §33.005. Finance Code, §33.005(5), authorizes the Commissioner to exempt a transaction from Finance Code, §33.001, if he finds that the transaction is not within the purposes of Subchapter A or that the regulation of the transaction is not necessary or appropriate to achieve the subchapter's objectives.

Discussion:

In your 17-page letter, you argue that the proposed investments of an individual Fund should not be aggregated with those of another Fund for purposes of Finance Code, §33.001. If the Department disagrees and determines that the investments should be aggregated, you argue that the resulting "total" of aggregated investments should not be considered to constitute "control" for purposes of triggering the statute's prior approval requirement. To support your position, you first describe [***] and the Funds and explain their organization, management and nature. You then identify a number of restrictions imposed upon [***] and the Funds by federal statute and rule and, further, detail the commitments made by [***] and the Funds to Fed in the Fed Agreement.[3] You assert that the foregoing effectively prevents [***] or the Funds from acquiring or effecting the type of "control" contemplated by Finance Code, §33.001.

Basically, you advise that [***] and its affiliates manage a number of investment companies organized as mutual funds. The companies, known collectively as [The *** Funds], invest in equity securities. [The *** Funds] include approximately 150

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[1]Finance Code, §31.002(a)(44), defines the term "principal shareholder" as "a person who owns or has the ability or power to vote, directly, acting through one or more persons, or otherwise indirectly, 10 percent of more of the outstanding shares . . . of any class of voting securities of a bank or other company."

3 You attach copies of the Fed Agreement and the letter of opinion of the General Counsel of the Federal Reserve System concluding that, assuming adherence to the commitments and compliance with applicable federal statutes and rules, the proposed Funds investments would not cause [***] to be considered to control a bank holding company for purposes of CBCA.

companies that comprise the [*** Name Funds], and also a limited number of funds sponsored by third parties that hire [***] to serve as investment advisor, the Subadvised Funds. [***] and its affiliates also manage or sponsor certain other accounts and funds that invest in equity securities, the Managed Accounts. The [*** Funds] and the Managed Accounts are referred to in this Opinion as "Fund" or "Funds" unless the context indicates otherwise.
You state that the Funds include among their investments the equity securities of banks and bank holding companies, including State Banks. Because of concerns regarding statutory change of control requirements imposed both by federal and

state law, [***] aggregates the Funds' holdings in a particular bank and limits the aggregated holdings to 10 percent of any class of the bank's outstanding voting securities. If the holdings must be aggregated, [***] and the Funds wish to increase the "cap" to 15 percent and seek the Department's agreement that to do so with respect to a State Bank will not trigger the "control" provisions of Finance Code, §33.001.

You first argue that the individual Funds' holdings in a State Bank should not be aggregated for purposes of Finance Code, §33.001, because of the Funds' organization and management. You represent that, although [***] serves as the investment advisor for all the Funds, each Fund has a separate legal existence and its own distinct shareholder base. Each has its own investment policies and objectives, and individual strategies to comply with and achieve those objectives and strategies. Moreover, each Fund has its own portfolio manager, who manages the Fund and makes decisions to buy or sell portfolio securities in accordance with the specific Fund's investment policies, objectives and strategies, and in a manner consistent with the fiduciary duty he or she owes the Fund.

You also argue that the nature of the Funds and their investments mitigates against a presumption of control for purposes of Finance Code, §33.001. Your letter states that the management and investment decisions for each Fund are predicated upon the Fund's acting as a passive investor. Investment decisions are not made for the purpose of obtaining control over or influencing a portfolio company's management or policy, but to further the Fund's specific policies and objectives, and to realize the best return consistent with those policies and objectives. You detail provisions of the Investment Company Act of 1940 relating to joint transactions and transactions with affiliates and the rules adopted thereunder by the Securities Exchange Commission that you assert require Fund diversification and prohibit or discourage registered investment companies such as the Funds from seeking to control or influence the management of the portfolio companies.[4]

You concede that, as a general rule, [***] votes individual Fund holdings in portfolio company stock, that many of the Funds' boards of directors have common membership, and that [***] hires and supervises individual Fund managers. However, you contend that the decentralized organization and management of the Funds, the passive nature of the Funds and their investments, and the constraints imposed by the referenced federal law outweigh these factors for purposes of analysis under Finance Code, §33.001, especially when coupled with the commitments and restrictions to which [***] and the Funds have agreed as reflected in the Fed Agreement. The Fed Agreement incorporates certain organizational restrictions that apply whenever the Funds' aggregate holdings in a particular bank exceed 10 percent of any class or series of that bank's voting securities. The restrictions include [***]’s commitment to cap the Funds' aggregated interests in any one bank at 15 percent of a class of the bank's voting securities, and to either vote shares in excess of 10 percent pursuant to a plan of "mirror" voting (whereby [***] will vote the excess shares in proportion to all other shares voted) or leave the shares unvoted. The restrictions also include provisions to prevent [***] and the Funds from becoming involved in monitoring, supervising or otherwise influencing the policies, business decisions and/or management of such a bank.

Because [***], as the Funds' investment advisor, ultimately decides how to vote the shares held by individual Funds in a State Bank, the Department concludes that the Funds' holdings should be aggregated for purposes of Finance Code, §33.001, analysis. As a result of aggregation, [***] and the Funds potentially come within the definitions of "control" set out in Finance Code, §31.002(a)(13)(A) and §33.001(b). However, the Commissioner believes that a finding of "control" under Finance Code, §33.001, is not necessary to achieve the purposes and objectives of the statute, provided that [***] and the Funds adhere to their current policies and procedures and comply with applicable restrictions imposed by current federal law and rule and the commitments and restrictions contained in the Fed Agreement.[5] Assuming these conditions are

[3]15 U.S.C. §§80a-1, *et seq*.

[4]Compliance with the conditions also assures that [***] and the Funds do not acquire "control" under the definitions of that term in Finance Code, §31.002(a)(13)(B), (C), or (D).

satisfied, the Funds may acquire, and their aggregated portfolios may hold, up to 15 percent of any class of outstanding voting securities of a State Bank without having to comply with the prior approval requirements of Finance Code, §33.001. As required by 7 TAC §15.81(h), however, [***] and the Funds must submit to the Department a copy of any application required to be filed with any federal regulatory authority.

The Commissioner declines to defer to the Fed with respect to clarifications of or modifications to the Fed Agreement. [***], on behalf of the Funds, must acknowledge to the Department in writing that it will notify the Department if the terms of the Fed Agreement are clarified or modified or any change occurs with respect to the laws, circumstances or facts set out in your letter of January 31, 2001. In the event of such a clarification, modification or change, the Commissioner will reconsider his conclusion regarding the need to secure prior approval under Finance Code, §33.001.

The conclusion expressed in this letter is limited to the facts and circumstances set forth in your letter. Different facts and circumstances may result in a different conclusion.

Opinion No. 04-03

A loan to a joint venture is considered a loan to a member of the joint venture that is a partnership and to the general partner of that partnership under 7 TAC §12.9(f)(1); File No. 04-169

May 7, 2004
Shannon Phillips, Jr. Assistant General Counsel

This letter is in response to your March 26, 2004 letter, in which you ask about the applicability of the legal lending limit provisions of the Texas Finance Code and related regulations to a certain proposed loan.

Question Presented:

You asked for our concurrence that neither Finance Code §34.201 nor 7 TAC §12.9 require a proposed bank loan to a joint venture ("the Loan") to be aggregated with the bank's loans to two limited partnerships that share a general partner with a third limited partnership that is a member of the joint venture.

Summary Response:

Under 7 TAC §12.9(f)(1), the Loan is considered a loan to the limited partnership member of the joint venture, and as a loan to the limited partnership, the Loan is likewise considered a loan to the limited partnership's general partner. Because all three limited partnerships mentioned in your letter share a general partner, the Loan and the loans to the limited partnerships are all considered loans to their common general partner and are aggregated for lending limit purposes.

Discussion:

A Texas state-chartered bank (Bank) has a lending limit of $1.5 million. The bank loaned $345,000 to a limited partnership ("LP1") and $775,000 to another limited partnership ("LP2") that have the same corporation as general partner (Corporation). The Corporation is wholly owned by an individual named Sam who has executed limited guaranties of the loans to LP1 (24%) and LP2 (18%). LP1 and LP2 each own income-generating real property as the expected source of repayment of its loans from the Bank. Corporation is the general partner of a third limited partnership ("LP3"). LP3 owns 49.5% of a joint venture ("JV"); an unrelated third party ("UTP") owns 50.5% of JV. The Bank wants to make a $500,000 loan to JV ("Loan"), guaranteed by Sam, for construction of a single-family residence that will be sold to repay the loan.

You state that you understand that, under §12.9(f)(1), a loan to JV is considered a loan to LP3 and UTP because they are members of JV; however, you express confusion as to whether the loan would also be considered a loan to the Corporation, as general partner of LP3. Your letter presumes that §12.9 would not attribute the Loan to the Corporation because, if it meant to do so, it would provide for aggregation when, as you put it, "the partners are directly or indirectly liable for the obligations of the partnership or joint venture, in a manner similar to the way that affiliation is determined by direct or indirect control in §12.9(c)(2)."

We disagree with your assertion that §12.9 does not attribute the Loan to Corporation. As you recognize, §12.9(f)(1) provides that "a loan or extension of credit to a partnership, joint venture, or association is considered to be a loan or extension of credit to each member of the partnership, joint venture, or association…."[6] Therefore, because LP3 is a member of JV, the Loan would be considered a loan to LP3. Likewise, because the Loan is considered a loan to LP3, we must treat the Loan as we would any other Bank loan to LP3 and consider it a loan to LP3's general partner, Corporation, as required by §12.9(f)(1). To rule otherwise would nullify §12.9(f)(1); borrowers could merely form one or more partnerships, joint ventures or associations to evade the legal lending limits without affecting the risks involved.

Conclusion:

Under 7 TAC §12.9(f)(1), the Loan is considered a loan to the limited partnership member (LP3) of the joint venture, and as a loan to LP3, the Loan is likewise considered a loan to the general partner of LP3. Because LP1, LP2, and LP3 share a general partner, the Loan and the loans to the limited partnerships are all considered loans to their common general partner. Thus, the proposed $500,000 loan to JV must be aggregated with the $345,000 loan to LP1 and the $775,000 loan to LP2.

Because the remainder of your letter rests on your conclusion that the Loan will not be attributed to Corporation—a conclusion we disagree with—it is not necessary for us to comment on it further.

<u>Opinion No. 07-01</u>

Whether a remote deposit capture machine established and maintained in Texas by a depository institution constitutes a branch under Texas law.

February 20, 2007
Everette D. Jobe, Senior Counsel

By letter dated December 20, 2006, you described the intent of your client, an FDIC-insured out-of-state state-chartered bank without a location in Texas, to provide its business customers in Texas with the ability to process checks received from their customers by use of an on-site remote deposit capture machine. You ask the Department to confirm your understanding that Texas law would permit the Bank to install a remote deposit capture machine in Texas at each such customer's place of business. You further request confirmation that these machines would not be required to be licensed on the basis that the machines are not bank branches under Texas law.

Question Presented:

Whether a remote deposit capture machine established and maintained in Texas by a depository institution constitutes a branch under Texas law.

Summary:

A remote service unit, as defined by 12 C.F.R. §7.4003, is not a "branch" under Texas law within the meaning of Texas Finance Code §31.002(a)(8) or §201.002(a)(8). A remote service unit as defined includes a remote deposit capture machine. Therefore, an out-of-state bank without a location in Texas may install and maintain a remote deposit capture machine at its customer's place of business in Texas. A remote service unit is not subject to licensure or registration under Texas law.

Facts:

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6 The provisions of 12.9(f)(1) does not consider a loan to a partnership, joint venture, or association, a loan to "those partners or members, by the terms of the partnership or membership agreement are not held generally liable for the debts or actions of the partnership, joint venture, or association provided those prov isions are valid against third parties under applicable law, and that have not otherwise agreed to guarantee or be personally liable on the loan or extension of credit." This exception is not discussed in this letter because it is not relevant to the question asked.

The Bank, an FDIC-insured out-of-state state-chartered bank, currently has offices in various states, not including Texas. The Bank intends to provide its business customers located within Texas the ability to process checks received from their customers by use of a remote deposit capture machine, to be located on the business customers' business premises and operated by personnel of the business customer as a back-office facility. The remote deposit capture machine will remotely transmit the data located on the checks to a third-party processor which will then remit the data to the Bank for processing and deposit. The Bank will provide these machines to its business customers located in Texas.

Analysis:

The term "branch" is defined by Texas Finance Code §31.002(a)(8) as "a location of a bank, other than the bank's home office, at which the bank engages the public in the business of banking," subject to specific exclusions.

Among the exclusions is an "electronic terminal," a term defined in Finance Code §31.002(a)(19) as "an electronic device, other than a telephone or modem operated by a customer of a depository institution, through which a person may initiate an electronic fund transfer, as defined by 15 U.S.C. Section 1693a(6)." The incorporated definition of an "electronic fund transfer" is found in the federal Electronic Fund Transfer Act, generally limited in application to electronic transactions affecting customers who are natural persons. A remote deposit capture machine operated by a business customer would therefore not be an electronic terminal for purposes of the federal Electronic Fund Transfer Act, see 15 U.S.C. Section 1693a(7). We conclude that a remote deposit capture machine is not an "electronic terminal" within the meaning of Finance Code §31.002(a)(19). Nevertheless, as explained below, we conclude that the device is a "remote service unit" that should be excluded from the definition of "branch."

Pursuant to 12 U.S.C. Section 36(j), the term branch "does not include an automated teller machine or a remote service unit."[7] The Office of the Comptroller of the Currency, on behalf of national banks, has defined a remote deposit capture machine such as you describe as a "remote service unit" in 12 C.F.R. §7.4003:

> **§ 7.4003 Establishment and operation of a remote service unit by a national bank.** A remote service unit (RSU) is an automated facility, operated by a customer of a bank, that conducts banking functions, such as receiving deposits, paying withdrawals, or lending money. A national bank may establish and operate an RSU pursuant to 12 U.S.C. 24(Seventh). <u>An RSU includes an</u> automated teller machine, automated loan machine, and <u>automated device for receiving deposits</u>. An RSU may be equipped with a telephone or televideo device that allows contact with bank personnel. <u>An RSU is not a "branch"</u> within the meaning of 12 U.S.C. 36(j), <u>and is not subject to state geographic or operational restrictions or licensing laws</u>.
>
> [Emphasis added.]

Article 16, §16(c) of the Texas Constitution provides that a state bank "has the same rights and privileges that are or may be granted to national banks of the United States domiciled in this State." *Also see* Texas Finance Code §32.009. Because a national bank has the authority to install and utilize a remote deposit capture machine at a customer's place of business in Texas, pursuant to Article 16, §16(c) of the Texas Constitution, we conclude that a Texas state bank may do so under the same terms and conditions. Therefore, a remote service unit established and operated by a Texas state bank is not a "branch" within the meaning of Texas Finance Code §31.002(a)(8). Although this conclusion does not contravene any explicit statutory prohibition in Texas law, as authorized by Texas Finance Code §31.002(a)(8)(H), we will likely pursue adoption of a rule that specifically excludes a "remote service unit" from the definition of "branch."

With respect to your specific inquiry, we also conclude that an out-of-state bank without an office in Texas may establish and operate remote service units in Texas. Texas branching by an out-of-state bank is governed by Chapter 203 of the Texas Finance Code. The relevant definition of "branch," set forth in Texas Finance Code §201.002(a)(8), incorporates the

7 The definition of "domestic branch" in the Federal Deposit Insurance Act similarly excludes an automated teller machine or a remote service unit, *see* 12 U.S.C. Section 1813(o). However, that definition, applicable to foreign bank operations within the United States and its territories and possessions, is not relevant for present purposes.

definition of "branch" in Texas Finance Code §31.002(a)(8). Therefore, we find that a "branch" for purposes of Texas Finance Code Chapter 203 similarly does not include a remote service unit as defined in 12 C.F.R. §7.4003.

Finally, we conclude that the filing requirements of Texas Finance Code §201.102 would not apply to the Bank. Texas Finance Code §201.102 requires an out-of-state financial institution, before operating a branch or other office in Texas, to qualify to do business in this state by filing an application for registration with the secretary of state in compliance "with the law of this state relating to foreign corporations doing business in this state." The Bank will not be operating a branch or other office in Texas. Further, establishing and operating remote service units in Texas would not invoke the foreign corporation qualification provisions of Texas law, *see* Texas Business Organizations Code §9.251(9).

This opinion is limited to the facts and circumstances set forth in your letter. Any change in those facts or circumstances may result in a different opinion.

Opinion No. 08-01
Whether a state bank has the authority to guarantee the performance of a transaction to which the bank's operating subsidiary is a party.

July 10, 2008
Everette D. Jobe, Senior Counsel

By letter dated February 6, 2008, you requested a determination from the Department regarding the authority of a state bank to guarantee certain transactions undertaken by its operating subsidiary. You stated that your client, Bank of the West, Irving, Texas, is a state bank in the process of forming a wholly owned subsidiary corporation that it intends to operate as a mortgage company. You advise that circumstances may potentially arise in connection with the closing and contemplated sale of mortgage loans to various investors that would require the mortgage company to repurchase a previously sold loan. Because certain investors demand assurance that the mortgage company has the financial capacity to meet such liability, they seek a "parental" guaranty from the state bank of the repurchase obligations of its newly formed, subsidiary mortgage company.

Question Presented:

Whether a state bank has the authority to guarantee the performance of a transaction to which the bank's operating subsidiary is a party.

Summary Conclusion:

In our opinion, a state bank has the authority to guarantee the performance of a transaction to which the bank's operating subsidiary is a party.

Discussion:

Former 7 TAC §11.83(b) provided that a state bank could "lend its credit, bind itself as a surety to indemnify another, or otherwise become a guarantor, if it has a substantial interest in the performance of the transaction involved or has a segregated deposit in sufficient amount to cover the bank's total potential liability." Although this section was repealed in 2002, we noted in connection with the repeal that the rule had been originally adopted in 1982 to help state banks remain competitive by authorizing certain powers and activities for state banks that were already authorized for national banks, and became unnecessary after the 1984 constitutional amendment to Texas Constitution, Article XVI, §16(c), that granted state banks "the same rights and privileges that are or may be granted to national banks of the United States domiciled in this State." 27 TexReg 8203 (Aug. 30, 2002).

A national bank has authority to act as a guarantor if it has a substantial interest in the performance of the transaction involved or if the guarantee is for the benefit of a customer and the bank has a segregated deposit in sufficient amount to cover the bank's total potential liability, see 12 CFR §7.1017(a). Therefore, pursuant to Article XVI, §16(c) of the Texas

Constitution, we conclude that a state bank has the authority to lend its credit, bind itself as a surety to indemnify another, or otherwise become a guarantor if (1) the bank has a substantial interest in the performance of the transaction involved, or (2) the transaction is for the benefit of a customer and the bank obtains from the customer a segregated deposit that is sufficient in amount to cover the bank's total potential liability.

Citing 12 CFR §7.1017(a), the Office of the Comptroller has concluded that a national bank always has a substantial interest in the financial performance of a subsidiary, see OCC Interpretive Letter 1010 (Oct. 2004). Because the financial condition and results of operation of a bank's operating subsidiaries are reported on a fully consolidated basis in the bank's financial statements, the consolidated risk profile of the bank is not altered if the bank guarantees a transaction with its operating subsidiary, whether on behalf of the subsidiary or for another party to the transaction. We therefore concur with the OCC to the extent necessary to conclude that a state bank has a substantial interest in the performance of a transaction to which the bank's operating subsidiary is a party, *cf*. Department of Banking Opinion No. 96-49 (March 5, 1997).

Finally, we note that the OCC has recently amended 12 CFR §7.1017, effective July 1, 2008, to potentially expand national bank guaranty authority, see 73 FR 22216, at 22225-22227 (April 24, 2008). As amended, 12 CFR 7.1017(b) provides that "a national bank may guarantee obligations of a customer, subsidiary or affiliate that are financial in character, provided the amount of the bank's financial obligation is reasonably ascertainable and otherwise consistent with applicable law." You have not indicated whether the bank guaranty of certain operating subsidiary transactions is "financial in character" and, if so, whether the amount of the anticipated bank obligation is "reasonably ascertainable." However, depending on undisclosed circumstances, we believe new 12 CFR §7.1017(b) may provide an independent basis for our conclusion that a state bank can guarantee an obligation of the bank's operating subsidiary.

<u>Opinion No. 08-02</u>

A state bank is authorized to make credit decisions at its loan production office so long as it does not disburse loan proceeds to the borrower in person at the loan production office.

October 3, 2008
Deborah H. Loomis, Assistant General Counsel

In connection with your notice letter to the Texas Department of Banking (Department) dated September 5, 2008, regarding the establishment of a loan production office (LPO), you have requested, as a matter of parity with national banks, permission for credit decisions to be made at [Bank]'s LPO.
You state, in pertinent part, as follows:

> This office will perform loan processes permitted under § 32.204 of the *Texas Finance Code*, and Chapter 7, § 3.91 of the Texas Administrative Code pertaining to loan production offices. Additionally, we request, as discussed below, that appropriate officers in the LPO may also be permitted to make credit decisions regarding loan applications as permitted under the parity provisions of § 32.009 of the *Texas Finance Code* . . . .
>
> The Bank will initially staff this loan production office with two individuals, one of whom will be [the] President and Chief Lending Officer of the Bank, the other being his assistant. . .
>
> This office will not disburse loan proceeds to the borrower in person; those proceeds will be funded at the Bank's [home] office or through an attorney office or escrow agent, in the case of a real estate loan closing.
>
> This facility will not be a branch office in the context that it will not receive deposits, pay checks or perform other services associated with the business conducted at a full service branch.

Letter from chief executive officer of Bank. (Bank Letter)

Question Presented:

Whether a state bank may make credit decisions at its LPO if it does not disburse loan proceeds at the LPO.

Summary Conclusion:

In our opinion, a state bank has the authority to make credit decisions at its LPO so long as it does not disburse loan proceeds to the borrower in person at the LPO.

Discussion:

Texas state banks are prohibited by statute from making credit decisions at an LPO. *Texas Finance Code* § 32.204(a). However, *Texas Finance Code* § 32.009(b), sets forth a mechanism whereby 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 may submit a letter to the banking commissioner detailing the activity and providing authority for national banks to engage in that activity. Your letter is such a letter. The banking commissioner may prohibit the Bank from performing the activity only if he 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.

Id.

The Comptroller of the Currency is the primary regulator of national banks. The Comptroller has issued a regulation which specifically authorizes a national bank to make credit decisions at a branch other than its main office or a branch office. 12 *Code of Federal Regulations* (CFR) § 7.1005 states as follows:

> A national bank and its operating subsidiary may make a credit decision regarding a loan application at a site other than the main office or a branch office of the bank without violating 12 U.S.C. 36 and 12 U.S.C. 81, provided that "money" is not deemed to be "lent" at those other sites within the meaning of § 7.1003.

12 CFR § 7.1005.

12 CFR § 7.1003(a) deems money to be "lent" only at the place, if any, where the borrower in-person receives loan proceeds. Section 7.1003(b) allows loan proceeds to be received by a borrower at an office other than the bank's main office or a branch so long as a third party such as an attorney or escrow agent at a real estate closing is used to deliver the funds. You have represented that the LPO "will not disburse loan proceeds to the borrower in person; those proceeds will be funded at the Bank's [home] office or through an attorney office or escrow agent, in the case of a real estate loan closing." Bank Letter at 1. Therefore, under federal law, money is not lent at the LPO and credit decisions may be made at the LPO.[8] A national bank domiciled in this state possesses the specific right or privilege to perform the activity the Bank seeks to perform. The Bank is not prohibited from making credit decisions at the LPO pursuant to *Texas Finance Code* § 32.009(b)(1).

The Department has also reviewed [the President and Chief Lending Officer's] qualifications. Given the assumption that all loans, wherever granted, will comply with the bank's general loan policies, the location where [the President and Chief Lending Officer] or persons he supervises underwrite and approve loans has no negative safety and soundness implications and, we believe, significant operating benefits to the Bank. See, *Texas Finance Code* § 32.009(b)(2). Therefore, we conclude that the Bank may make credit decisions at its LPO subject to the conditions that at all times the totality of activities performed at the LPO would be permissible for a national bank, and that all loans will comply with the general loan policies of the Bank. Please note that we are sending a copy of this letter to the Federal Deposit Insurance Corporation as it also regulates the Bank's activities.

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8 See also, Interpretive Letter No. 902, Comptroller of the Currency (January 2001).

Your request for a waiver of the 30-day waiting period is also granted. You may establish your LPO at [address], [City], Texas at any time after October 3, 2008**.**

The Department's conclusion that the Bank may make credit decisions at the LPO is based upon the written and verbal representations from you and other representatives of the Bank regarding the Bank's activities. We caution that our conclusion is limited to the facts and circumstances you have presented. If we have in any way misunderstood the facts, or if they in any way materially change, please advise the Department immediately.

I hope that this letter is fully responsive to your inquiry. Please feel free to contact me if you have any additional questions or concerns.

Opinion No. 08-03

A loan attributed to its guarantor, for legal lending limit purposes, need not remain attributed for the life of the loan if certain conditions are met and the bank conducts a thorough review and re-underwriting of the obligor's creditworthiness and overall relationship with the bank.

July 31, 2008
Robert L. Bacon, Deputy Commissioner

You requested that the Department answer a question regarding the application of the lending limits requirements of Texas Finance Code §34.201 and 7 Texas Administrative Code §12.9 to the guarantor of an existing loan and a proposed new loan by your client (Bank).

You stated that the Bank wishes to retain as much as legally permissible of a proposed loan (New Loan) to a limited partnership (New Obligor) to build a retail strip center. New Obligor's general partner is a limited liability company (LLC) which has a 1% ownership interest in New Obligor. The sole manager of LLC is an individual (Guarantor) who is to provide an unlimited personal guaranty of the New Loan. Guarantor has a 49% limited partnership interest in New Obligor, with another limited partner holding the remaining 50% limited partnership interest. In making the New Loan, the Bank also expects to require an unlimited personal guaranty of the loan from the other limited partner of New Obligor.

Guarantor previously guaranteed a loan (Existing Loan) to another limited partnership (Existing Obligor). The general partner of Existing Obligor is a corporation (Inc.), with a 1% ownership interest. Guarantor serves as president of Inc. Guarantor has a 99% limited partnership interest in Existing Obligor, and has personally guaranteed the Existing Loan.

The Bank made the Existing Loan to Existing Obligor to build a retail strip center. You represent that the center is now 100% leased and provides cash flow such that, if the Bank were originating the Existing Loan today, the Bank would be able to rely on Existing Obligor for the repayment of the loan rather than on the guaranty of Guarantor.

You asked the Department to assume, for the purposes of answering your question, that the legal lending limit for the Bank is less than the combined amounts of New Loan and Existing Loan.

Question Presented:

Whether the Existing Loan, made in reliance on the guaranty of Guarantor and attributed to Guarantor at inception, must be attributed again to Guarantor and combined with the New Loan proposed to be guaranteed by Guarantor for legal lending limit purposes, where the Existing Obligor generates sufficient cash flow such that, if the Bank were making the Existing Loan today, it could demonstrate reliance on the Existing Obligor and not on the Guarantor.

Summary Conclusion:

In our opinion, Texas Finance Code §34.201 and 7 Texas Administrative Code §12.9 do not require the derivative obligation of Guarantor on the Existing Loan to be attributed to the Guarantor and combined with the New Loan proposed to be guaranteed by Guarantor, provided the Bank demonstrates that: (1) it is currently relying on the Existing Obligor for repayment of the Existing Loan; and (2) it would make the Existing Loan in reliance on the Existing Obligor for repayment and not on the Guarantor, if the Bank were making the Existing Loan today. The Bank must re-underwrite the Existing Loan, as specified below, to demonstrate reasonable reliance on the Existing Obligor's current creditworthiness for repayment of the Existing Loan, rather than on the guaranty of the Guarantor.

Discussion:

Under Texas Finance Code §34.201(a), absent the prior written approval of the Banking Commissioner, the total loans and extensions of credit by a state bank outstanding at any one time to a person may not exceed 25% of the lesser of the bank's unimpaired capital and surplus.[9] The term "loans and extensions of credit" is defined in Texas Finance Code §31.002(a)(34) as "…direct or indirect advances of money by a state bank to a person that are conditioned on the obligation of the person to repay the money or that are repayable from specific property pledged by or on behalf of the person."

Aggregation and attribution for legal lending limit purposes are addressed by 7 Texas Administrative Code Section12.9. The general rule is set forth in subsection (a), which provides that a loan or extension of credit to one borrower is attributed to another person, and each person will be considered a borrower, if: (1) proceeds of the loan or extension of credit are to be used for the direct benefit of the other person, (2) a common enterprise is deemed to exist between the persons, (3) the expected source of repayment for each loan or extension of credit is the same for each person, or (4) notwithstanding another provision of Section 12.9, the banking commissioner determines that a loan should be attributed to another person.

For attribution based on a guaranty, Subsection (g) of the rule provides that the derivative obligation of a guarantor will not be aggregated with direct loans or extensions of credit of the guarantor if the bank reasonably is "relying primarily on the creditworthiness of the primary obligor and none of the tests set forth in this section [the direct benefit, common enterprise, and source of repayment tests] are satisfied." The reliance of the lending bank on the primary obligor must be evidenced by the certification of an officer of the bank that the bank is, on stated facts, reasonably relying primarily on the responsibility and financial condition of the primary obligor for payment of the loan and not on the guaranty of the guarantor.

Subsection (g) concludes by stating as follows:

> In the event that the loan or extension of credit to the primary obligor, considered by the bank to be of sufficient credit quality at its inception, experiences subsequent deterioration to the point that the primary obligor is no longer performing in accordance with the terms of the initial loan agreement, such event will not result in a lending limit violation on behalf of the guarantor by virtue of the primary obligator's nonperformance. However, the total amount of the deteriorated loans guaranteed by such accommodating person must be combined with all other obligations of such guarantor in determining whether the guarantor may obtain additional loans or extensions of credit from the bank.

This guaranty test is a specialized application of the source of repayment test, i.e., whether the expected source of repayment is actually the guarantor.[10]

The Bank asserts that there has been an improvement in the credit quality of the Existing Loan and thus in the creditworthiness of the Existing Obligor since the inception of the Existing Loan, such that the Bank is now relying on the Existing Obligor as the source of repayment of the Existing Loan and not on the guaranty of the Guarantor.

Thus, the Existing Loan and guaranty here at issue present the reverse of the loan and guaranty described in the last two sentences of Subsection (g). If Subsection (g) requires a bank to attribute to a guarantor all loans guaranteed by that

9 "Unimpaired capital and surplus" is equivalent to the bank's quarterly Tier 1 capital, see Title 7, Texas Administrative Code §12.2(1).

10 For the purposes of this opinion, we are assuming that there are no facts requiring combination of the Existing Loan and the New Loan under either the direct benefit test or the common enterprise test set forth in 7 TAC §12.9. This opinion also assumes that there are no facts requiring application to the Existing Loan and the New Loan of the lending limit for corporate groups under 7 TAC §12.9(e). Under Subsection (e), the total of all loans or extensions of credit to members of a corporate group may not exceed 75% of the Bank's Tier 1 capital.

guarantor which have deteriorated to the point that the primary obligor is no longer performing, then the rule logically applies as follows to the reverse situation. An existing loan made in reliance on a guaranty and attributed to the guarantor at inception need not be attributed again to the guarantor and combined with a new loan to be guaranteed by the guarantor for legal lending limit purposes, if the creditworthiness of the existing loan has improved to the point that the primary obligor is fully performing and presenting sound and reasonable repayment capacity, collateral margins, and financial support. However, the bank must re-underwrite the loan, as further specified below, to prove its reasonable reliance on the primary obligor, rather than on the guarantor, for repayment of the existing loan[11].
In our opinion, therefore, Subsection (g) will not require the derivative obligation of Guarantor on the Existing Loan to be attributed to the Guarantor and aggregated with the New Loan to be guaranteed by Guarantor, if the Bank re-underwrites the loan to document the Existing Obligor's current creditworthiness for the Existing Loan. For this post-inception underwriting, the Bank should undertake and document a detailed analysis of the current payment capacity and financial strength of the Existing Obligor, an evaluation of current collateral support for the Existing Loan, and an assessment of **current** market conditions and other credit enhancements. The resulting analysis should be of similar quality and detail to the underwriting by the Bank of a new loan of similar size and complexity. Considering the size of the relationship and the legal issues, the Bank's Board of Directors loan committee should evaluate and approve the analysis.

Our conclusion is based only on the facts, circumstances, assumptions and representations stated in this letter. Any change in those facts, circumstances, assumptions or representations could result in a different conclusion. Furthermore, our conclusion should not be construed as an endorsement of the creditworthiness or suitability of any proposed loan.

As you are undoubtedly aware, a bank must heed the underlying purpose of the legal lending limit, reduction of risk by preventing one individual, or a relatively small group, from borrowing an unduly large amount of the state bank's funds. The bank, therefore, must appropriately evaluate and manage the risks inherent in such lending activities. An examiner will closely scrutinize these types of loans to monitor the bank's adherence to its policies and procedures and to ensure that the bank is administering such loans in a manner that is consistent with safe and sound banking practices.

Opinion No. 09-01

The Bank's leases purchased from Lessor will be considered to be loans to the Lessor, attributed to it as the borrower and aggregated with the Bank's other loans and extensions of credit to Lessor, and will not be considered to be loans to the individual lessees.

February 24, 2009
Mary Kelly Pauwels, Assistant General Counsel

This opinion responds to your November 10, 2008 opinion request concerning whether leases [*******] purchased from [********] (Lessor) should be considered loans to the Lessor or to the individual lessees for legal lending limit purposes under Texas Finance Code §34.201 and Title 7, Texas Administrative Code (TAC) §12.7(b). In the Texas Department of Banking's recent report of examination of the Bank, Examiner [*****] cited the Bank for apparent legal lending limit violations under Finance Code §34.201 arising from the Bank's purchase of leases from Lessor. You requested a legal opinion on the validity of this citation for legal lending limit violations and asked how the Bank could resolve any past, and avoid any future, legal lending limit violations arising from these lease purchases.

Summary of Opinion:

The Bank's leases purchased from Lessor will be considered to be loans to the Lessor, attributed to it as the borrower and aggregated with the Bank's other loans and extensions of credit to Lessor, and will not be considered to be loans to the individual lessees. The Lessor collects the lease payments, deposits the payment checks into its corporate account at another bank, and then makes one monthly payment on all the leases to the Bank. This lease payment arrangement does not meet the requirement of 7 TAC §12.7(b)(5) that lease payments must be paid to the bank directly by the lessee, one of six

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11 The bank need not release the guarantor from the guaranty of the existing loan if it can otherwise demonstrate its reasonable reliance on the primary obligor for repayment of the loan. The bank may wish to retain such guaranty in place as an abundance of caution.

requirements that must be met for leases purchased by a bank from a leasing company to be attributed to the lessee and not the leasing company for legal lending limit purposes. However, the Bank may satisfy 7 TAC §12.7(b)(5) by restructuring its lease payment arrangement on all the leases purchased from Lessor to require lessees to make payments directly to the Bank by sending them to a lockbox controlled by the Bank. If the leases purchased from Lessor also satisfy the other five conditions set forth in 7 TAC §12.7(b), then the leases will be considered loans to the lessees and not attributed to Lessor and aggregated with its other Bank loans and extensions of credit under Texas Finance Code §34.201.

Background:

During a recent examination of [******] by the Department of Banking (DOB), Examiner [*********] cited the Bank for apparent violations of the legal lending limits under Texas Finance Code §34.201 for leases the Bank purchased from Lessor which [*****] determined should be attributed to Lessor and aggregated with the Bank's other loans and extensions of credit to Lessor. At the time of the examination, the leases the Bank had purchased from Lessor totaled $6,584,311, exceeding the Bank's legal lending limit of $1,821,000.[12] According to DOB's report of examination, Lessor leases equipment to different entities, and the bank finances these lease transactions by purchasing the lease paper from Lessor. In your letter, you represent that the Bank purchases leases from Lessor, and that each lease is underwritten on its own merits by the Bank and has been appropriately assigned to the Bank. Your letter also states that Lessor services the leases for the Bank, collects the payments, deposits them into its corporate account at a different bank, and then makes one payment to the Bank each month. According to the examination report, the monthly payment by Lessor includes a breakdown of the individual payments from each lessee. Examiner [*****] attributed all the leases to Lessor and aggregated them with the Bank's other loans to Lessor for legal lending limit purposes under Finance Code §34.201, because the lease payments do not come directly to the Bank from the lessees, as required by 7 TAC §12.7(b)(5).

Discussion:

Under Texas Finance Code §34.201(a), absent the prior written approval of the Banking Commissioner, the total loans and extensions of credit by a state bank to a person outstanding at one time may not exceed 25% of the lesser of the bank's unimpaired capital and surplus.[13] The term "loans and extensions of credit" is defined in Texas Finance Code §31.002(a)(34) as "…direct or indirect advances of money by a state bank to a person that are conditioned on the obligation of the person to repay the money or that are repayable from specific property pledged by or on behalf of the person." (Emphasis added.) Finance Code §34.204, which permits state banks to provide the equivalent of a financing transaction by acting as a lessor under a lease for the benefit of a customer,[14] provides that a lease financing transaction is considered to be a loan or extension of credit for purposes of §34.201.[15]

The Texas Finance Commission created an exception by rule, in 7 TAC §12.7(b), to the legal lending limit in Finance Code §34.201[16] for loans to leasing companies where the loans satisfy six stated conditions.[17] A loan to a leasing company for the purpose of purchasing equipment for lease is considered a loan to the lessee, under 7 TAC §12.7(b), provided that:

(1) the bank documents the basis for its reliance on the lessee as the primary source of repayment before the loan is extended to the leasing corporation;

(2) the loan is without recourse to the leasing corporation;

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[12] The Bank states in its letter that the volume of the leases from Lessor totaled $6,112,587 at the time of the examination. [*****] found that an apparent legal lending limit violation occurred on March 31, 2007, with $2,087,989 of total leases purchased from Lessor when the Bank's legal lending limit was $1,922,000. By October 23, 2008, he found that the volume of leases purchased had grown to $6,584,311 when the legal lending limit was $1,821,000.
[13] "Unimpaired capital and surplus" is equivalent to the bank's quarterly Tier 1 capital. See 7 TAC §12.2(1).
[14] Tex. Fin. Code §34.204(a).
[15] Tex. Fin. Code §34.204(c), which also provides that it is considered to be a loan or extension of credit for purposes of Finance Code §34.202.
[16] Under Finance Code §34.201(b), the Texas Finance Commission has rulemaking authority to create other exemptions to the legal lending limit for particular classes or categories of loans or extensions of credit.
[17] 7 TAC §12.3(a)(7) defines lease financing transactions made pursuant to Finance Code §34.204 as a "loan or extension of credit" for purposes of Finance Code §34.201, unless they are otherwise exempt under 7 TAC §12.7.

(3) the bank receives a security interest in the equipment and, in the event of default, may proceed directly against the equipment and the lessee for any deficiency resulting from the sale of the equipment;

(4) the leasing corporation assigns all of its rights under the lease to the bank;

(5) the lessee's payments are assigned and paid to the bank directly by the lessee; and

(6) the lease terms are subject to the same limitations that would apply to a state bank acting as a lessor under the Finance Code, §34.204.

The leases the Bank purchased from Lessor do not satisfy the condition in Section 12.7(b)(5), as correctly cited by Examiner [*****] in his examination of the Bank. Lessor collects the payments for all the leases purchased by the Bank, deposits the payments into Lessor's account at another bank, and then makes one monthly payment to the Bank for all the leases. Such monthly payment by Lessor does not constitute a payment to the bank directly by the lessee on each lease to the Bank as 7 TAC §12.7(b)(5) requires. Therefore, all the leases the Bank purchased from Lessor, in which the payments are collected by Lessor and paid to the Bank in this manner, are properly attributable to Lessor and not to the lessees. Consequently, these leases must be aggregated with the Bank's other loans and extensions of credit to Lessor for legal lending limit purposes under Finance Code §34.201.

The Department of Banking reached the same conclusion in Opinion No. 02-01, published in the DOB Law and Guidance Manual,[18] on a very similar legal lending limit question. In that opinion, Assistant General Counsel Robin Robinson determined that loans under a proposed leasing program in which the leasing company was to service leases it had assigned to a bank should be attributed to the leasing company and not be considered loans to lessees. The program provided for: the lessees to mail checks payable to the bank for their lease payments to a lockbox controlled by the leasing company at another bank; the bank to authorize the leasing company to deposit, endorse, and otherwise negotiate the individual lease payments; and the leasing company to deduct monthly taxes from those payments and then remit the remaining payments to the bank. The opinion found that the payment arrangement did not constitute "a direct payment from the lessee to the Bank" as 7 TAC §12.7(b)(5) requires.[19]

The opinion also considered whether a leasing company could act as a servicing agent for a bank to which it had assigned leases, if subsection (b)(5) was otherwise met. The same question arises in this opinion request, as well, as the Bank authorized Lessor to service the leases it sold to the Bank. Opinion 02-01 found that servicing by the leasing company would be "permissible when the activities of the leasing company are limited to collecting lease payments and submitting them to the Bank." However, the leasing company's negotiation and control of the lease payments went beyond merely collecting and delivering the payments to the bank and thus failed to meet the requirements under 7 TAC §12.7(b)(5), the opinion concluded.

The Office of the Comptroller of the Currency (OCC), in a 2003 interpretive letter,[20] also reached the same conclusion in addressing a similar question under the OCC's lease financing rule applicable to national banks. That rule, Title 12, Code of Federal Regulations (CFR) §32.3(c)(10), has six conditions similar to those stated in 7 TAC §12.7(b). Subsection (c)(10)(v) requires that "the lessee's lease payments are assigned and paid to the bank…." The OCC found during an examination that the bank in question had violated its legal lending limit[21] because the leases assigned as security for the bank's loans to a leasing company met only five of the six conditions of 12 CFR §32.3(c)(10). The OCC's examiners found that the leases failed to meet Subsection (c)(10)(v)'s requirement because the lessees made their payments to the leasing company and it remitted the payments on a monthly basis to the bank.

The OCC, in the interpretive letter, approved a modification proposed by the bank to the lease servicing arrangement which would require the lessees to make their lease payments to a lockbox account controlled by the bank. With the lockbox procedure in place, the leasing company could continue to provide billing and collections for the leases assigned to the bank, the OCC concluded.[22]

[18] Texas Department of Banking Opinion No. 02-01 (2002), Texas Department of Banking, 2007 Law and Guidance Manual 3189.
[19] Id. at 3190.
[20] OCC Interpretive Letter No. 955 (January 31, 2003).
[21] See 12 United States Code § 84 for the legal lending limits applicable to national banks.
[22] OCC Interpretive Letter No. 955 at 2.

Conclusion:

Based on the above authority, the Bank may satisfy 7 TAC §12.7(b)(5) by restructuring its lease payment arrangement on all the leases purchased from Lessor to require the lessees to make payments directly to the Bank by sending them to a lockbox controlled by the Bank. If the leases purchased from Lessor also satisfy the other five conditions set forth in 7 TAC §12.7(b), then the leases will be considered loans to the lessees and not attributed to Lessor and aggregated with its other Bank loans and extensions of credit for legal lending purposes under Texas Finance Code §34.201.

Our conclusion is based only on the facts, circumstances, assumptions and representations stated in this letter. Any change in those facts, circumstances, assumptions or representations could result in a different conclusion. Furthermore, our conclusion should not be construed as an endorsement of the creditworthiness or suitability of any proposed loan.

As you are undoubtedly aware, a bank must heed the underlying purpose of the legal lending limit, reduction of risk by preventing one individual, or a relatively small group, from borrowing an unduly large amount of the state bank's funds. The bank, therefore, must appropriately evaluate and manage the risks inherent in such lending activities. An examiner will closely scrutinize these types of loans to monitor the bank's adherence to its policies and procedures and to ensure that the bank is administering such loans in a manner that is consistent with safe and sound banking practices.

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OUTSTANDING SUPERVISORY MEMORANDUMS

SUPERVISORY MEMORANDUM – 1001

May 12, 2010 (rev.)

TO: All State-Chartered Banks, Foreign Bank Agencies, and Electronic Data Processors
All Bank and Trust Examining Personnel

FROM: Charles G. Cooper, Commissioner

SUBJECT: Rating Systems for Commercial Banks, Trust Departments, Foreign Bank Agencies, and Electronic Data Processing Operations Supervised by the Department of Banking

BACKGROUND

Supervisory Memorandum 1001 was previously modified on 3/20/97 and 12/31/98 to adopt revised federal rating systems for financial institutions, trust departments, and information technology systems. This revision further clarifies the rating system for trust departments.

OVERVIEW

This Memorandum communicates the rating systems used by the Department to evaluate the condition of entities under its supervision, including state-chartered commercial banks and their trust and electronic data processing (EDP) departments, foreign bank agencies licensed in Texas, and independent EDP providers servicing entities supervised by the Department. The Department also supervises state-chartered trust companies; however, the rating system for these entities is communicated separately in Supervisory Memorandum - 1002. This Memorandum also addresses the Department's policy regarding the disclosure of ratings.

RATING POLICY

The rating systems utilized by the Department, and entities to which they are applicable, are reflected in the following table. The text of the rating systems is attached to this Memorandum.

Regulated Entity	Applicable Rating System
Commercial Banks	Uniform Financial Institutions Rating System ("CAMELS")
Commercial Bank Trust Departments	Uniform Interagency Trust Rating System (modified) ("UITRS")
Commercial Bank EDP Departments & Independent EDP Service Providers	Uniform Interagency Rating System for Information Technology ("URSIT")
Foreign Bank Agencies	Rating System for U.S. Branches and Agencies of Foreign Banking Organizations (the ROCA rating)

DISCLOSURE POLICY

The rating systems assign a component rating to each area of evaluation, as well as a composite rating for the overall institution. It is the policy of this Department to advise boards of directors of regulated entities of all of the ratings assigned by this agency, pursuant to either an independent examination, or a joint or concurrent examination with federal regulators. By disclosing all component or performance ratings, we believe the directors will be more fully informed of the condition of the entities and, therefore, be better equipped to address all financial and operational deficiencies.

While the ratings assigned by the Department may be the same as those assigned by the respective federal agency, some differences in component and/or composite ratings may exist. It is the Department's policy to only disclose the ratings directly assigned by the Department.

The board of directors of each entity will be advised of the ratings assigned by the Department of Banking in a separate, confidential letter addressed to the board. The ratings will not be a matter of public information. It is important to note that the overall composite rating is not an arithmetic average of the individual component or performance ratings, but the composite rating should be consistent with the individual component or performance ratings.

Attachments

UNIFORM FINANCIAL INSTITUTIONS RATING SYSTEM[1]

INTRODUCTION

The Uniform Financial Institutions Rating System (UFIRS) was adopted by the Federal Financial Institutions Examination Council (FFIEC) on November 13, 1979. Over the years, the UFIRS has proven to be an effective internal supervisory tool for evaluating the soundness of financial institutions on a uniform basis and for identifying those institutions requiring special attention or concern. A number of changes, however, have occurred in the banking industry and in the Federal supervisory agencies' policies and procedures which have prompted a review and revision of the 1979 rating system. The revisions to UFIRS include the addition of a sixth component addressing sensitivity to market risks, the explicit reference to the quality of risk management processes in the management component, and the identification of risk elements within the composite and component rating descriptions.

The revisions to UFIRS are not intended to add to the regulatory burden of institutions or require additional policies or processes. The revisions are intended to promote and complement efficient examination processes. The revisions have been made to update the rating system, while retaining the basic framework of the original rating system.

The UFIRS takes into consideration certain financial, managerial, and compliance factors that are common to all institutions. Under this system, the supervisory agencies endeavor to ensure that all financial institutions are evaluated in a comprehensive and uniform manner, and that supervisory attention is appropriately focused on the financial institutions exhibiting financial and operational weaknesses or adverse trends.

The UFIRS also serves as a useful vehicle for identifying problem or deteriorating financial institutions, as well as for categorizing institutions with deficiencies in particular component areas. Further, the rating system assists Congress in following safety and soundness trends and in assessing the aggregate strength and soundness of the financial industry. As such, the UFIRS assists the agencies in fulfilling their collective mission of maintaining stability and public confidence in the nation's financial system.

OVERVIEW

Under the UFIRS, each financial institution is assigned a composite rating based on an evaluation and rating of six essential components of an institution's financial condition and operations. These component factors address the adequacy of capital, the quality of assets, the capability of management, the quality and level of earnings, the adequacy of liquidity and the sensitivity to market risk. Evaluations of the components take into consideration the institution's size and sophistication, the nature and complexity of its activities, and its risk profile.

Composite and component ratings are assigned based on a 1 to 5 numerical scale. A 1 indicates the highest rating, strongest performance and risk management practices, and least degree of supervisory concern, while a 5 indicates the lowest rating, weakest performance, inadequate risk management practices and, therefore, the highest degree of supervisory concern.

The composite rating generally bears a close relationship to the component ratings assigned. However, the composite rating is not derived by computing an arithmetic average of the component ratings. Each component rating is based on a qualitative analysis of the factors comprising that component and its interrelationship with the other components. When assigning a composite rating, some components may be given more weight than others depending on the situation at the institution. In general, assignment of a composite rating may incorporate any factor that bears significantly on the overall condition and soundness of the financial institution. Assigned composite and

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[1] For the purposes of this rating system, the term "financial institution" refers to those insured depository institutions whose primary Federal supervisory agency is represented on the Federal Financial Institutions Examination Council (FFIEC). The agencies comprising the FFIEC are the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the National Credit Union Administration, the Office of the Comptroller of the Currency, and the Office of Thrift Supervision. The term "financial institution" includes Federally supervised commercial banks, savings and loan associations, mutual savings banks, and credit unions.

component ratings are disclosed to the institution's board of directors and senior management.

The ability of management to respond to changing circumstances and to address the risks that may arise from changing business conditions, or the initiation of new activities or products, is an important factor in evaluating a financial institution's overall risk profile and the level of supervisory attention warranted. For this reason, the management component is given special consideration when assigning a composite rating.

The ability of management to identify, measure, monitor, and control the risks of its operations is also taken into account when assigning each component rating. It is recognized, however, that appropriate management practices vary considerably among financial institutions, depending on their size, complexity, and risk profile. For less complex institutions engaged solely in traditional banking activities and whose directors and senior managers, in their respective roles, are actively involved in the oversight and management of day-to-day operations, relatively basic management systems and controls may be adequate. At more complex institutions, on the other hand, detailed and formal management systems and controls are needed to address their broader range of financial activities and to provide senior managers and directors, in their respective roles, with the information they need to monitor and direct day-to-day activities. All institutions are expected to properly manage their risks. For less complex institutions engaging in less sophisticated risk taking activities, detailed or highly formalized management systems and controls are not required to receive strong or satisfactory component or composite ratings.

Foreign Branch and specialty examination findings and the ratings assigned to those areas are taken into consideration, as appropriate, when assigning component and composite ratings under UFIRS. The specialty examination areas include: Compliance, Community Reinvestment, Government Security Dealers, Information Systems, Municipal Security Dealers, Transfer Agent, and Trust.

The following two sections contain the composite rating definitions, and the descriptions and definitions for the six component ratings.

COMPOSITE RATINGS

Composite ratings are based on a careful evaluation of an institution's managerial, operational, financial, and compliance performance. The six key components used to assess an institution's financial condition and operations are: capital adequacy, asset quality, management capability, earnings quantity and quality, the adequacy of liquidity, and sensitivity to market risk. The rating scale ranges from 1 to 5, with a rating of 1 indicating: the strongest performance and risk management practices relative to the institution's size, complexity, and risk profile; and the level of least supervisory concern. A 5 rating indicates: the most critically deficient level of performance; inadequate risk management practices relative to the institution's size, complexity, and risk profile; and the greatest supervisory concern. The composite ratings are defined as follows:

Composite 1 — Financial institutions in this group are sound in every respect and generally have components rated 1 or 2. Any weaknesses are minor and can be handled in a routine manner by the board of directors and management. These financial institutions are the most capable of withstanding the vagaries of business conditions and are resistant to outside influences such as economic instability in their trade area. These financial institutions are in substantial compliance with laws and regulations. As a result, these financial institutions exhibit the strongest performance and risk management practices relative to the institution's size, complexity, and risk profile, and give no cause for supervisory concern.

Composite 2 — Financial institutions in this group are fundamentally sound. For a financial institution to receive this rating, generally no component rating should be more severe than 3. Only moderate weaknesses are present and are well within the board of directors' and management's capabilities and willingness to correct. These financial institutions are stable and are capable of withstanding business fluctuations. These financial institutions are in substantial compliance with laws and regulations. Overall risk management practices are satisfactory relative to the institution's size, complexity, and risk profile. There are no material supervisory concerns and, as a result, the supervisory response is informal and limited.

Composite 3 — Financial institutions in this group exhibit some degree of supervisory concern in one or more of the component areas. These financial institutions exhibit a combination of weaknesses that may range from moderate to severe; however, the magnitude of the deficiencies generally will not cause a component to be rated more severely than 4. Management may lack the ability or willingness to effectively address weaknesses within appropriate time frames. Financial institutions in this group generally are less capable of withstanding business fluctuations and are more vulnerable to outside influences than those institutions rated a composite 1 or 2. Additionally, these financial institutions may be in significant noncompliance with laws and regulations. Risk management practices may be less than satisfactory relative to the institution's size, complexity, and risk profile. These financial institutions require more than normal supervision, which may include formal or informal enforcement actions. Failure appears unlikely, however, given the overall strength and financial capacity of these institutions.

Composite 4 — Financial institutions in this group generally exhibit unsafe and unsound practices or conditions. There are serious financial or managerial deficiencies that result in unsatisfactory performance. The problems range from severe to critically deficient. The weaknesses and problems are not being satisfactorily addressed or resolved by the board of directors and management. Financial institutions in this group generally are not capable of withstanding business fluctuations. There may be significant noncompliance with laws and regulations. Risk management practices are generally unacceptable relative to the institution's size, complexity, and risk profile. Close supervisory attention is required, which means, in most cases, formal enforcement action is necessary to address the problems. Institutions in this group pose a risk to the deposit insurance fund. Failure is a distinct possibility if the problems and weaknesses are not satisfactorily addressed and resolved.

Composite 5 — Financial institutions in this group exhibit extremely unsafe and unsound practices or conditions; exhibit a critically deficient performance; often contain inadequate risk management practices relative to the institution's size, complexity, and risk profile; and are of the greatest supervisory concern. The volume and severity of problems are beyond management's ability or willingness to control or correct. Immediate outside financial or other assistance is needed in order for the financial institution to be viable. Ongoing supervisory attention is necessary. Institutions in this group pose a significant risk to the deposit insurance fund and failure is highly probable.

COMPONENT RATINGS

Each of the component rating descriptions is divided into three sections: an introductory paragraph; a list of the principal evaluation factors that relate to that component; and a brief description of each numerical rating for that component. Some of the evaluation factors are reiterated under one or more of the other components to reinforce the interrelationship between components. The listing of evaluation factors for each component rating is in no particular order of importance.

Capital Adequacy

A financial institution is expected to maintain capital commensurate with the nature and extent of risks to the institution and the ability of management to identify, measure, monitor, and control these risks. The effect of credit, market, and other risks on the institution's financial condition should be considered when evaluating the adequacy of capital. The types and quantity of risk inherent in an institution's activities will determine the extent to which it may be necessary to maintain capital at levels above required regulatory minimums to properly reflect the potentially adverse consequences that these risks may have on the institution's capital.

The capital adequacy of an institution is rated based upon, but not limited to, an assessment of the following evaluation factors:

- X The level and quality of capital and the overall financial condition of the institution.
- X The ability of management to address emerging needs for additional capital.
- X The nature, trend, and volume of problem assets, and the adequacy of allowances for loan and lease losses and other valuation reserves.
- X Balance sheet composition, including the nature and amount of intangible assets, market risk, concentration risk, and risks associated with nontraditional activities.
- X Risk exposure represented by off-balance sheet activities.

- X The quality and strength of earnings, and the reasonableness of dividends.
- X Prospects and plans for growth, as well as past experience in managing growth.
- X Access to capital markets and other sources of capital, including support provided by a parent holding company.

Capital Adequacy Ratings

1 A rating of 1 indicates a strong capital level relative to the institution's risk profile.

2 A rating of 2 indicates a satisfactory capital level relative to the financial institution's risk profile.

3 A rating of 3 indicates a less than satisfactory level of capital that does not fully support the institution's risk profile. The rating indicates a need for improvement, even if the institution's capital level exceeds minimum regulatory and statutory requirements.

4 A rating of 4 indicates a deficient level of capital. In light of the institution's risk profile, viability of the institution may be threatened. Assistance from shareholders or other external sources of financial support may be required.

5 A rating of 5 indicates a critically deficient level of capital such that the institution's viability is threatened. Immediate assistance from shareholders or other external sources of financial support is required.

Asset Quality

The asset quality rating reflects the quantity of existing and potential credit risk associated with the loan and investment portfolios, other real estate owned, and other assets, as well as off-balance sheet transactions. The ability of management to identify, measure, monitor, and control credit risk is also reflected here. The evaluation of asset quality should consider the adequacy of the allowance for loan and lease losses and weigh the exposure to counterparty, issuer, or borrower default under actual or implied contractual agreements. All other risks that may affect the value or marketability of an institution's assets, including, but not limited to, operating, market, reputation, strategic, or compliance risks, should also be considered.

The asset quality of a financial institution is rated based upon, but not limited to, an assessment of the following evaluation factors:

- X The adequacy of underwriting standards, soundness of credit administration practices, and appropriateness of risk identification practices.
- X The level, distribution, severity, and trend of problem, classified, nonaccrual, restructured, delinquent, and nonperforming assets for both on- and off-balance sheet transactions.
- X The adequacy of the allowance for loan and lease losses and other asset valuation reserves.
- X The credit risk arising from or reduced by off-balance sheet transactions, such as unfunded commitments, credit derivatives, commercial and standby letters of credit, and lines of credit.
- X The diversification and quality of the loan and investment portfolios.
- X The extent of securities underwriting activities and exposure to counterparties in trading activities.
- X The existence of asset concentrations.
- X The adequacy of loan and investment policies, procedures, and practices.
- X The ability of management to properly administer its assets, including the timely identification and collection of problem assets.
- X The adequacy of internal controls and management information systems.
- X The volume and nature of credit documentation exceptions.

Asset Quality Ratings

1 A rating of 1 indicates strong asset quality and credit administration practices. Identified weaknesses are minor in nature and risk exposure is modest in relation to capital protection and management's abilities. Asset quality in such institutions is of minimal supervisory concern.

2 A rating of 2 indicates satisfactory asset quality and credit administration practices. The level and severity of classifications and other weaknesses warrant a limited level of supervisory attention. Risk exposure is commensurate with capital protection and management's abilities.

3 A rating of 3 is assigned when asset quality or credit administration practices are less than satisfactory. Trends may be stable or indicate deterioration in asset quality or an increase in risk exposure. The level and severity of classified assets, other weaknesses, and risks require an elevated level of supervisory concern. There is generally a need to improve credit administration and risk management practices.

4 A rating of 4 is assigned to financial institutions with deficient asset quality or credit administration practices. The levels of risk and problem assets are significant, inadequately controlled, and subject the financial institution to potential losses that, if left unchecked, may threaten its viability.

5 A rating of 5 represents critically deficient asset quality or credit administration practices that present an imminent threat to the institution's viability.

Management

The capability of the board of directors and management, in their respective roles, to identify, measure, monitor, and control the risks of an institution's activities and to ensure a financial institution's safe, sound, and efficient operation in compliance with applicable laws and regulations is reflected in this rating. Generally, directors need not be actively involved in day-to-day operations; however, they must provide clear guidance regarding acceptable risk exposure levels and ensure that appropriate policies, procedures, and practices have been established. Senior management is responsible for developing and implementing policies, procedures, and practices that translate the board's goals, objectives, and risk limits into prudent operating standards.

Depending on the nature and scope of an institution's activities, management practices may need to address some or all of the following risks: credit, market, operating or transaction, reputation, strategic, compliance, legal, liquidity, and other risks. Sound management practices are demonstrated by: active oversight by the board of directors and management; competent personnel; adequate policies, processes, and controls taking into consideration the size and sophistication of the institution; maintenance of an appropriate audit program and internal control environment; and effective risk monitoring and management information systems. This rating should reflect the board's and management's ability as it applies to all aspects of banking operations as well as other financial service activities in which the institution is involved.

The capability and performance of management and the board of directors is rated based upon, but not limited to, an assessment of the following evaluation factors:

X The level and quality of oversight and support of all institution activities by the board of directors and management.
X The ability of the board of directors and management, in their respective roles, to plan for, and respond to, risks that may arise from changing business conditions or the initiation of new activities or products.
X The adequacy of, and conformance with, appropriate internal policies and controls addressing the operations and risks of significant activities.
X The accuracy, timeliness, and effectiveness of management information and risk monitoring systems appropriate for the institution's size, complexity, and risk profile.
X The adequacy of audits and internal controls to: promote effective operations and reliable financial and regulatory reporting; safeguard assets; and ensure compliance with laws, regulations, and internal policies.
X Compliance with laws and regulations. Responsiveness to recommendations from auditors and supervisory authorities.

X Management depth and succession.
X The extent that the board of directors and management is affected by, or susceptible to, dominant influence or concentration of authority.
X Reasonableness of compensation policies and avoidance of self-dealing.
X Demonstrated willingness to serve the legitimate banking needs of the community.
X The overall performance of the institution and its risk profile.

Management Ratings

1 A rating of 1 indicates strong performance by management and the board of directors and strong risk management practices relative to the institution's size, complexity, and risk profile. All significant risks are consistently and effectively identified, measured, monitored, and controlled. Management and the board have demonstrated the ability to promptly and successfully address existing and potential problems and risks.

2 A rating of 2 indicates satisfactory management and board performance and risk management practices relative to the institution's size, complexity, and risk profile. Minor weaknesses may exist, but are not material to the safety and soundness of the institution and are being addressed. In general, significant risks and problems are effectively identified, measured, monitored, and controlled.

3 A rating of 3 indicates management and board performance that need improvement or risk management practices that are less than satisfactory given the nature of the institution's activities. The capabilities of management or the board of directors may be insufficient for the type, size, or condition of the institution. Problems and significant risks may be inadequately identified, measured, monitored, or controlled.

4 A rating of 4 indicates deficient management and board performance or risk management practices that are inadequate considering the nature of an institution's activities. The level of problems and risk exposure is excessive. Problems and significant risks are inadequately identified, measured, monitored, or controlled and require immediate action by the board and management to preserve the soundness of the institution. Replacing or strengthening management or the board may be necessary.

5 A rating of 5 indicates critically deficient management and board performance or risk management practices. Management and the board of directors have not demonstrated the ability to correct problems and implement appropriate risk management practices. Problems and significant risks are inadequately identified, measured, monitored, or controlled and now threaten the continued viability of the institution. Replacing or strengthening management or the board of directors is necessary.

Earnings

This rating reflects not only the quantity and trend of earnings, but also factors that may affect the sustainability or quality of earnings. The quantity as well as the quality of earnings can be affected by excessive or inadequately managed credit risk that may result in loan losses and require additions to the allowance for loan and lease losses, or by high levels of market risk that may unduly expose an institution's earnings to volatility in interest rates. The quality of earnings may also be diminished by undue reliance on extraordinary gains, nonrecurring events, or favorable tax effects. Future earnings may be adversely affected by an inability to forecast or control funding and operating expenses, improperly executed or ill-advised business strategies, or poorly managed or uncontrolled exposure to other risks.

The rating of an institution's earnings is based upon, but not limited to, an assessment of the following evaluation factors:

X The level of earnings, including trends and stability.
X The ability to provide for adequate capital through retained earnings.
X The quality and sources of earnings.
X The level of expenses in relation to operations.

- X The adequacy of the budgeting systems, forecasting processes, and management information systems in general.
- X The adequacy of provisions to maintain the allowance for loan and lease losses and other valuation allowance accounts.
- X The earnings exposure to market risk such as interest rate, foreign exchange, and price risks.

Earnings Ratings

1 A rating of 1 indicates earnings that are strong. Earnings are more than sufficient to support operations and maintain adequate capital and allowance levels after consideration is given to asset quality, growth, and other factors affecting the quality, quantity, and trend of earnings.

2 A rating of 2 indicates earnings that are satisfactory. Earnings are sufficient to support operations and maintain adequate capital and allowance levels after consideration is given to asset quality, growth, and other factors affecting the quality, quantity, and trend of earnings. Earnings that are relatively static, or even experiencing a slight decline, may receive a 2 rating provided the institution's level of earnings is adequate in view of the assessment factors listed above.

3 A rating of 3 indicates earnings that need to be improved. Earnings may not fully support operations and provide for the accretion of capital and allowance levels in relation to the institution's overall condition, growth, and other factors affecting the quality, quantity, and trend of earnings.

4 A rating of 4 indicates earnings that are deficient. Earnings are insufficient to support operations and maintain appropriate capital and allowance levels. Institutions so rated may be characterized by erratic fluctuations in net income or net interest margin, the development of significant negative trends, nominal or unsustainable earnings, intermittent losses, or a substantive drop in earnings from the previous years.

5 A rating of 5 indicates earnings that are critically deficient. A financial institution with earnings rated 5 is experiencing losses that represent a distinct threat to its viability through the erosion of capital.

Liquidity

In evaluating the adequacy of a financial institution's liquidity position, consideration should be given to the current level and prospective sources of liquidity compared to funding needs, as well as to the adequacy of funds management practices relative to the institution's size, complexity, and risk profile. In general, funds management practices should ensure that an institution is able to maintain a level of liquidity sufficient to meet its financial obligations in a timely manner and to fulfill the legitimate banking needs of its community. Practices should reflect the ability of the institution to manage unplanned changes in funding sources, as well as react to changes in market conditions that affect the ability to quickly liquidate assets with minimal loss. In addition, funds management practices should ensure that liquidity is not maintained at a high cost, or through undue reliance on funding sources that may not be available in times of financial stress or adverse changes in market conditions.

Liquidity is rated based upon, but not limited to, an assessment of the following evaluation factors:

- X The adequacy of liquidity sources compared to present and future needs and the ability of the institution to meet liquidity needs without adversely affecting its operations or condition.
- X The availability of assets readily convertible to cash without undue loss.
- X Access to money markets and other sources of funding.
- X The level of diversification of funding sources, both on- and off-balance sheet.
- X The degree of reliance on short-term, volatile sources of funds, including borrowings and brokered deposits, to fund longer term assets.
- X The trend and stability of deposits.
- X The ability to securitize and sell certain pools of assets.

- X The capability of management to properly identify, measure, monitor, and control the institution's liquidity position, including the effectiveness of funds management strategies, liquidity policies, management information systems, and contingency funding plans.

Liquidity Ratings

1 A rating of 1 indicates strong liquidity levels and well-developed funds management practices. The institution has reliable access to sufficient sources of funds on favorable terms to meet present and anticipated liquidity needs.

2 A rating of 2 indicates satisfactory liquidity levels and funds management practices. The institution has access to sufficient sources of funds on acceptable terms to meet present and anticipated liquidity needs. Modest weaknesses may be evident in funds management practices.

3 A rating of 3 indicates liquidity levels or funds management practices in need of improvement. Institutions rated 3 may lack ready access to funds on reasonable terms or may evidence significant weaknesses in funds management practices.

4 A rating of 4 indicates deficient liquidity levels or inadequate funds management practices. Institutions rated 4 may not have or be able to obtain a sufficient volume of funds on reasonable terms to meet liquidity needs.

5 A rating of 5 indicates liquidity levels or funds management practices so critically deficient that the continued viability of the institution is threatened. Institutions rated 5 require immediate external financial assistance to meet maturing obligations or other liquidity needs.

Sensitivity to Market Risk

The sensitivity to market risk component reflects the degree to which changes in interest rates, foreign exchange rates, commodity prices, or equity prices can adversely affect a financial institution's earnings or economic capital. When evaluating this component, consideration should be given to: management's ability to identify, measure, monitor, and control market risk; the institution's size; the nature and complexity of its activities; and the adequacy of its capital and earnings in relation to its level of market risk exposure.

For many institutions, the primary source of market risk arises from nontrading positions and their sensitivity to changes in interest rates. In some larger institutions, foreign operations can be a significant source of market risk. For some institutions, trading activities are a major source of market risk.

Market risk is rated based upon, but not limited to, an assessment of the following evaluation factors:

- X The sensitivity of the financial institution's earnings or the economic value of its capital to adverse changes in interest rates, foreign exchanges rates, commodity prices, or equity prices.
- X The ability of management to identify, measure, monitor, and control exposure to market risk given the institution's size, complexity, and risk profile.
- X The nature and complexity of interest rate risk exposure arising from nontrading positions.
- X Where appropriate, the nature and complexity of market risk exposure arising from trading and foreign operations.

Sensitivity to Market Risk Ratings

1 A rating of 1 indicates that market risk sensitivity is well controlled and that there is minimal potential that the earnings performance or capital position will be adversely affected. Risk management practices are strong for the size, sophistication, and market risk accepted by the institution. The level of earnings and capital provide substantial support for the degree of market risk taken by the institution.

2 A rating of 2 indicates that market risk sensitivity is adequately controlled and that there is only moderate potential that the earnings performance or capital position will be adversely affected. Risk management practices are satisfactory for the size, sophistication, and market risk accepted by the institution. The level of earnings and capital provide adequate support for the degree of market risk taken by the institution.

3 A rating of 3 indicates that control of market risk sensitivity needs improvement or that there is significant potential that the earnings performance or capital position will be adversely affected. Risk management practices need to be improved given the size, sophistication, and level of market risk accepted by the institution. The level of earnings and capital may not adequately support the degree of market risk taken by the institution.

4 A rating of 4 indicates that control of market risk sensitivity is unacceptable or that there is high potential that the earnings performance or capital position will be adversely affected. Risk management practices are deficient for the size, sophistication, and level of market risk accepted by the institution. The level of earnings and capital provide inadequate support for the degree of market risk taken by the institution.

5 A rating of 5 indicates that control of market risk sensitivity is unacceptable or that the level of market risk taken by the institution is an imminent threat to its viability. Risk management practices are wholly inadequate for the size, sophistication, and level of market risk accepted by the institution.

UNIFORM INTERAGENCY TRUST RATING SYSTEM (MODIFIED)

OVERVIEW

Under the modified UITRS, the fiduciary activities of financial institutions are assigned a composite rating based on an evaluation and rating of five essential components of an institution's fiduciary activities. These components address the following: the capability of management; the adequacy of operations, controls and audits; the quality and level of earnings; compliance with governing instruments, applicable law (including self-dealing and conflicts of interest laws and regulations), and sound fiduciary principles; and the management of fiduciary assets.

Composite and component ratings are assigned based on a 1 to 5 numerical scale. A 1 is the highest rating and indicates the strongest performance and risk management practices and the least degree of supervisory concern. A 5 is the lowest rating and indicates the weakest performance and risk management practices and, therefore, the highest degree of supervisory concern. A rating of 0 is also possible under the Asset Management component of the modified UITRS, for institutions which do not engage in any asset management activities. Evaluation of the composite and components considers the size and sophistication, the nature and complexity, and the risk profile of the institution's fiduciary activities.

The composite rating generally bears a close relationship to the component ratings assigned. However, the composite rating is not derived by computing an arithmetic average of the component ratings. Each component rating is based on a qualitative analysis of the factors comprising that component and its interrelationship with the other components. When assigning a composite rating, some components may be given more weight than others depending on the situation at the institution. In general, assignment of a composite rating may incorporate any factor that bears significantly on the overall administration of the financial institution's fiduciary activities. Assigned composite and component ratings are disclosed to the institution's board of directors and senior management.

The ability of management to respond to changing circumstances and to address the risks that may arise from changing business conditions, or the initiation of new fiduciary activities or products, is an important factor in evaluating an institution's overall fiduciary risk profile and the level of supervisory attention warranted. For this reason, the management component is given special consideration when assigning a composite rating.

The ability of management to identify, measure, monitor, and control the risks of its fiduciary operations is also taken into account when assigning each component rating. It is recognized, however, that appropriate management practices may vary considerably among financial institutions, depending on the size, complexity and risk profiles of their fiduciary activities. For less complex institutions engaged solely in traditional fiduciary activities and whose directors and senior managers are actively involved in the oversight and management of day-to-day operations, relatively basic management systems and controls may be adequate. On the other hand, at more complex institutions, detailed and formal management systems and controls are needed to address a broader range of activities and to provide senior managers and directors with the information they need to supervise day-to-day activities.

All institutions are expected to properly manage their risks. For less complex institutions engaging in less risky activities, detailed or highly formalized management systems and controls are not required to receive strong or satisfactory component or composite ratings.

The following two sections contain the composite rating definitions, and the descriptions and definitions for the five component ratings.

COMPOSITE RATINGS

Composite ratings are based on a careful evaluation of how an institution conducts its fiduciary activities. The review encompasses the capability of management, the soundness of policies and practices, the quality of service rendered to the public, and the effect of fiduciary activities upon the soundness of the institution. The five key components used to assess an institution's fiduciary activities are: the capability of management; the adequacy of operations, controls and audits; the quality and level of earnings; compliance with governing instruments, applicable law (including self-dealing and conflicts of interest laws and regulations), and sound fiduciary principles; and the management of fiduciary assets. The composite ratings are defined as follows:

Composite 1 — Administration of fiduciary activities is sound in every respect. Generally all components are rated 1 or 2. Any weaknesses are minor and can be handled in a routine manner by management. The institution is in substantial compliance with fiduciary laws and regulations. Risk management practices are strong relative to the size, complexity, and risk profile of the institution's fiduciary activities. Fiduciary activities are conducted in accordance with sound fiduciary principles and give no cause for supervisory concern.

Composite 2 — Administration of fiduciary activities is fundamentally sound. Generally no component rating should be more severe than 3. Only moderate weaknesses are present and are well within management's capabilities and willingness to correct. Fiduciary activities are conducted in substantial compliance with laws and regulations. Overall risk management practices are satisfactory relative to the institution's size, complexity, and risk profile. There are no material supervisory concerns and, as a result, the supervisory response is informal and limited.

Composite 3 — Administration of fiduciary activities exhibits some degree of supervisory concern in one or more of the component areas. A combination of weaknesses exists that may range from moderate to severe; however, the magnitude of the deficiencies generally does not cause a component to be rated more severely than 4. Management may lack the ability or willingness to effectively address weaknesses within appropriate time frames. Additionally, fiduciary activities may reveal some significant noncompliance with laws and regulations. Risk management practices may be less than satisfactory relative to the institution's size, complexity, and risk profile. While problems of relative significance may exist, they are not of such importance as to pose a threat to the trust beneficiaries generally, or to the soundness of the institution. The institution's fiduciary activities require more than normal supervision and may include formal or informal enforcement actions.

Composite 4 — Fiduciary activities generally exhibit unsafe and unsound practices or conditions, resulting in unsatisfactory performance. The problems range from severe to critically deficient and may be centered around inexperienced or inattentive management, weak or dangerous operating practices, or an accumulation of unsatisfactory features of lesser importance. The weaknesses and problems are not being satisfactorily addressed or resolved by the board of directors and management. There may be significant noncompliance with laws and regulations. Risk management practices are generally unacceptable relative to the size, complexity, and risk profile of fiduciary activities. These problems pose a threat to the account beneficiaries generally and, if left unchecked, could evolve into conditions that could cause significant losses to the institution and ultimately undermine the public confidence in the institution. Close supervisory attention is required, which means, in most cases, formal enforcement action is necessary to address the problems.

Composite 5 — Fiduciary activities are conducted in an extremely unsafe and unsound manner. Administration of fiduciary activities is critically deficient in numerous major respects, with problems resulting from incompetent or neglectful administration, flagrant and/or repeated disregard for laws and regulations, or a willful departure from sound fiduciary principles and practices. The volume and severity of problems are beyond management's ability or willingness to control or correct. Such conditions evidence a flagrant disregard for the interests of the beneficiaries and may pose a serious threat to the soundness of the institution. Continuous close supervisory attention is warranted and may include termination of the institution's fiduciary activities.

COMPONENT RATINGS

Each of the component rating descriptions is divided into three sections: a narrative description of the component; a list of the principal factors used to evaluate that component; and a description of each numerical rating for that component. Some of the evaluation factors are reiterated under one or more of the other components to reinforce the interrelationship among components. The listing of evaluation factors is in no particular order of importance.

Management

This rating reflects the capability of the board of directors and management, in their respective roles, to identify, measure, monitor and control the risks of an institution's fiduciary activities. It also reflects their ability to ensure that the institution's fiduciary activities are conducted in a safe and sound manner, and in compliance with applicable laws and regulations. Directors should provide clear guidance regarding acceptable risk exposure levels and ensure that appropriate policies, procedures and practices are established and followed. Senior fiduciary management is responsible for developing and implementing policies, procedures and practices that translate the board's objectives and risk limits into prudent operating standards.

Depending on the nature and scope of an institution's fiduciary activities, management practices may need to address some or all of the following risks: reputation, operating or transaction, strategic, compliance, legal, credit, market, liquidity and other risks. Sound management practices are demonstrated by: active oversight by the board of directors and management; competent personnel; adequate policies, processes, and controls that consider the size and complexity of the institution's fiduciary activities; and effective risk monitoring and management information systems. This rating should reflect the board's and management's ability as it applies to all aspects of fiduciary activities in which the institution is involved.

The management rating is based upon an assessment of the capability and performance of management and the board of directors, including, but not limited to, the following evaluation factors:

- The level and quality of oversight and support of fiduciary activities by the board of directors and management, including committee structure and adequate documentation of committee actions.
- The ability of the board of directors and management, in their respective roles, to plan for, and respond to, risks that may arise from changing business conditions or the introduction of new activities or products.
- The adequacy of, and conformance with, appropriate internal policies, practices and controls addressing the operations and risks of significant fiduciary activities.
- The accuracy, timeliness, and effectiveness of management information and risk monitoring systems appropriate for the institution's size, complexity, and fiduciary risk profile.
- The overall level of compliance with laws, regulations, and sound fiduciary principles.
- Responsiveness to recommendations from auditors and regulatory authorities.
- Strategic planning for fiduciary products and services.
- The level of experience and competence of fiduciary management and staff, including issues relating to turnover and succession planning.
- The adequacy of insurance coverage.
- The availability of competent legal counsel.
- The extent and nature of pending litigation associated with fiduciary activities, and its potential impact on earnings, capital, and the institution's reputation.
- The process for identifying and responding to fiduciary customer complaints.

Management Ratings

Rating No. 1 — indicates strong performance by management and the board of directors and strong risk management practices relative to the size, complexity and risk profile of the institution's fiduciary activities. All significant risks are consistently and effectively identified, measured, monitored, and controlled. Management and the board are proactive, and have demonstrated the ability to promptly and successfully address existing and potential problems and risks.

Rating No. 2 — indicates satisfactory management and board performance and risk management practices relative to the size, complexity and risk profile of the institution's fiduciary activities. Moderate weaknesses may exist, but are not material to the sound administration of fiduciary activities, and are being addressed. In general, significant risks and problems are effectively identified, measured, monitored, and controlled.

Rating No. 3 — indicates management and board performance that needs improvement or risk management practices that are less than satisfactory given the nature of the institution's fiduciary activities. The capabilities of management or the board of directors may be insufficient for the size, complexity, and risk profile of the institution's fiduciary activities. Problems and significant risks may be inadequately identified, measured, monitored, or controlled.

Rating No. 4 — indicates deficient management and board performance or risk management practices that are inadequate considering the size, complexity, and risk profile of the institution's fiduciary activities. The level of problems and risk exposure is excessive. Problems and significant risks are inadequately identified, measured, monitored, or controlled and require immediate action by the board and management to protect the assets of account beneficiaries and to prevent erosion of public confidence in the institution. Replacing or strengthening management or the board may be necessary.

Rating No. 5 — indicates critically deficient management and board performance or risk management practices. Management and the board of directors have not demonstrated the ability to correct problems and implement appropriate risk management practices. Problems and significant risks are inadequately identified, measured, monitored, or controlled and now threaten the continued viability of the institution or its administration of fiduciary activities, and pose a threat to the safety of the assets of account beneficiaries. Replacing or strengthening management or the board of directors is necessary.

Operations, Internal Controls & Auditing

This rating reflects the adequacy of the institution's fiduciary operating systems and internal controls in relation to the volume and character of business conducted. Audit coverage must assure the integrity of the financial records, the sufficiency of internal controls, and the adequacy of the compliance process.

The institution's fiduciary operating systems, internal controls, and audit function subject it primarily to transaction and compliance risk. Other risks including reputation, strategic, and financial risk may also be present. The ability of management to identify, measure, monitor and control these risks is reflected in this rating. The operations, internal controls and auditing rating is based upon, but not limited to, an assessment of the following evaluation factors:

Operations and Internal Controls, including the adequacy of:

- Staff, facilities and operating systems;
- Records, accounting and data processing systems (including controls over systems access and such accounting procedures as aging, investigation and disposition of items in suspense accounts);
- Trading functions and securities lending activities;
- Vault controls and securities movement;
- Segregation of duties;
- Controls over disbursements (checks or electronic) and unissued securities;
- Controls over income processing activities;
- Reconciliation processes (depository, cash, vault, sub-custodians, suspense accounts, etc.);
- Disaster and/or business recovery programs;
- Hold-mail procedures and controls over returned mail; and,
- Investigation and proper escheatment of funds in dormant accounts.

Auditing, including:

- The independence, frequency, quality and scope of the internal and external fiduciary audit function relative to the volume, character and risk profile of the institution's fiduciary activities;
- The volume and/or severity of internal control and audit exceptions and the extent to which these issues are tracked and resolved; and
- The experience and competence of the audit staff.

Operations, Internal Controls & Auditing Ratings

Rating No. 1 — indicates that operations, internal controls, and auditing are strong in relation to the volume and character of the institution's fiduciary activities. All significant risks are consistently and effectively identified, measured, monitored, and controlled.

Rating No. 2 — indicates that operations, internal controls and auditing are satisfactory in relation to the volume and character of the institution's fiduciary activities. Moderate weaknesses may exist, but are not material. Significant risks, in general, are effectively identified, measured, monitored, and controlled.

Rating No. 3 — indicates that operations, internal controls or auditing need improvement in relation to the volume and character of the institution's fiduciary activities. One or more of these areas are less than satisfactory. Problems and significant risks may be inadequately identified, measured, monitored, or controlled.

Rating No. 4 — indicates deficient operations, internal controls or audits. One or more of these areas are inadequate or the level of problems and risk exposure is excessive in relation to the volume and character of the institution's fiduciary activities. Problems and significant risks are inadequately identified, measured, monitored, or controlled and require immediate action. Institutions with this level of deficiencies may make little provision for audits, or may evidence weak or potentially dangerous operating practices in combination with infrequent or inadequate audits.

Rating No. 5 — indicates critically deficient operations, internal controls or audits. Operating practices, with or without audits, pose a serious threat to the safety of assets of fiduciary accounts. Problems and significant risks are inadequately identified, measured, monitored, or controlled and now threaten the ability of the institution to continue engaging in fiduciary activities.

Earnings

This rating reflects the profitability of an institution's fiduciary activities and its effect on the financial condition of the institution. The use and adequacy of budgets and earnings projections by functions, product lines and clients are reviewed and evaluated.

Risk exposure that may lead to negative earnings is also evaluated.

An evaluation of earnings is required for all institutions with fiduciary activities. An assignment of an earnings rating, however, is required only for institutions that, at the time of the examination, have total trust assets of more than $100 million, or are a non-deposit trust company (those institutions that would be required to file Schedule E of FFIEC 001).

For institutions where the assignment of an Earnings rating is not required by the UITRS, the Department of Banking has the option to assign an earnings rating using an alternate set of ratings. A rating will be assigned in accordance with implementing guidelines adopted by the supervisory agency. The definitions for the alternate ratings may be found in the section immediately following the definitions for the required ratings.

The evaluation of earnings is based upon, but not limited to, an assessment of the following factors:

- The profitability of fiduciary activities in relation to the size and scope of those activities and to the overall business of the institution.
- The overall importance to the institution of offering fiduciary services to its customers and local community.
- The effectiveness of the institution's procedures for monitoring fiduciary activity income and expense relative to the size and scope of these activities and their relative importance to the institution, including the frequency and scope of profitability reviews and planning by the institution's board of directors or a committee thereof.
- The level and consistency of profitability, or the lack thereof, generated by the institution's fiduciary activities in relation to the volume and character of the institution's business.
- Dependence upon non-recurring fees and commissions, such as fees for court accounts.
- The effects of charge-offs or compromise actions.
- Unusual features regarding the composition of business and fee schedules.
- Accounting practices that contain practices such as (1) unusual methods of allocating direct and indirect expenses and overhead, or (2) unusual methods of allocating fiduciary income and expense where two or

more fiduciary institutions within the same holding company family share fiduciary services and/or processing functions.

- The extent of management's use of budgets, projections and other cost analysis procedures.
- Methods used for directors' approval of financial budgets and/or projections.
- Management's attitude toward growth and new business development.
- New business development efforts, including types of business solicited, market potential, advertising, competition, relationships with local organizations, and an evaluation by management of risk potential inherent in new business areas.

Earnings Ratings

Rating No. 1 — indicates strong earnings. The institution consistently earns a rate of return on its fiduciary activities that is commensurate with the risk of those activities. This rating would normally be supported by a history of consistent profitability over time and a judgment that future earnings prospects are favorable.

In addition, management techniques for evaluating and monitoring earnings performance are fully adequate and there is appropriate oversight by the institution's board of directors or a committee thereof. Management makes effective use of budgets and cost analysis procedures. Methods used for reporting earnings information to the board of directors, or a committee thereof, are comprehensive.

Rating No. 2 — indicates satisfactory earnings. Although the earnings record may exhibit some weaknesses, earnings performance does not pose a risk to the overall institution nor to its ability to meet its fiduciary obligations. Generally, fiduciary earnings meet management targets and appear to be at least sustainable. Management processes for evaluating and monitoring earnings are generally sufficient in relationship to the size and risk of fiduciary activities that exist, and any deficiencies can be addressed in the normal course of business. A rating of 2 may also be assigned to institutions with a history of profitable operations if there are indications that management is engaging in activities with which it is not familiar, or where there may be inordinately high levels of risk present that have not been adequately evaluated. Alternatively, an institution with otherwise strong earnings performance may also be assigned a 2 rating if there are significant deficiencies in its methods used to monitor and evaluate earnings.

Rating No. 3 — indicates less than satisfactory earnings. Earnings are not commensurate with the risk associated with the fiduciary activities undertaken. Earnings may be erratic or exhibit downward trends, and future prospects are unfavorable. This rating may also be assigned if management processes for evaluating and monitoring earnings exhibit serious deficiencies, provided the deficiencies identified do not pose an immediate danger to either the overall financial condition of the institution or its ability to meet its fiduciary obligations.

Rating No. 4 — indicates earnings that are seriously deficient. Fiduciary activities have a significant adverse effect on the overall income of the institution and its ability to generate adequate capital to support the continued operation of its fiduciary activities. The institution is characterized by fiduciary earnings performance that is poor historically, or faces the prospect of significant losses in the future. Management processes for monitoring and evaluating earnings may be poor. The board of directors has not adopted appropriate measures to address significant deficiencies.

Rating No. 5 — indicates critically deficient earnings. In general, an institution with this rating is experiencing losses from fiduciary activities that have a significant negative impact on the overall institution, representing a distinct threat to its viability through the erosion of its capital. The board of directors has not implemented effective actions to address the situation.

Alternate Rating of Earnings

Alternate ratings are assigned based on the level of implementation of four minimum standards by the board of directors and management.

These standards are:

- Standard No. 1 — The institution has reasonable methods for measuring income and expense commensurate with the volume and nature of the fiduciary services offered.
- Standard No. 2 — The level of profitability is reported to the board of directors, or a committee thereof, at least annually.
- Standard No. 3 — The board of directors periodically determines that the continued offering of fiduciary services provides an essential service to the institution's customers or to the local community.
- Standard No. 4 — The board of directors, or a committee thereof, reviews the justification for the institution to continue to offer fiduciary services even if the institution does not earn sufficient income to cover the expenses of providing those services.

Alternate Ratings

Rating No. 1 — may be assigned where an institution has implemented all four minimum standards. If fiduciary earnings are lacking, management views this as a cost of doing business as a full service institution and believes that the negative effects of not offering fiduciary services are more significant than the expense of administrating those services.

Rating No. 2 — may be assigned where an institution has implemented, at a minimum, at least three of the four standards. This rating may be assigned if the institution is not generating positive earnings or where formal earnings information may not be available.

Rating No. 3 — may be assigned if the institution has implemented at least two of the four standards. While management may have attempted to identify and quantify other revenue to be earned by offering fiduciary services, it has decided that these services should be offered as a service to customers, even if they cannot be operated profitably.

Rating No. 4 — may be assigned if the institution has implemented only one of the four standards. Management has undertaken little or no effort to identify or quantify the collateral advantages, if any, to the institution from offering fiduciary services.

Rating No. 5 — may be assigned if the institution has implemented none of the standards.

Compliance

This rating reflects an institution's overall compliance with applicable laws, regulations, accepted standards of fiduciary conduct, governing account instruments, duties associated with account administration, and internally established policies and procedures. This component specifically incorporates an assessment of a fiduciary's duty of undivided loyalty and compliance with applicable laws, regulations, and accepted standards of fiduciary conduct related to self-dealing and other conflicts of interest.

The compliance component includes reviewing and evaluating the adequacy and soundness of adopted policies, procedures, and practices generally, and as they relate to specific transactions and accounts. It also includes reviewing policies, procedures, and practices to evaluate the sensitivity of management and the board of directors to refrain from self-dealing, minimize potential conflicts of interest, and resolve actual conflict situations in favor of the fiduciary account beneficiaries.

Risks associated with account administration are potentially unlimited because each account is a separate contractual relationship that contains specific obligations. Risks associated with account administration include: failure to comply with applicable laws, regulations or terms of the governing instrument; inadequate account administration practices; and inexperienced management or inadequately trained staff. Risks associated with a fiduciary's duty of undivided loyalty generally stem from engaging in self-dealing or other conflict of interest transactions. An institution may be exposed to compliance, strategic, financial and reputation risk related to account administration and conflicts of interest activities. The ability of management to identify, measure, monitor and control these risks is reflected in this rating. Policies, procedures and practices pertaining to account administration and conflicts of interest are evaluated in light of the size and character of an institution's fiduciary business.

The compliance rating is based upon, but not limited to, an assessment of the following evaluation factors:

- Compliance with applicable federal and state statutes and regulations, including, but not limited to, federal and state fiduciary laws, the Employee Retirement Income Security Act of 1974, federal and state securities laws, state investment standards, state principal and income acts, and state probate codes;
- Compliance with the terms of governing instruments;
- The adequacy of overall policies, practices, and procedures governing compliance, considering the size, complexity, and risk profile of the institution's fiduciary activities;
- The adequacy of policies and procedures addressing account administration;
- The adequacy of policies and procedures addressing conflicts of interest, including those designed to prevent the improper use of “material inside information”;
- The effectiveness of systems and controls in place to identify actual and potential conflicts of interest;
- The adequacy of securities trading policies and practices relating to the allocation of brokerage business, the payment of services with “soft dollars” and the combining, crossing, and timing of trades;
- The extent and permissibility of transactions with related parties, including, but not limited to, the volume of related commercial and fiduciary relationships and holdings of corporations in which directors, officers, or employees of the institution may be interested;
- The decision making process used to accept, review, and terminate accounts; and
- The decision making process related to account administration duties, including cash balances, overdrafts, and discretionary distributions.

Compliance Ratings

Rating No. 1 — indicates strong compliance policies, procedures and practices. Policies and procedures covering conflicts of interest and account administration are appropriate in relation to the size and complexity of the institution's fiduciary activities. Accounts are administered in accordance with governing instruments, applicable laws and regulations, sound fiduciary principles, and internal policies and procedures. Any violations are isolated, technical in nature and easily correctable. All significant risks are consistently and effectively identified, measured, monitored and controlled.

Rating No. 2 — indicates fundamentally sound compliance policies, procedures and practices in relation to the size and complexity of the institution's fiduciary activities. Account administration may be flawed by moderate weaknesses in policies, procedures or practices. Management's practices indicate a determination to minimize the instances of conflicts of interest. Fiduciary activities are conducted in substantial compliance with laws and regulations, and any violations are generally technical in nature. Management corrects violations in a timely manner and without loss to fiduciary accounts. Significant risks are effectively identified, measured, monitored, and controlled.

Rating No. 3 — indicates compliance practices that are less than satisfactory in relation to the size and complexity of the institution's fiduciary activities. Policies, procedures and controls have not proven effective and require strengthening. Fiduciary activities may be in substantial noncompliance with laws, regulations or governing instruments, but losses are no worse than minimal. While management may have the ability to achieve compliance, the number of violations that exist, or the failure to correct prior violations, are indications that management has not devoted sufficient time and attention to its compliance responsibilities. Risk management practices generally need improvement.

Rating No. 4 — indicates an institution with deficient compliance practices in relation to the size and complexity of its fiduciary activities. Account administration is notably deficient. The institution makes little or no effort to minimize potential conflicts or refrain from self-dealing, and is confronted with a considerable number of potential or actual conflicts. Numerous substantive and technical violations of laws and regulations exist and many may remain uncorrected from previous examinations. Management has not exerted sufficient effort to effect compliance and may lack the ability to effectively administer fiduciary activities. The level of compliance problems is significant and, if left unchecked, may subject the institution to monetary losses or reputation risk. Risks are inadequately identified, measured, monitored and controlled.

Rating No. 5 — indicates critically deficient compliance practices. Account administration is critically deficient or incompetent and there is a flagrant disregard for the terms of the governing instruments and interests of account beneficiaries. The institution frequently engages in transactions that compromise its fundamental duty of undivided loyalty to account beneficiaries. There are flagrant or repeated violations of laws and regulations and significant departures from sound fiduciary principles. Management is unwilling or unable to operate within the scope of laws and regulations or within the terms of governing instruments and efforts to obtain voluntary compliance have been unsuccessful. The severity of noncompliance presents an imminent monetary threat to account beneficiaries and creates significant legal and financial exposure to the institution. Problems and significant risks are inadequately identified, measured, monitored, or controlled and now threaten the ability of management to continue engaging in fiduciary activities.

Asset Management

This rating reflects the risks associated with managing the assets (including cash) of others. Prudent portfolio management is based on an assessment of the needs and objectives of each account or portfolio. An evaluation of asset management should consider the adequacy of processes related to the investment of all discretionary accounts and portfolios, including collective investment funds, proprietary mutual funds, and investment advisory arrangements.

The institution's asset management activities subject it to reputation, compliance and strategic risks. In addition, each individual account or portfolio managed by the institution is subject to financial risks such as market, credit, liquidity, and interest rate risk, as well as transaction and compliance risk. The ability of management to identify, measure, monitor and control these risks is reflected in this rating.

The asset management rating is based upon, but not limited to, an assessment of the following evaluation factors:

- The adequacy of overall policies, practices and procedures governing asset management, considering the size, complexity and risk profile of the institution's fiduciary activities.
- The decision-making processes used for selection, retention and preservation of discretionary assets including adequacy of documentation, committee review and approval, and a system to review and approve exceptions.
- The use of quantitative tools to measure the various financial risks in investment accounts and portfolios.
- The existence of policies and procedures addressing the use of derivatives or other complex investment products.
- The adequacy of procedures related to the purchase or retention of miscellaneous assets including real estate, notes, closely held companies, limited partnerships, mineral interests, insurance and other unique assets.
- The extent and adequacy of periodic reviews of investment performance, taking into consideration the needs and objectives of each account or portfolio.
- The monitoring of changes in the composition of fiduciary assets for trends and related risk exposure.
- The quality of investment research used in the decision-making process and documentation of the research.
- The due diligence process for evaluating investment advice received from vendors and/or brokers (including approved or focus lists of securities).
- The due diligence process for reviewing and approving brokers and/or counter parties used by the institution.

Asset Management Ratings

This rating may not be applicable for some institutions because their operations do not include activities involving the management of any discretionary assets. Functions of this type would include, but not necessarily be limited to, directed agency relationships, securities clearing, non-fiduciary custody relationships, transfer agent and registrar activities. In institutions of this type, the rating for Asset Management may be omitted by the examiner in accordance with the examining agency's implementing guidelines. However, this component should be assigned when the institution provides investment advice, even though it does not have discretion over the account assets. An example of this type of activity would be where the institution selects or recommends the menu of mutual funds offered to participant directed 401(k) plans.

Rating No. 0 — indicates an institution that does not engage in any asset management. Functions that do not require asset management may include, but are not necessarily limited to: directed agency relationships, securities clearing, non-fiduciary custody relationships, and transfer agent and registrar activities. In institutions of the type, the Asset Management rating may be 0 if:

- Operations do not include activities involving the management of any discretionary assets.
- Investment advisory services are not offered.
- There are no assets held on-site.
- There are no unique assets, such as closely-held investments, real estate, limited partnerships, or notes receivable, that require special handling such as non-standard registration or insurance protection.
- There is no discretion regarding the investment of cash balances.
- Although administering a participant-directed plan, the institution does not select or recommend the menu of funds offered to the participants.

Rating No. 1 — indicates strong asset management practices. Identified weaknesses are minor in nature. Risk exposure is modest in relation to management's abilities and the size and complexity of the assets managed.

Rating No. 2 — indicates satisfactory asset management practices. Moderate weaknesses are present and are well within management's ability and willingness to correct. Risk exposure is commensurate with management's abilities and the size and complexity of the assets managed. Supervisory response is limited.

Rating No. 3 — indicates that asset management practices are less than satisfactory in relation to the size and complexity of the assets managed. Weaknesses may range from moderate to severe; however, they are not of such significance as to generally pose a threat to the interests of account beneficiaries. Asset management and risk management practices generally need to be improved. An elevated level of supervision is normally required.

Rating No. 4 — indicates deficient asset management practices in relation to the size and complexity of the assets managed. The levels of risk are significant and inadequately controlled. The problems pose a threat to account beneficiaries generally, and if left unchecked, may subject the institution to losses and could undermine the reputation of the institution.

Rating No. 5 — represents critically deficient asset management practices and a flagrant disregard of fiduciary duties. These practices jeopardize the interests of account beneficiaries, subject the institution to losses, and may pose a threat to the soundness of the institution.

UNIFORM INTERAGENCY RATING SYSTEM FOR INFORMATION TECHNOLOGY

INTRODUCTION

The quality, reliability, and integrity of a financial institution or service provider's information technology (IT) affects all aspects of its performance. An assessment of the technology risk management framework is necessary whether or not the institution or a third-party service provider manages these operations. The Uniform Rating System for Information Technology (URSIT) is an internal rating system used by federal and state regulators to uniformly assess financial institution and service provider risks introduced by IT. It also allows the regulators to identify those insured institutions and service providers whose information technology risk exposure or performance requires special supervisory attention.

The rating system includes component and composite rating descriptions and the explicit identification of risks and assessment factors that examiners consider in assigning component ratings. Additionally, information technology can affect the risks associated with financial institutions. The effect on credit, operational, market, reputation, strategic, liquidity, interest rate, and compliance risks should be considered for each IT rating component.

The primary purpose of the rating system is to identify those entities whose condition or performance of information technology functions requires special supervisory attention. This rating system assists examiners in making an assessment of risk and compiling examination findings. However, the rating system does not drive the scope of an examination. Examiners should use the rating system to help evaluate the entity's overall risk exposure and risk management performance, and determine the degree of supervisory attention believed necessary to ensure that weaknesses are addressed and that risk is properly managed.

OVERVIEW

The URSIT is based on a risk evaluation of four critical components: Audit, Management, Development and Acquisition, and Support and Delivery (AMDS). These components are used to assess the overall performance of IT within an organization. Examiners evaluate the functions identified within each component to assess the institution's ability to identify, measure, monitor and control information technology risks. Each organization examined for IT is assigned a summary or composite rating based on the overall results of the evaluation. The IT composite rating and each component rating are based on a scale of “1” through “5” in ascending order of supervisory concern; “1” representing the highest rating and least degree of concern, and “5” representing the lowest rating and highest degree of concern.

The first step in developing an IT composite rating for an organization is the assignment of a performance rating to the individual AMDS components. The evaluation of each of these components, their interrelationships, and relative importance is the basis for the composite rating. The composite rating is derived by making a qualitative summarization of all of the AMDS components. A direct relationship exists between the composite rating and the individual AMDS component performance ratings. However, the composite rating is not an arithmetic average of the individual components. An arithmetic approach does not reflect the actual condition of IT when using a risk-focused approach. A poor rating in one component may heavily influence the overall composite rating for an institution. For example, if the audit function is viewed as inadequate, the overall integrity of the IT systems is not readily verifiable. Thus, a composite rating of less than satisfactory (“3”-“5”) would normally be appropriate.

A principal purpose of the composite rating is to identify those financial institutions and service providers that pose an inordinate amount of information technology risk and merit special supervisory attention. Thus, individual risk exposures that more explicitly affect the viability of the organization and/or its customers should be given more weight in the composite rating.

The FFIEC recognizes that management practices, particularly as they relate to risk management, vary considerably among financial institutions and service bureaus depending on their size and sophistication, the nature and complexity of their business activities and their risk profile. Accordingly, the FFIEC also recognizes that for less complex information systems environments, detailed or highly formalized systems and controls are not required to receive the higher composite and component ratings.

The following two sections contain the URSIT composite rating definitions, the assessment factors, and definitions for the four component ratings. These assessment factors and definitions outline various IT functions and controls that may be evaluated as part of the examination.

COMPOSITE RATINGS

Composite 1 — Financial institutions and service providers rated composite "1" exhibit strong performance in every respect and generally have components rated 1 or 2. Weaknesses in IT are minor in nature and are easily corrected during the normal course of business. Risk management processes provide a comprehensive program to identify and monitor risk relative to the size, complexity and risk profile of the entity. Strategic plans are well defined and fully integrated throughout the organization. This allows management to quickly adapt to changing market, business and technology needs of the entity. Management identifies weaknesses promptly and takes appropriate corrective action to resolve audit and regulatory concerns. The financial condition of the service provider is strong and overall performance shows no cause for supervisory concern.

The descriptive examples in the numeric composite rating definitions are intended to provide guidance to examiners as they evaluate the overall condition of Information Technology. Examiners must use professional judgment when making this assessment and assigning the numeric rating.

Composite 2 — Financial institutions and service providers rated composite "2" exhibit safe and sound performance but may demonstrate modest weaknesses in operating performance, monitoring, management processes or system development. Generally, senior management corrects weaknesses in the normal course of business. Risk management processes adequately identify and monitor risk relative to the size, complexity and risk profile of the entity. Strategic plans are defined but may require clarification, better coordination or improved communication throughout the organization. As a result, management anticipates, but responds less quickly to changes in market, business, and technological needs of the entity. Management normally identifies weaknesses and takes appropriate corrective action. However, greater reliance is placed on audit and regulatory intervention to identify and resolve concerns. The financial condition of the service provider is acceptable and while internal control weaknesses may exist, there are no significant supervisory concerns. As a result, supervisory action is informal and limited.

Composite 3 — Financial institutions and service providers rated composite "3" exhibit some degree of supervisory concern due to a combination of weaknesses that may range from moderate to severe. If weaknesses persist, further deterioration in the condition and performance of the institution or service provider is likely. Risk management processes may not effectively identify risks and may not be appropriate for the size, complexity, or risk profile of the entity. Strategic plans are vaguely defined and may not provide adequate direction for IT initiatives. As a result, management often has difficulty responding to changes in business, market, and technological needs of the entity. Self-assessment practices are weak and are generally reactive to audit and regulatory exceptions. Repeat concerns may exist, indicating that management may lack the ability or willingness to resolve concerns. The financial condition of the service provider may be weak and/or negative trends may be evident. While financial or operational failure is unlikely, increased supervision is necessary. Formal or informal supervisory action may be necessary to secure corrective action.

Composite 4 — Financial institutions and service providers rated composite "4" operate in an unsafe and unsound environment that may impair the future viability of the entity. Operating weaknesses are indicative of serious managerial deficiencies. Risk management processes inadequately identify and monitor risk, and practices are not appropriate given the size, complexity, and risk profile of the entity. Strategic plans are poorly defined and not coordinated or communicated throughout the organization. As a result, management and the board are not committed to, or may be incapable of ensuring that technological needs are met. Management does not perform self-assessments and demonstrates an inability or unwillingness to correct audit and regulatory concerns. The financial condition of the service provider is severely impaired and/or deteriorating. Failure of the financial institution or service provider may be likely unless IT problems are remedied. Close supervisory attention is necessary and, in most cases, formal enforcement action is warranted.

Composite 5 — Financial institutions and service providers rated composite "5" exhibit critically deficient operating performance and are in need of immediate remedial action. Operational problems and serious weaknesses may exist throughout the organization. Risk management processes are severely deficient and provide management little or no perception of risk relative to the size, complexity, and risk profile of the entity. Strategic plans do not exist or are ineffective, and management and the board provide little or no direction for IT initiatives. As a result, management is unaware of, or inattentive to technological needs of the entity. Management is unwilling or incapable of correcting audit and regulatory concerns. The financial condition of the service provider is poor and failure is highly probable due to poor operating performance or financial instability. Ongoing supervisory attention is necessary.

COMPONENT RATINGS

Audit

Financial institutions and service providers are expected to provide independent assessments of their exposure to risks and the quality of internal controls associated with the acquisition, implementation and use of information technology. Audit practices should address the IT risk exposures throughout the institution and its service provider(s) in the areas of user and data center operations, client/server architecture, local and wide area networks, telecommunications, information security, electronic data interchange, systems development, and contingency planning. This rating should reflect the adequacy of the organization's overall IT audit program, including the internal and external auditor's abilities to detect and report significant risks to management and the board of directors on a timely basis. It should also reflect the internal and external auditor's capability to promote a safe, sound, and effective operation.

The descriptive examples in the numeric component rating definitions are intended to provide guidance to examiners as they evaluate the individual components. Examiners must use professional judgment when assessing a component area and assigning a numeric rating value as it is likely that examiners will encounter conditions that correspond to descriptive examples in two or more numeric rating value definitions.

Financial institutions that outsource their data processing operations should obtain copies of internal audit reports, SAS 70 reviews, and/or regulatory examination reports of their service providers.

The performance of audit is rated based upon an assessment of factors such as:

- The level of independence maintained by audit and the quality of the oversight and support provided by the board of directors and management.
- The adequacy of audit's risk analysis methodology used to prioritize the allocation of audit resources and to formulate the audit schedule.
- The scope, frequency, accuracy, and timeliness of internal and external audit reports.
- The extent of audit participation in application development, acquisition, and testing, to ensure the effectiveness of internal controls and audit trails.
- The adequacy of the overall audit plan in providing appropriate coverage of IT risks.
- The auditor's adherence to codes of ethics and professional audit standards.
- The qualifications of the auditor, staff succession, and continued development through training.
- The existence of timely and formal follow-up and reporting on management's resolution of identified problems or weaknesses.
- The quality and effectiveness of internal and external audit activity as it relates to IT controls.

Audit Ratings

Rating No. 1 — indicates strong audit performance. Audit independently identifies and reports weaknesses and risks to the board of directors or its audit committee in a thorough and timely manner. Outstanding audit issues are monitored until resolved. Risk analysis ensures that audit plans address all significant IT operations, procurement, and development activities with appropriate scope and frequency. Audit work is performed in accordance with professional auditing standards and report content is timely, constructive, accurate, and complete. Because audit is strong, examiners may place substantial reliance on audit results.

Rating No. 2 — indicates satisfactory audit performance. Audit independently identifies and reports weaknesses and risks to the board of directors or audit committee, but reports may be less timely. Significant outstanding audit issues are monitored until resolved. Risk analysis ensures that audit plans address all significant IT operations, procurement, and development activities; however, minor concerns may be noted with the scope or frequency. Audit work is performed in accordance with professional auditing standards; however, minor or infrequent problems may arise with the timeliness, completeness and accuracy of reports. Because audit is satisfactory, examiners may rely on audit results but because minor concerns exist, examiners may need to expand verification procedures in certain situations.

Rating No. 3 — indicates less than satisfactory audit performance. Audit identifies and reports weaknesses and risks; however, independence may be compromised and reports presented to the board or audit committee may be less than satisfactory in content and timeliness. Outstanding audit issues may not be adequately monitored. Risk analysis is less than satisfactory. As a result, the audit plan may not provide sufficient audit scope or frequency for IT operations, procurement, and development activities. Audit work is generally performed in accordance with professional auditing standards; however, occasional problems may be noted with the timeliness, completeness and/or accuracy of reports. Because audit is less than satisfactory, examiners must use caution if they rely on the audit results.

Rating No. 4 — indicates deficient audit performance. Audit may identify weaknesses and risks but it may not independently report to the board or audit committee and report content may be inadequate. Outstanding audit issues may not be adequately monitored and resolved. Risk analysis is deficient. As a result, the audit plan does not provide adequate audit scope or frequency for IT operations, procurement, and development activities. Audit work is often inconsistent with professional auditing standards and the timeliness, accuracy, and completeness of reports is unacceptable. Because audit is deficient, examiners cannot rely on audit results.

Rating No. 5 — indicates critically deficient audit performance. If an audit function exists, it lacks sufficient independence and, as a result, does not identify and report weaknesses or risks to the board or audit committee. Outstanding audit issues are not tracked and no follow-up is performed to monitor their resolution. Risk analysis is critically deficient. As a result, the audit plan is ineffective and provides inappropriate audit scope and frequency for IT operations, procurement and development activities. Audit work is not performed in accordance with professional auditing standards and major deficiencies are noted regarding the timeliness, accuracy, and completeness of audit reports. Because audit is critically deficient examiners cannot rely on audit results.

Management

This rating reflects the abilities of the board and management as they apply to all aspects of IT acquisition, development, and operations. Management practices may need to address some or all of the following IT-related risks: strategic planning, quality assurance, project management, risk assessment, infrastructure and architecture, end-user computing, contract administration of third party service providers, organization and human resources, regulatory and legal compliance. Generally, directors need not be actively involved in day-to-day operations; however, they must provide clear guidance regarding acceptable risk exposure levels and ensure that appropriate policies, procedures, and practices have been established. Sound management practices are demonstrated through active oversight by the board of directors and management, competent personnel, sound IT plans, adequate policies and standards, an effective control environment, and risk monitoring. This rating should reflect the board's and management's ability as it applies to all aspects of IT operations.

The performance of management and the quality of risk management are rated based upon an assessment of factors such as:

- The level and quality of oversight and support of the IT activities by the board of directors and management.
- The ability of management to plan for and initiate new activities or products in response to information needs and to address risks that may arise from changing business conditions.
- The ability of management to provide information reports necessary for informed planning and decision making in an effective and efficient manner.

- The adequacy of, and conformance with, internal policies and controls addressing the IT operations and risks of significant business activities.
- The effectiveness of risk monitoring systems.
- The timeliness of corrective action for reported and known problems.
- The level of awareness of and compliance with laws and regulations.
- The level of planning for management succession.
- The ability of management to monitor the services delivered and to measure the organization's progress toward identified goals in an effective and efficient manner.
- The adequacy of contracts and management's ability to monitor relationships with third-party servicers.
- The adequacy of strategic planning and risk management practices to identify, measure, monitor, and control risks, including management's ability to perform self-assessments.
- The ability of management to identify, measure, monitor, and control risks and to address emerging information technology needs and solutions.

In addition to the above, factors such as the following are included in the assessment of management at service providers:

- The financial condition and ongoing viability of the entity.
- The impact of external and internal trends and other factors on the ability of the entity to support continued servicing of client financial institutions.
- The propriety of contractual terms and plans.

Management Ratings

Rating No. 1 — indicates strong performance by management and the board. Effective risk management practices are in place to guide IT activities, and risks are consistently and effectively identified, measured, controlled, and monitored. Management immediately resolves audit and regulatory concerns to ensure sound operations. Written technology plans, policies and procedures, and standards are thorough and properly reflect the complexity of the IT environment. They have been formally adopted, communicated, and enforced throughout the organization. IT systems provide accurate, timely reports to management. These reports serve as the basis of major decisions and as an effective performance-monitoring tool. Outsourcing arrangements are based on comprehensive planning; routine management supervision sustains an appropriate level of control over vendor contracts, performance, and services provided. Management and the board have demonstrated the ability to promptly and successfully address existing IT problems and potential risks.

Rating No. 2 — indicates satisfactory performance by management and the board. Adequate risk management practices are in place and guide IT activities. Significant IT risks are identified, measured, monitored, and controlled; however, risk management processes may be less structured or inconsistently applied and modest weaknesses exist. Management routinely resolves audit and regulatory concerns to ensure effective and sound operations, however, corrective actions may not always be implemented in a timely manner. Technology plans, policies and procedures, and standards are adequate and are formally adopted. However, minor weaknesses may exist in management's ability to communicate and enforce them throughout the organization. IT systems provide quality reports to management which serve as a basis for major decisions and a tool for performance planning and monitoring. Isolated or temporary problems with timeliness, accuracy or consistency of reports may exist. Outsourcing arrangements are adequately planned and controlled by management, and provide for a general understanding of vendor contracts, performance standards and services provided. Management and the board have demonstrated the ability to address existing IT problems and risks successfully.

Rating No. 3 — indicates less than satisfactory performance by management and the board. Risk management practices may be weak and offer limited guidance for IT activities. Most IT risks are generally identified; however, processes to measure and monitor risk may be flawed. As a result, management's ability to control risk is less than satisfactory. Regulatory and audit concerns may be addressed, but time frames are often excessive and the corrective action taken may be inappropriate. Management may be unwilling or incapable of addressing deficiencies. Technology plans, policies and procedures, and standards exist, but may be incomplete. They may not be formally adopted, effectively communicated, or enforced throughout the organization. IT systems provide requested reports to management, but periodic problems with accuracy, consistency and timeliness lessen the reliability and usefulness of reports and may adversely affect decision making and performance monitoring. Outsourcing arrangements may be entered into without thorough planning. Management may provide only cursory supervision that limits their understanding of vendor contracts, performance standards, and services provided. Management and the board may not be capable of addressing existing IT problems and risks, evidenced by untimely corrective actions for outstanding IT problems.

Rating No. 4 — indicates deficient performance by management and the board. Risk management practices are inadequate and do not provide sufficient guidance for IT activities. Critical IT risk are not properly identified, and processes to measure and monitor risks are deficient. As a result, management may not be aware of and is unable to control risks. Management may be unwilling and/or incapable of addressing audit and regulatory deficiencies in an effective and timely manner. Technology plans, policies and procedures, and standards are inadequate, have not been formally adopted, or effectively communicated throughout the organization, and management does not effectively enforce them. IT systems do not routinely provide management with accurate, consistent, and reliable reports, thus contributing to ineffective performance monitoring and/or flawed decision making. Outstanding arrangements may be entered into without planning or analysis, and management may provide little or no supervision of vendor contracts, performance standards, or services provided. Management and the board are unable to address existing IT problems and risks, as evidenced by ineffective actions and longstanding IT weaknesses. Strengthening of management and its processes is necessary. The financial condition of the service provider may threaten its viability.

Rating No. 5 — indicates critically deficient performance by management and the board. Risk management practices are severely flawed and provide inadequate guidance for IT activities. Critical IT risks are not identified, and processes to measure and monitor risks do not exist, or are not effective. Management's inability to control risk may threaten the continued viability of the institution or service provider. Management is unable and/or unwilling to correct audit and regulatory identified deficiencies and immediate action by the board is required to preserve the viability of the institution or service provider. If they exist, technology plans, policies and procedures, and standards are critically deficient. Because of systemic problems, IT systems do not produce management reports which are accurate, timely, or relevant. Outsourcing arrangements may have been entered into without management planning or analysis, resulting in significant losses to the financial institution or ineffective vendor services. The financial condition of the service provider presents an imminent threat to its viability.

Development and Acquisition

This rating reflects an organization's ability to identify, acquire, install, and maintain appropriate information technology solutions. Management practices may need to address all or parts of the business process for implementing any kind of change to the hardware or software used. These business processes include an institution's or service provider's purchase of hardware or software, development and programming performed by the institution or service provider, purchase of services from independent vendors or affiliated data centers, or a combination of these activities. The business process is defined as all phases taken to implement a change including researching alternatives available, choosing an appropriate option for the organization as a whole, and converting to the new system, or integrating the new system with existing systems. This rating reflects the adequacy of the institution's systems development methodology and related risk management practices for acquisition and deployment of information technology. This rating also reflects the boards and management's ability to enhance and replace information technology prudently in a controlled environment.

The performance of systems development and acquisition and related risk management practice is rated based upon an assessment of factors such as:

- The level and quality of oversight and support of systems development and acquisition activities by senior management and the board of directors.
- The adequacy of the organizational and management structures to establish accountability and responsibility for IT systems and technology initiatives.

- The volume, nature, and extent of risk exposure to the financial institution in the area of systems development and acquisition.
- The adequacy of the institution's Systems Development Life Cycle (SDLC) and programming standards.
- The quality of project management programs and practices which are followed by developers, operators, executive management/owners, independent vendors or affiliated servicers, and end-users.
- The independence of the quality assurance function and the adequacy of controls over program changes.
- The quality and thoroughness of system documentation.
- The integrity and security of the network, system, and application software.
- The development of information technology solutions that meet the needs of end users.
- The extent of end user involvement in the system development process.

In addition to the above, factors such as the following are included in the assessment of development and acquisition at service providers:

- The quality of software releases and documentation.
- The adequacy of training provided to clients.

Development and Acquisition Ratings

Rating No. 1 — indicates strong systems development, acquisition, implementation, and change management performance. Management and the board routinely demonstrate successfully the ability to identify and implement appropriate IT solutions while effectively managing risk. Project management techniques and the SDLC are fully effective and supported by written policies, procedures and project controls that consistently result in timely and efficient project completion. An independent quality assurance function provides strong controls over testing and program change management. Technology solutions consistently meet end user needs. No significant weaknesses or problems exist.

Rating No. 2 — indicates satisfactory systems development, acquisition, implementation, and change management performance. Management and the board frequently demonstrate the ability to identify and implement appropriate IT solutions while managing risk. Project management and the SDLC are generally effective; however, weaknesses may exist that result in minor project delays or cost overruns. An independent quality assurance function provides adequate supervision of testing and program change management, but minor weaknesses may exist. Technology solutions meet end user needs. However, minor enhancements may be necessary to meet original user expectations. Weaknesses may exist; however, they are not significant and they are easily corrected in the normal course of business.

Rating No. 3 — indicates less than satisfactory systems development, acquisition, implementation, and change management performance. Management and the board may often be unsuccessful in identifying and implementing appropriate IT solutions; therefore, unwarranted risk exposure may exist. Project management techniques and the SDLC are weak and may result in frequent project delays, backlogs or significant cost overruns. The quality assurance function may not be independent of the programming function which may adversely impact the integrity of testing and program change management. Technology solutions generally meet end user needs, but often require an inordinate level of change after implementation. Because of weaknesses, significant problems may arise that could result in disruption to operations or significant losses.

Rating No. 4 — indicates deficient systems development, acquisition, implementation, and change management performance. Management and the board may be unable to identify and implement appropriate IT solutions and do not effectively manage risk. Project management techniques and the SDLC are ineffective and may result in severe project delays and cost overruns. The quality assurance function is not fully effective and may not provide independent or comprehensive review of testing controls or program change management. Technology solutions may not meet the critical needs of the organization. Problems and significant risks exist that require immediate action by the board and management to preserve the soundness of the institution.

Rating No. 5 — indicates critically deficient systems development, acquisition, implementation, and change management performance. Management and the board appear to be incapable of identifying, and implementing appropriate information technology solutions. If they exist, project management techniques and the SDLC are critically deficient and provide little or no direction for development of systems or technology projects. The quality assurance function is severely deficient or not present and unidentified problems in testing and program change management have caused significant IT risks. Technology solutions do not meet the needs of the organization. Serious problems and significant risks exist which raise concern for the financial institution's or service providers' ongoing viability.

Support and Delivery

This rating reflects an organization's ability to provide technology services in a secure environment. It reflects not only the condition of IT operations but also factors such as reliability, security, and integrity, which may affect the quality of the information delivery system. The factors include customer support and training, and the ability to manage problems and incidents, operations, system performance, capacity planning, and facility and data management. Risk management practices should promote effective, safe and sound IT operations that ensure the continuity of operations and the reliability and availability of data. The scope of this component rating includes operational risks throughout the organization and service providers.

The rating of IT support and delivery is based on a review and assessment of requirements such as:

- The ability to provide a level of service that meets the requirements of the business.
- The adequacy of security policies, procedures, and practices in all units and at all levels of the financial institution and service providers.
- The adequacy of data controls over preparation, input, processing, and output.
- The adequacy of corporate contingency planning and business resumption for data centers, networks, service providers and business units.
- The quality of processes or programs that monitor capacity and performance.
- The adequacy of controls and the ability to monitor controls at service providers.
- The quality of assistance provided to users, including the ability to handle problems.
- The adequacy of operating policies, procedures, and manuals.
- The quality of physical and logical security, including the privacy of data.
- The adequacy of firewall architectures and the security of connections with public networks.

In addition to the above, factors such as the following are included in the assessment of support and delivery at service providers:

- The adequacy of customer service provided to clients.
- The ability of the entity to provide and maintain service level performance that meets the requirements of the client.

Support and Delivery Ratings

Rating No. 1 — indicates strong IT support and delivery performance. The organization provides technology services that are reliable and consistent. Service levels adhere to well-defined service level agreements and routinely meet or exceed business requirements. A comprehensive corporate contingency and business resumption plan is in place. Annual contingency plan testing and updating is performed; and, critical systems and applications are recovered within acceptable time frames. A formal written data security policy and awareness program is communicated and enforced throughout the organization. The logical and physical security for all IT platforms is closely monitored and security incidents and weaknesses are identified and quickly corrected. Relationships with third-party service providers are closely monitored. IT operations are highly reliable, and risk exposure is successfully identified and controlled.

Rating No. 2 — indicates satisfactory IT support and delivery performance. The organization provides technology services that are generally reliable and consistent, however, minor discrepancies in service levels may occur. Service performance adheres to service agreements and meets business requirements. A corporate contingency and business resumption plan is in place, but minor enhancements may be necessary. Annual plan testing and updating is performed and minor problems may occur when recovering systems or applications. A written data security policy is in place but may require improvement to ensure its adequacy. The policy is generally enforced and communicated throughout the organization, e.g. via a security awareness program. The logical and physical security for critical IT platforms is satisfactory. Systems are monitored, and security incidents and weaknesses are identified and resolved within reasonable time frames. Relationships with third-party service providers are monitored. Critical IT operations are reliable and risk exposure is reasonably identified and controlled.

Rating No. 3 — indicates that the performance of IT support and delivery is less than satisfactory and needs improvement. The organization provides technology services that may not be reliable or consistent. As a result, service levels periodically do not adhere to service level agreements or meet business requirements. A corporate contingency and business resumption plan is in place but may not be considered comprehensive. The plan is periodically tested; however, the recovery of critical systems and applications is frequently unsuccessful. A data security policy exists; however, it may not be strictly enforced or communicated throughout the organization. The logical and physical security for critical IT platforms is less than satisfactory. Systems are monitored; however, security incidents and weaknesses may not be resolved in a timely manner. Relationships with third-party service providers may not be adequately monitored. IT operations are not acceptable and unwarranted risk exposures exist. If not corrected, weaknesses could cause performance degradation or disruption to operations.

Rating No. 4 — indicates deficient IT support and delivery performance. The organization provides technology services that are unreliable and inconsistent. Service level agreements are poorly defined and service performance usually fails to meet business requirements. A corporate contingency and business resumption plan may exist, but its content is critically deficient. If contingency testing is performed, management is typically unable to recover critical systems and applications. A data security policy may not exist. As a result, serious supervisory concerns over security and the integrity of data exist. The logical and physical security for critical IT platforms is deficient. Systems may be monitored, but security incidents and weaknesses are not successfully identified or resolved. Relationships with third-party service providers are not monitored. IT operations are not reliable and significant risk exposure exists. Degradation in performance is evident and frequent disruption in operations has occurred.

Rating No. 5 — indicates critically deficient IT support and delivery performance. The organization provides technology services that are not reliable or consistent. Service level agreements do not exist and service performance does not meet business requirements. A corporate contingency and business resumption plan does not exist. Contingency testing is not performed and management has not demonstrated the ability to recover critical systems and applications. A data security policy does not exist, and a serious threat to the organization's security and data integrity exists. The logical and physical security for critical IT platforms is inadequate, and management does not monitor systems for security incidents and weaknesses. Relationships with third-party service providers are not monitored, and the viability of a service provider may be in jeopardy. IT operations are severely deficient, and the seriousness of weaknesses could cause failure of the financial institution or service provider if not addressed.

RATING SYSTEM FOR U.S. BRANCHES AND AGENCIES OF FOREIGN BANKING ORGANIZATIONS

The rating system for U.S. branches and agencies[1] of foreign banking organizations (FBOs) is a management information and supervisory tool designed to assess the condition of a branch and to identify significant supervisory concerns at a branch in a systematic and consistent fashion. The rating system (ROCA) has been revised from the previous rating system of asset quality, internal controls, and management (AIM) to better assess the condition of a branch within the context of the FBO, of which it is an integral part, and to pinpoint the key areas of concern in a branch office.

For evaluation purposes, the rating system divides a branch's overall activities into three individual components: risk management, operational controls, and compliance. These components represent the major activities or processes of the branch that may raise supervisory concern. The rating system also provides for a specific rating of the quality of the branch's stock of assets as of the examination date.

COMPOSITE RATING

The overall or composite rating indicates whether, in the aggregate, the operations of the branch may present supervisory concerns and the extent of any concerns. While the individual component ratings will be taken into consideration in arriving at the branch's overall assessment, the composite rating should not be considered merely an arithmetic average of the individual components. The examiner should assign and justify in the report a composite rating using definitions provided below as a guide.[2] The composite rating is based on a scale of one through five in ascending order of supervisory concern. Thus, one represents the lowest level of supervisory concern while five represents the highest level. The five composite ratings are defined as follows.

Composite Rating 1 — Branches in this group are strong in every respect. These branches require only normal supervisory attention.

Composite Rating 2 — Branches in this group are in satisfactory condition, but may have modest weaknesses that can be corrected by branch management in the normal course of business. Generally, they do not require additional or more than normal supervisory attention.

Composite Rating 3 — Branches in this group are viewed as fair due to a combination of weaknesses in risk management, operational controls, and compliance, or asset quality problems that in combination with the condition of the FBO or other factors, cause supervisory concern. In addition, branch and/or head office management may not be taking the necessary corrective actions to address substantive weaknesses. This rating may also be assigned when risk management, operational controls, or compliance is individually viewed as unsatisfactory. Generally, these branches raise supervisory concern and require more than normal supervisory attention to address their weaknesses.

Composite Rating 4 — Branches in this group are in marginal condition due to serious weaknesses as reflected in the assessments of the individual components. Serious problems or unsafe and unsound banking practices or operations exist, which have not been satisfactorily addressed or resolved by branch and/or head office management. Branches in this category require close supervisory attention and surveillance monitoring and a definitive plan for corrective action by branch and head office management.

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[1] Branches and agencies are hereafter collectively referred to as branches.

[2] Assessment of asset quality is an integral part of any examination; however, under certain circumstances, it may be appropriate to give the individual asset quality rating component greater or lesser weight in arriving at an overall composite rating. In ensuring the protection of branch creditors, an important factor is the strength of the FBO. As the financial strength of the FBO weakens, it becomes increasingly important to look to the quality of the assets booked in the United States as the source of protection for local creditors, and, at a certain point, asset maintenance should be imposed. Similarly, where the FBO is strong, and the need to look to local assets for protection of creditors seems remote, the relative weighing of the asset quality component in the overall evaluation diminishes.

It also should be recognized that different offices of the FBO can be assigned widely different roles in the FBO's overall strategy. Thus, an individual office that books very few loans, but is otherwise poorly managed, should not be given undue credit for having good asset quality. Alternatively, a branch that is designated to hold problem assets generated by other offices of the FBO, in order to better manage the workout process, should not be penalized, so long as the FBO has the ability to support the level of problem assets.

Finally, it should be recognized that asset quality tends to be a "trailing" indicator of branch performance. In instances where risk management systems are weak, but problem assets are currently nominal, it is realistic to assume there will be future deterioration in asset quality. By the same measure, management should be given credit in the overall evaluation where the causes of past asset quality problems have been corrected.

Composite Rating 5 — Branches in this group are in unsatisfactory condition due to a high level of severe weaknesses or unsafe and unsound conditions, and consequently require urgent restructuring of operations by branch and head office management.

DISCLOSURE

Following approval of the rating by appropriate senior supervisory officials at the examining agency, the composite numeric rating should be disclosed in the open, summary section of the examination report. In disclosing the rating, its meaning should be explained clearly using the appropriate composite rating definition. The report should also make it clear that the rating is part of the overall findings of the examination and is thus confidential. Any composite rating disclosed or discussed at an examination closeout meeting should be held out by the examiner-in-charge to be tentative.

COMPONENT EVALUATIONS

Similar to the composite rating, the individual rating components are evaluated on a scale of one to five, where one represents the lowest level of supervisory concern and five represents the highest. Each component is discussed below followed by a description of the individual performance ratings.

Risk Management

Risk is an inevitable component of any financial institution. Risk management, or the process of identifying, measuring, and controlling risk, is therefore an important responsibility of any financial institution. In a branch, which is typically removed from its head office by location and time zone, an effective risk management system is critical not only to manage the scope of its activities but to achieve comprehensive, ongoing oversight by branch and head office management. In the examination process, examiners will therefore determine the extent to which risk management techniques are adequate (i) to control risk exposures that result from the branch's activities and (ii) to ensure adequate oversight by branch and head office management and thereby promote a safe and sound banking environment.

The primary components of a sound risk management system are a comprehensive risk assessment approach; a detailed structure of limits, guidelines, and other parameters used to govern risk taking; and a strong management information system for monitoring and reporting risks.

The process of risk assessment includes the identification of all the risks associated with the branch's balance sheet and off-balance-sheet activities and grouping them into appropriate risk categories. These categories broadly relate to credit, market, liquidity, operational, and legal risks.[3] All major risks should be measured explicitly and consistently by branch management; risks should also be reevaluated on an ongoing basis as underlying risk assumptions relating to economic and market conditions vary and as the branch's activities change. The branch's expansion into new products or business lines should not outpace proper risk management or supervision by head office. Where risks cannot be explicitly measured, management should demonstrate knowledge of their potential

[3] While operational risks are identified as part of the branch's overall risk assessment process, the effectiveness of the branch's operational controls is separately evaluated under ROCA.

impact and a sense of how to manage such risks.

Risk identification and measurement are followed by an evaluation of the tradeoff between risks and returns to establish acceptable risk exposure levels, which are stated primarily in the branch's lending and trading policies subject to the approval of head office management. These policies should give standards for evaluating and undertaking risk exposure in individual branch activities as well as procedures for tracking and reporting risk exposure to monitor compliance with established policy limits or guidelines.

Head office management has a role in developing and approving the branch's risk management system as part of its responsibility to provide a comprehensive system of oversight for the branch. Generally, the branch's risk management system, including risk identification, measurement, limits or guidelines, and monitoring should be modeled on that of the FBO as a whole to provide for a fully-integrated institution-wide risk management system.[4]

In assigning the risk management rating, examiners should evaluate the current, ongoing situation and concentrate on developments since the previous examination. The rating should not concentrate on past problems, such as those relating to the current quality of the branch's stock of assets, if risk management techniques have improved significantly since those problems developed.[5]

More specifically, in rating the branch's risk management procedures, examiners should consider the following:

* The extent to which the branch is able to manage the risks inherent in its lending, trading, and other activities, specifically its ability to identify, measure, and control these risks.
* The soundness of the qualitative and quantitative assumptions implicit in the risk management system.
* Whether risk policies, guidelines, and limits at the branch are consistent with its lending, trading, and other activities; management's experience level; and the overall financial strength of the branch and/or the FBO.
* Whether the management information system and other forms of communication are consistent with the level of business activity at the branch and sufficient to accurately monitor risk exposure, compliance with established limits, and sufficient to enable the head office to monitor the real performance and risks of the branch.
* Management's ability to recognize and accommodate new risks that may arise from the changing environment, and to identify and address risks not readily quantified in a risk management system.

For example, in the lending area, a branch would be expected to have (1) experienced lending officers, an effective credit approval and review function, and, where appropriate, credit work-out personnel; (2) a credit risk evaluation system that was viewed as adequate in assessing relative credit risks; (3) branch officer lending limits, lending guidelines, and portfolio policies consistent with the abilities of branch personnel and the financial expertise and resources of the FBO; (4) a system that identified existing and potential problem credits, a method for assessing the likely impact of those credits on existing and future profits, and procedures for accurately informing head office of the credit quality of the portfolio and possible credit losses; and (5) procedures for assessing the impact on the portfolio of specific or general changes in the business climate.

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[4] For a more detailed overview of the risk management process, refer to the Federal Reserve's *Trading Activities Manual.*

[5] Thus, for example, the change in the level of problem assets since the previous examination would normally be more important than the absolute level of problem assets. At the same time, a loan portfolio that has few borrowers experiencing debt service problems does not necessarily indicate a sound risk management system because weak underwriting standards may make the branch vulnerable to credit problems during a future economic downturn.

Risk Management Ratings

A rating of 1 indicates that management has a fully-integrated risk management system that effectively identifies and controls all major types of risk at the branch, including those from new products and the changing environment. This assessment, in most cases, will be supported by a superior level of financial performance and asset quality at the branch. No supervisory concerns are evident.

A rating of 2 indicates that the risk management system is fully effective with respect to almost all major risk factors. It reflects a responsiveness and ability to cope successfully with existing and foreseeable exposures that may arise in carrying out the branch's business plan. While the branch may have residual risk-related weaknesses, these problems have been recognized and are being addressed by the branch and/or head office. Any such weaknesses will not have a material adverse effect on the branch. Generally, risks are being controlled in a manner that does not require additional or more than normal supervisory attention.

A rating of 3 signifies a risk management system that is lacking in some important measures. Its effectiveness in dealing with the branch's level of risk exposures is cause for more than normal supervisory attention, and deterioration in financial performance indicators is probable. Current risk-related procedures are considered fair, existing problems are not being satisfactorily addressed, or risks are not being adequately identified and controlled. While these deficiencies may not have caused significant problems yet, there are clear indications that the branch is vulnerable to risk-related deterioration.

A rating of 4 represents a marginal risk management system that generally fails to identify and control significant risk exposures in many important respects. Generally, such a situation reflects a lack of adequate guidance and supervision by head office management. As a result, deterioration in overall performance is imminent or is already evident in the branch's overall performance since the previous examination. Failure of management to correct risk management deficiencies that have created significant problems in the past warrants close supervisory attention.

A branch rated 5 has critical performance problems that are due to the absence of an effective risk management system in almost every respect. Not only are there a large volume of problem risk exposures, the problems are also intensifying. Management has not demonstrated the capability to stabilize the branch's situation. If corrective actions are not taken immediately, the operations of the branch are severely endangered.

Operational Controls

This component assesses the effectiveness of the branch's operational controls, including accounting and financial controls. The assessment is based on the expectation that branches should have an independent internal audit function and/or an adequate system of head office or external audits as well as a system of internal controls consistent with the size and complexity of their operations. In this regard, internal audit and control procedures should ensure that operations are conducted in accordance with internal guidelines and regulatory policies and that all reports and analysis provided to the head office and branch senior management are timely and accurate. This aspect of supervision in the context of branches is intended to achieve two basic goals. One goal is that the participation of branches in U.S. financial markets does not undermine the high standards, efficiency, and confidence in U.S. markets. The second goal is that head office management has adequate controls in place at the branch that both ensure that the branch is operating within corporate policies and enable head office management, and by extension the home country supervisor, to supervise the FBO on a consolidated basis in accordance with the Basle supervisory principles. The rating of operational controls should include the following:

* The adequacy of controls and the level of adherence to existing procedures and systems. (These are separate but related factors.)
* The frequency, scope, and adequacy of the branch's internal and external audit function, relative to the size and risk profile of the branch, and the independence of the internal audit function from line management.
* The number and severity of internal control and audit exceptions.
* Whether internal control and audit exceptions are effectively tracked and resolved in a timely manner.

* The adequacy and accuracy of management information reports. This assessment should be based primarily on whether reports and analysis are sufficient to properly inform head office management of the branch's condition on a timely basis, and whether there are sufficient procedures to ensure the accuracy of those reports.
* Whether the system of controls is regularly reviewed to keep pace with changes in the branch's business plan and laws and regulations.

Operational Controls Ratings

A branch that is rated 1 has a fully comprehensive system of operational controls that protects against losses from transactional and operational risks and ensures accurate financial reporting. Branch operations are fully consistent with sound market practices. The branch also has a well-defined and independent audit function that is appropriate to the size and risk profile of the branch. No supervisory concerns are evident.

A rating of 2 may indicate some minor weaknesses, such as the presence of new business activities where some modest control deficiencies exist, but which management is addressing. Some recommendations may be noted. Overall, the system of controls, including the audit function, is considered satisfactory and effective in maintaining a safe and sound branch operation. Only routine supervisory attention is required.

A rating of 3 indicates that the branch's system of controls, including the quality of the audit function, is lacking in some important respects, particularly as indicated by continued control exceptions and/or substantial deficiencies in or failure to adhere to written policies and procedures. As a result, more than normal supervisory attention is required.

A branch that is rated 4 signifies that the system of operational controls has serious deficiencies that require substantial improvement. In such a case, the branch may lack control functions, including those related to the audit function, that meet minimal expectations; therefore, adherence to bank and regulatory policy is questionable. Head office management has failed to give the branch proper support to maintain operations in accordance with U.S. norms. Close supervisory attention is required.

A branch that is rated 5 lacks a system of operational controls to such a degree that its operations are in serious jeopardy. The branch either lacks or has a wholly deficient audit function. Immediate substantial improvement is required by branch and head office management, along with strong supervisory attention.

Compliance

In addition to maintaining an effective system of operational controls, branches should also demonstrate compliance with all applicable state and federal laws and regulations including reporting and special supervisory requirements. To the extent possible, given the size and risk profile of the branch, these responsibilities should be vested in a branch official or compliance officer whose function is separate from line management. Branch management should also ensure that all appropriate personnel are properly trained in meeting regulatory requirements on an ongoing basis. The scope of the branch's audit function also should ensure that the branch is meeting all applicable regulatory requirements. Accordingly, the branch's level of compliance should be rated based on the following factors:

* The level of adherence to applicable state and federal laws and regulations and any supervisory follow-up actions.
* The effectiveness of (i) written compliance procedures and (ii) training of line personnel charged with maintaining compliance with regulatory requirements.
* Management's ability to submit required regulatory reports in a timely and accurate manner.
* Management's ability to identify and correct compliance issues.
* Whether the internal audit function checks for compliance with applicable state and federal laws and regulations.

Compliance Ratings

A branch accorded a rating of 1 demonstrates an outstanding level of compliance with applicable laws, regulations, and reporting requirements. No supervisory concerns are evident.

A rating of 2 indicates that compliance is generally effective with respect to most factors. Compliance monitoring and related training programs are sufficient to prevent significant problems. Minor reporting errors may be present, but they are being adequately addressed by branch management. Only normal supervisory attention is warranted.

A branch that is rated 3 has deficiencies in management and training systems that result in an atmosphere where significant compliance problems could and do occur. Such deficiencies could include a lack of written compliance procedures, no system for identifying possible compliance issues, or a substantial number of minor or repeat violations or deficiencies. More than normal supervisory attention is warranted.

A rating of 4 indicates that compliance matters are not given proper attention by branch and head office management, and close supervisory attention is warranted. The lack of an effective compliance program, including an ongoing training program, may be evident along with a failure to meet significant regulatory requirements and/or significant, widespread inaccuracies in regulatory reports.

A rating of 5 would signal that attention to compliance matters is wholly lacking at the branch to the extent that immediate supervisory attention is warranted.

Asset Quality

Generally, asset quality is evaluated to determine whether a financial entity has sufficient capital to absorb prospective losses and, ultimately, whether it can maintain its viability as an ongoing entity. The evaluation of asset quality in a branch does not have the same result because a branch is not a separately capitalized entity. Instead, a branch relies on the financial and managerial support of the FBO as a whole.

Nonetheless, the evaluation of asset quality is important both in assessing the effectiveness of credit risk management and in the event of a possible liquidation of a branch. However, as indicated above, a branch is not strictly limited by its own internal and external funding sources in meeting solvency and liquidity needs. The ability of a branch to honor its liabilities ultimately is based upon the condition and level of support from the FBO, a concept that is integral to the FBO supervision program.

This concept states that if the condition of the FBO is satisfactory, the FBO is presumed to be able to support the branch with sufficient capital and reserves on a consolidated basis. As a result, the assessment of asset quality in such circumstances would not, in and of itself, be a predominant factor in the branch's overall assessment, if existing risk management techniques are satisfactory. If, however, the condition of the FBO is less than satisfactory and/or support from the FBO is questionable, the evaluation of asset quality should be carefully considered in determining whether supervisory actions are needed to improve the branch's ability to meet its obligations on a stand-alone basis. In cases where a branch is subject to asset maintenance, it is expected that asset quality issues will be addressed by disqualifying classified assets as eligible assets.

The quality of the branch's stock of assets is evaluated based on the following factors. Generally, credit administration concerns should be addressed in rating risk management.

* The level, distribution, and severity of asset and off-balance-sheet exposures classified for credit and transfer risk.[6]
* The level and composition of nonaccrual and reduced rate assets.

Asset Quality Ratings

A branch accorded a rating of 1 has strong asset quality.

[6] For specific guidance on evaluating the amount of risk inherent in classified assets and off-balance-sheet or contingent exposures, examiners should refer to the examination manual and any applicable supervisory policies.

A branch accorded a rating of 2 has satisfactory asset quality.

A branch accorded a rating of 3 has fair asset quality.

A branch accorded a rating of 4 has marginal asset quality.

A branch accorded a rating of 5 has unsatisfactory asset quality.

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SUPERVISORY MEMORANDUM – 1002

December 31, 1998 (rev.)

TO: All State-Chartered Trust Companies
All Bank and Trust Examining Personnel

FROM: Catherine A. Ghiglieri, Commissioner

SUBJECT: Trust Company Rating Systems

OVERVIEW

The Department of Banking uses two distinct rating systems to assess the condition of state-chartered trust companies under its supervision: the Trust Company Rating System is used to evaluate the strength of the corporate entity; and, a modified version of the federal Uniform Interagency Trust Rating System (UITRS) is used to assess the condition of the fiduciary operations. It is also the policy of the Department to advise boards of directors of trust companies of the ratings assigned pursuant to an examination by this agency. This is consistent with Departmental policy for commercial banks. The Trust Company Rating System and the modified version of the Uniform Interagency Trust Rating System are attached.

FOCUS OF THE RATING SYSTEMS

The Trust Company Rating System (the CAMEL rating) is similar to the regulatory rating system used for commercial banks. Five primary aspects of the corporate entity's condition are evaluated and rated. These are: **C**apital adequacy, **A**sset quality, **M**anagement, **E**arnings and **L**iquidity; hence, the acronym CAMEL.

Under the modified UITRS, the fiduciary activities of financial institutions are assigned a composite rating based on an evaluation and rating of five essential components of an institution's fiduciary activities. These components address the following: the capability of management; the adequacy of operations, controls and audits; the quality and level of earnings; compliance with governing instruments, applicable law (including self-dealing and conflicts of interest laws and regulations), and sound fiduciary principles; and the management of fiduciary assets.

DISCLOSURE OF RATINGS

Each rating system arrives at a "composite" rating, disclosed on page 1 of an examination report, which summarizes the overall condition of the company, and reflects the risk and comparable importance of each individual component. While not an arithmetic average of the component ratings, the composite ratings are consistent with the individual component ratings.

The board of directors and management of each trust company is advised of the assigned CAMEL and UITRS ratings in a separate, confidential letter addressed to the board. These ratings are not a matter of public information. By disclosing the entire CAMEL and UITRS ratings to the board, the Department believes directors will be more fully informed of the company's condition and therefore be better equipped to address all financial and operational deficiencies.

Attachments

TRUST COMPANY RATING SYSTEM

OVERVIEW

The rating system is based upon an evaluation of five critical dimensions of a trust company's operations that reflect in a comprehensive fashion an institution's financial condition, compliance with fiduciary regulations and statutes, and overall operating soundness. The specific dimensions that are to be evaluated are the following:

Capital Adequacy
Asset Quality
Management/Administration
Earnings
Liquidity

Each of these dimensions is rated on a scale of 1 through 5 in descending order of performance quality. Thus, 1 represents the highest and, 5 the lowest (and most critically deficient), level of operating performance.

Each trust company is accorded a summary or composite rating that is predicated upon the evaluations of the specific performance dimensions. The composite rating is also based upon a scale of 1 through 5 in ascending order of supervisory concern. In arriving at a composite rating, each financial dimension must be weighed and due consideration given to the interrelationships among the various aspects of a company's operations. The delineation of specific performance dimensions does not preclude consideration of other factors that, in the judgement of the examiner or reviewer, are deemed relevant to accurately reflect the overall condition and soundness of a particular trust company. However, the assessment of the specific performance dimensions represents the essential foundation upon which the composite rating is based.

COMPOSITE RATINGS

The five composite ratings are defined and distinguished as follows:

Composite 1

Companies in this group are sound institutions in almost every respect; any critical findings are basically of a minor nature and can be handled in a routine manner. Such companies are resistant to external economic and financial disturbances and capable of withstanding the vagaries of business conditions more ably than companies with lower composite ratings.

Composite 2

Companies in this group are also fundamentally sound institutions but may reflect modest weaknesses correctable in the normal course of business. Such companies are stable and also able to withstand business fluctuations quite well; however, areas of weakness could develop into conditions of greater concern. To the extent that minor adjustments are handled in the normal course of business, the supervisory response is limited.

Composite 3

Companies in this group exhibit a combination of weaknesses ranging from moderately severe to unsatisfactory. Such companies are only nominally resistant to the onset of adverse business conditions and could easily deteriorate if concerted action is not effective in correcting the areas of weakness. Consequently, such companies are vulnerable and require more than normal supervision. Overall strength and financial capacity, however, are still such as to make failure only a remote possibility.

Composite 4

Companies in this group have an immoderate volume of asset weaknesses, or a combination of other conditions that are less than satisfactory. Unless prompt action is taken to correct these conditions, they could reasonably develop into a situation that could impair future viability and/or threaten the safety of fiduciary assets. A potential for failure is present but is not pronounced. Companies in this category require close supervisory attention and financial surveillance.

Composite 5

This category is reserved for companies whose conditions are worse than defined under number 4 above. The volume and character of weaknesses are such as to require urgent aid from the shareholders or other sources. Such companies require immediate corrective action and constant supervisory attention. The probability of failure is high for these companies.

PERFORMANCE EVALUATION

As already noted, the five key performance dimensions -- capital adequacy, asset quality, management/administration, earnings, and liquidity -- are to be evaluated on a scale of one to five. Following is a description of the gradations to be utilized in assignment performance ratings:

Rating No. 1 - indicates strong performance. It is the highest rating and is indicative of performance that is significantly higher than average.

Rating No. 2 - reflects satisfactory performance. It reflects performance that is average or above; it includes performance that adequately provides for the safe and sound operation of the company.

Rating No. 3 - represents performance that is flawed to some degree; as such, is considered fair. It is neither satisfactory nor marginal but is characterized by performance of below average quality.

Rating No. 4 - represents marginal performance which is significantly below average; if left unchecked, such performance might evolve into weaknesses or conditions that could threaten the viability of the institution.

Rating No. 5 - is considered unsatisfactory. It is the lowest rating and is indicative of performance that is critically deficient and in need of immediate remedial attention. Such performance by itself, or in combination with other weaknesses, could threaten the viability of the institution.

Capital Adequacy

Capital is rated 1 through 5 in relation to: (a) the volume of risk assets and off-balance sheet items; (b) the volume of marginal and inferior quality assets; (c) growth experience, plans, and prospects; and, (d) the strength of management in relation to (a), (b) and (c). In addition, consideration may be given to a company's total capital accounts relative to the minimum required level, its earnings retention, and its access to capital markets or other appropriate sources of financial assistance.

Companies rated 1 or 2 are considered to have adequate capital, although the former's capital level will generally exceed that of the latter. A 3 rating should be ascribed to a company's capital position when the relationship of the capital structure to points (a), (b) or (c) is adverse even giving weight to management as a mitigating factor. Companies rated 4 and 5 are clearly inadequately capitalized, the latter representing a situation of such gravity as to threaten viability and solvency. A 5 rating also denotes a company that requires urgent assistance from shareholders or other external sources of financial support.

Asset Quality

Asset quality is rated 1 through 5 in relation to: (a) the level, distribution and severity of classified assets; and, (b) the level and composition of nonaccrual and reduced rate assets. Obviously, adequate valuation reserves mitigate to some degree the weaknesses inherent in a given level of classified assets. In evaluating asset quality, consideration should also be given to any undue degree of concentration of investments, the investment grades and the adequacy of investment policies.

Asset quality ratings of 1 and 2 represent situations involving a minimal level of concern. Both ratings represent sound portfolios although the level and severity of classifications of the latter generally exceed those of the former. A 3 asset rating indicates a situation involving an appreciable degree of concern, especially to the extent that current adverse trends suggest potential future problems. Ratings 4 and 5 represent increasingly more severe asset problems; rating 5, in particular, represents an imminent threat to company viability through the corrosive effect of asset problems on the level of capital support.

Management/Administration

Management's performance must be evaluated against virtually all factors considered necessary to operate the company within accepted fiduciary practices and in a safe and sound manner. Thus, management is rated 1 through 5 with respect to: (a) technical competence, leadership and administrative ability; (b) compliance with regulation and statutes; (c) ability to plan and respond to changing circumstances; (d) adequacy of and compliance with internal policies; (e) depth and succession; (f) tendencies toward self-dealing; and (g) demonstrated willingness to serve the legitimate fiduciary needs of the community.

A 1 rating is indicative of management that is fully effective with respect to almost all factors and exhibits a responsiveness and ability to cope successfully with existing and foreseeable problems that may arise in the conduct of the company's affairs. A 2 rating reflects some deficiencies but generally indicates a satisfactory record of performance in light of the company's particular circumstances. A rating of 3 reflects performance that is lacking in some measure of competence desirable to meet responsibilities of the situation in which management is found. Either it is characterized by modest talent when above-average abilities are called for, or it is distinctly below average for the type and size of company in which it operates. Thus, its responsiveness or ability to correct less than satisfactory conditions may be lacking. The 4 rating is indicative of management that is generally inferior in ability compared to the responsibilities with which it is charged. A rating of 5 is applicable to those instances where incompetence has been demonstrated. In these cases, problems resulting from management weakness are of such severity that management must be strengthened or replaced before sound conditions can be brought about.

Earnings

Earnings will be rated 1 through 5 with respect to: (a) the ability to cover losses and provide for adequate capital; (b) earnings trends; and (c) quality and composition of net income. Consideration must also be given to the interrelationships that exist between the dividend payout ratio, the rate of growth of retained earnings and the adequacy of company capital. A dividend payout rate that is sufficiently high as to cause an adverse relationship to exist suggests conditions warranting a lower rating despite a level of earnings that might otherwise warrant a more favorable appraisal. Quality is also an important factor in evaluating this dimension of a company's performance. Consideration should be given to the adequacy of transfers to a valuation reserve and the extent to which extraordinary items, securities transactions, and tax effects contribute to net income.

Earnings rated 1 are sufficient to make full provision for the absorption of losses and the accretion of capital when due consideration is given to asset quality and company growth. A company whose earnings are relatively static or even moving downward may receive a 2 rating provided its level of earnings is adequate in view of the considerations discussed above. A 3 should be accorded earnings that are not sufficient to make full provision for the absorption of losses and the accretion of capital in relation to company growth. The earnings pictures of such companies may be further clouded by static or inconsistent earnings trends, chronically insufficient earnings, a high dividend payout rate or less than satisfactory asset quality. Earnings rated 4, while generally positive, may be characterized by erratic fluctuations in net income, the development of a downward trend, intermittent losses or a substantial drop from the previous year. Companies with earnings accorded a 5 rating should be experiencing pre-provision operating losses or reflecting a level of earnings that is worse than defined in No. 4 above. Such losses may represent a distinct threat to the company's solvency through the erosion of capital.

Liquidity

Liquidity is rated 1 through 5 with respect to: (a) the volatility of trust funds; (b) reliance on interest-sensitive funds and frequency and level of borrowings; (c) technical competence relative to structure of liabilities; (d) availability of assets readily convertible into cash; and (e) access to money markets of other ready sources of cash. Ultimately, the company's liquidity must be evaluated on the basis of its capacity to promptly meet the demand for payment of its obligations. In appraising liquidity, attention should be directed to the company's average liquidity over a specific time period as well as its liquidity position on any particular date. Consideration should be given where appropriate to the overall effectiveness of asset-liability management strategies and compliance with and adequacy of established liquidity policies.

A liquidity rating of 1 indicates a more than sufficient volume of liquid assets and/or ready and easy access on favorable terms to external sources of liquidity within the context of the company's overall asset-liability management strategy. A company developing a trend toward decreasing liquidity and increasing reliance on borrowed funds, yet still within acceptable proportions, may be accorded a 2 rating. A 3 liquidity rating reflects an insufficient volume of liquid assets and/or a reliance on interest-sensitive funds that is approaching or exceeds reasonable proportions for a given company. Ratings of 4 and 5 represent increasingly serious liquidity positions. Companies with liquidity positions so critical as to constitute an imminent threat to continued viability should be accorded a 5 rating. Such companies require immediate remedial action or external financial assistance to allow them to meet their maturing obligations.

UNIFORM INTERAGENCY TRUST RATING SYSTEM (modified)

OVERVIEW

Under the modified UITRS, the fiduciary activities of financial institutions are assigned a composite rating based on an evaluation and rating of five essential components of an institution's fiduciary activities. These components address the following: the capability of management; the adequacy of operations, controls and audits; the quality and level of earnings; compliance with governing instruments, applicable law (including self-dealing and conflicts of interest laws and regulations), and sound fiduciary principles; and the management of fiduciary assets.

Composite and component ratings are assigned based on a 1 to 5 numerical scale. A 1 is the highest rating and indicates the strongest performance and risk management practices and the least degree of supervisory concern. A 5 is the lowest rating and indicates the weakest performance and risk management practices and, therefore, the highest degree of supervisory concern. A rating of 0 is also possible under the Asset Management component of the modified UITRS, for institutions which do not engage in any asset management activities. Evaluation of the composite and components considers the size and sophistication, the nature and complexity, and the risk profile of the institution's fiduciary activities.

The composite rating generally bears a close relationship to the component ratings assigned. However, the composite rating is not derived by computing an arithmetic average of the component ratings. Each component rating is based on a qualitative analysis of the factors comprising that component and its interrelationship with the other components. When assigning a composite rating, some components may be given more weight than others depending on the situation at the institution. In general, assignment of a composite rating may incorporate any factor that bears significantly on the overall administration of the financial institution's fiduciary activities. Assigned composite and component ratings are disclosed to the institution's board of directors and senior management.

The ability of management to respond to changing circumstances and to address the risks that may arise from changing business conditions, or the initiation of new fiduciary activities or products, is an important factor in evaluating an institution's overall fiduciary risk profile and the level of supervisory attention warranted. For this reason, the management component is given special consideration when assigning a composite rating.

The ability of management to identify, measure, monitor, and control the risks of its fiduciary operations is also taken into account when assigning each component rating. It is recognized, however, that appropriate management practices may vary considerably among financial institutions, depending on the size, complexity and risk profiles of their fiduciary activities. For less complex institutions engaged solely in traditional fiduciary activities and whose directors and senior managers are actively involved in the oversight and management of day-to-day operations, relatively basic management systems and controls may be adequate. On the other hand, at more complex institutions, detailed and formal management systems and controls are needed to address a broader range of activities and to provide senior managers and directors with the information they need to supervise day-to-day activities.

All institutions are expected to properly manage their risks. For less complex institutions engaging in less risky activities, detailed or highly formalized management systems and controls are not required to receive strong or satisfactory component or composite ratings.

The following two sections contain the composite rating definitions, and the descriptions and definitions for the five component ratings.

COMPOSITE RATINGS

Composite ratings are based on a careful evaluation of how an institution conducts its fiduciary activities. The review encompasses the capability of management, the soundness of policies and practices, the quality of service rendered to the public, and the effect of fiduciary activities upon the soundness of the institution. The five key components used to assess an institution's fiduciary activities are: the capability of management; the adequacy of operations, controls and audits; the quality and level of earnings; compliance with governing instruments, applicable law (including self-dealing and conflicts of interest laws and regulations), and sound fiduciary principles; and the management of fiduciary assets. The composite ratings are defined as follows:

Composite 1

Administration of fiduciary activities is sound in every respect. Generally all components are rated 1 or 2. Any weaknesses are minor and can be handled in a routine manner by management. The institution is in substantial compliance with fiduciary laws and regulations. Risk management practices are strong relative to the size, complexity, and risk profile of the institution's fiduciary activities. Fiduciary activities are conducted in accordance with sound fiduciary principles and give no cause for supervisory concern.

Composite 2

Administration of fiduciary activities is fundamentally sound. Generally no component rating should be more severe than 3. Only moderate weaknesses are present and are well within management's capabilities and willingness to correct. Fiduciary activities are conducted in substantial compliance with laws and regulations. Overall risk management practices are satisfactory relative to the institution's size, complexity, and risk profile. There are no material supervisory concerns and, as a result, the supervisory response is informal and limited.

Composite 3

Administration of fiduciary activities exhibits some degree of supervisory concern in one or more of the component areas. A combination of weaknesses exists that may range from moderate to severe; however, the magnitude of the deficiencies generally does not cause a component to be rated more severely than 4. Management may lack the ability or willingness to effectively address weaknesses within appropriate time frames. Additionally, fiduciary activities may reveal some significant noncompliance with laws and regulations. Risk management practices may be less than satisfactory relative to the institution's size, complexity, and risk profile. While problems of relative significance may exist, they are not of such importance as to pose a threat to the trust beneficiaries generally, or to the soundness of the institution. The institution's fiduciary activities require more than normal supervision and may include formal or informal enforcement actions.

Composite 4

Fiduciary activities generally exhibit unsafe and unsound practices or conditions, resulting in unsatisfactory performance. The problems range from severe to critically deficient and may be centered around inexperienced or inattentive management, weak or dangerous operating practices, or an accumulation of unsatisfactory features of lesser importance. The weaknesses and problems are not being satisfactorily addressed or resolved by the board of directors and management. There may be significant noncompliance with laws and regulations. Risk management practices are generally unacceptable relative to the size, complexity, and risk profile of fiduciary activities. These problems pose a threat to the account beneficiaries generally and, if left unchecked, could evolve into conditions that could cause significant losses to the institution and ultimately undermine the public confidence in the institution. Close supervisory attention is required, which means, in most cases, formal enforcement action is necessary to address the problems.

Composite 5

Fiduciary activities are conducted in an extremely unsafe and unsound manner. Administration of fiduciary activities is critically deficient in numerous major respects, with problems resulting from incompetent or neglectful administration, flagrant and/or repeated disregard for laws and regulations, or a willful departure from sound fiduciary principles and practices. The volume and severity of problems are beyond management's ability or willingness to control or correct. Such conditions evidence a flagrant disregard for the interests of the beneficiaries and may pose a serious threat to the soundness of the institution. Continuous close supervisory attention is warranted and may include termination of the institution's fiduciary activities.

COMPONENT RATINGS

Each of the component rating descriptions is divided into three sections: a narrative description of the component; a list of the principal factors used to evaluate that component; and a description of each numerical rating for that component. Some of the evaluation factors are reiterated under one or more of the other components to reinforce the interrelationship among components. The listing of evaluation factors is in no particular order of importance.

Management

This rating reflects the capability of the board of directors and management, in their respective roles, to identify, measure, monitor and control the risks of an institution's fiduciary activities. It also reflects their ability to ensure that the institution's fiduciary activities are conducted in a safe and sound manner, and in compliance with applicable laws and regulations. Directors should provide clear guidance regarding acceptable risk exposure levels and ensure that appropriate policies, procedures and practices are established and followed. Senior fiduciary management is responsible for developing and implementing policies, procedures and practices that translate the board's objectives and risk limits into prudent operating standards.

Depending on the nature and scope of an institution's fiduciary activities, management practices may need to address some or all of the following risks: reputation, operating or transaction, strategic, compliance, legal, credit, market, liquidity and other risks. Sound management practices are demonstrated by: active oversight by the board of directors and management; competent personnel; adequate policies, processes, and controls that consider the size and complexity of the institution's fiduciary activities; and effective risk monitoring and management information systems. This rating should reflect the board's and management's ability as it applies to all aspects of fiduciary activities in which the institution is involved.

The management rating is based upon an assessment of the capability and performance of management and the board of directors, including, but not limited to, the following evaluation factors:

The level and quality of oversight and support of fiduciary activities by the board of directors and management, including committee structure and adequate documentation of committee actions.

The ability of the board of directors and management, in their respective roles, to plan for, and respond to, risks that may arise from changing business conditions or the introduction of new activities or products.

The adequacy of, and conformance with, appropriate internal policies, practices and controls addressing the operations and risks of significant fiduciary activities.

The accuracy, timeliness, and effectiveness of management information and risk monitoring systems appropriate for the institution's size, complexity, and fiduciary risk profile.

The overall level of compliance with laws, regulations, and sound fiduciary principles.

Responsiveness to recommendations from auditors and regulatory authorities.

Strategic planning for fiduciary products and services.

The level of experience and competence of fiduciary management and staff, including issues relating to turnover and succession planning.

The adequacy of insurance coverage.

The availability of competent legal counsel.

The extent and nature of pending litigation associated with fiduciary activities, and its potential impact on earnings, capital, and the institution's reputation.

The process for identifying and responding to fiduciary customer complaints.

Management Ratings

Rating No. 1 - indicates strong performance by management and the board of directors and strong risk management practices relative to the size, complexity and risk profile of the institution's fiduciary activities. All significant risks are consistently and effectively identified, measured, monitored, and controlled. Management and the board are proactive, and have demonstrated the ability to promptly and successfully address existing and potential problems and risks.

Rating No. 2 - indicates satisfactory management and board performance and risk management practices relative to the size, complexity and risk profile of the institution's fiduciary activities. Moderate weaknesses may exist, but are not material to the sound administration of fiduciary activities, and are being addressed. In general, significant risks and problems are effectively identified, measured, monitored, and controlled.

Rating No. 3 - indicates management and board performance that needs improvement or risk management practices that are less than satisfactory given the nature of the institution's fiduciary activities. The capabilities of management or the board of directors may be insufficient for the size, complexity, and risk profile of the institution's fiduciary activities. Problems and significant risks may be inadequately identified, measured, monitored, or controlled.

Rating No. 4 - indicates deficient management and board performance or risk management practices that are inadequate considering the size, complexity, and risk profile of the institution's fiduciary activities. The level of problems and risk exposure is excessive. Problems and significant risks are inadequately identified, measured, monitored, or controlled and require immediate action by the board and management to protect the assets of account beneficiaries and to prevent erosion of public confidence in the institution. Replacing or strengthening management or the board may be necessary.

Rating No. 5 - indicates critically deficient management and board performance or risk management practices. Management and the board of directors have not demonstrated the ability to correct problems and implement appropriate risk management practices. Problems and significant risks are inadequately identified, measured, monitored, or controlled and now threaten the continued viability of the institution or its administration of fiduciary activities, and pose a threat to the safety of the assets of account beneficiaries. Replacing or strengthening management or the board of directors is necessary.

Operations, Internal Controls & Auditing

This rating reflects the adequacy of the institution's fiduciary operating systems and internal controls in relation to the volume and character of business conducted. Audit coverage must assure the integrity of the financial records, the sufficiency of internal controls, and the adequacy of the compliance process.

The institution's fiduciary operating systems, internal controls, and audit function subject it primarily to transaction and compliance risk. Other risks including reputation, strategic, and financial risk may also be present. The ability of management to identify, measure, monitor and control these risks is reflected in this rating. The operations, internal controls and auditing rating is based upon, but not limited to, an assessment of the following evaluation factors:

Operations and Internal Controls, including the adequacy of:

Staff, facilities and operating systems;

Records, accounting and data processing systems (including controls over systems access and such accounting procedures as aging, investigation and disposition of items in suspense accounts);

Trading functions and securities lending activities;

Vault controls and securities movement;

Segregation of duties;

Controls over disbursements (checks or electronic) and unissued securities;

Controls over income processing activities;

Reconciliation processes (depository, cash, vault, sub-custodians, suspense accounts, etc.);

Disaster and/or business recovery programs;

Hold-mail procedures and controls over returned mail; and,

Investigation and proper escheatment of funds in dormant accounts.

Auditing, including:

The independence, frequency, quality and scope of the internal and external fiduciary audit function relative to the volume, character and risk profile of the institution's fiduciary activities;

The volume and/or severity of internal control and audit exceptions and the extent to which these issues are tracked and resolved; and

The experience and competence of the audit staff.

Operations, Internal Controls & Auditing Ratings

Rating No. 1 - indicates that operations, internal controls, and auditing are strong in relation to the volume and character of the institution's fiduciary activities. All significant risks are consistently and effectively identified, measured, monitored, and controlled.

Rating No. 2 - indicates that operations, internal controls and auditing are satisfactory in relation to the volume and character of the institution's fiduciary activities. Moderate weaknesses may exist, but are not material. Significant risks, in general, are effectively identified, measured, monitored, and controlled.

Rating No. 3 - indicates that operations, internal controls or auditing need improvement in relation to the volume and character of the institution's fiduciary activities. One or more of these areas are less than satisfactory. Problems and significant risks may be inadequately identified, measured, monitored, or controlled.

Rating No. 4 - indicates deficient operations, internal controls or audits. One or more of these areas are inadequate or the level of problems and risk exposure is excessive in relation to the volume and character of the institution's fiduciary activities. Problems and significant risks are inadequately identified, measured, monitored, or controlled and require immediate action. Institutions with this level of deficiencies may make little provision for audits, or may evidence weak or potentially dangerous operating practices in combination with infrequent or inadequate audits.

Rating No. 5 - indicates critically deficient operations, internal controls or audits. Operating practices, with or without audits, pose a serious threat to the safety of assets of fiduciary accounts. Problems and significant risks are inadequately identified, measured, monitored, or controlled and now threaten the ability of the institution to continue engaging in fiduciary activities.

Earnings

This rating reflects the profitability of an institution's fiduciary activities and its effect on the financial condition of the institution. The use and adequacy of budgets and earnings projections by functions, product lines and clients are reviewed and evaluated.

Risk exposure that may lead to negative earnings is also evaluated.

The evaluation of earnings is based upon, but not limited to, an assessment of the following factors:

The profitability of fiduciary activities in relation to the size and scope of those activities and to the overall business of the institution.

The overall importance to the institution of offering fiduciary services to its customers and local community.

The effectiveness of the institution's procedures for monitoring fiduciary activity income and expense relative to the size and scope of these activities and their relative importance to the institution, including the frequency and scope of profitability reviews and planning by the institution's board of directors or a committee thereof.

The level and consistency of profitability, or the lack thereof, generated by the institution's fiduciary activities in relation to the volume and character of the institution's business.

Dependence upon non-recurring fees and commissions, such as fees for court accounts.

The effects of charge-offs or compromise actions.

Unusual features regarding the composition of business and fee schedules.

Accounting practices that contain practices such as (1) unusual methods of allocating direct and indirect expenses and overhead, or (2) unusual methods of allocating fiduciary income and expense where two or more fiduciary institutions within the same holding company family share fiduciary services and/or processing functions.

The extent of management's use of budgets, projections and other cost analysis procedures.

Methods used for directors' approval of financial budgets and/or projections.

Management's attitude toward growth and new business development.

New business development efforts, including types of business solicited, market potential, advertising, competition, relationships with local organizations, and an evaluation by management of risk potential inherent in new business areas.

Earnings Ratings

Rating No. 1 - indicates strong earnings. The institution consistently earns a rate of return on its fiduciary activities that is commensurate with the risk of those activities. This rating would normally be supported by a history of consistent profitability over time and a judgement that future earnings prospects are favorable. In addition, management techniques for evaluating and monitoring earnings performance are fully adequate and there is appropriate oversight by the institution's board of directors or a committee thereof. Management makes effective use of budgets and cost analysis procedures. Methods used for reporting earnings information to the board of directors, or a committee thereof, are comprehensive.

Rating No. 2 - indicates satisfactory earnings. Although the earnings record may exhibit some weaknesses, earnings performance does not pose a risk to the overall institution nor to its ability to meet its fiduciary obligations. Generally, fiduciary earnings meet management targets and appear to be at least sustainable. Management processes for evaluating and monitoring earnings are generally sufficient in relationship to the size and risk of fiduciary activities that exist, and any deficiencies can be addressed in the normal course of business. A rating of 2 may also be assigned to institutions with a history of profitable operations if there are indications that management is engaging in activities with which it is not familiar, or where there may be inordinately high levels of risk present that have not been adequately evaluated. Alternatively, an institution with otherwise strong earnings performance may also be assigned a 2 rating if there are significant deficiencies in its methods used to monitor and evaluate earnings.

Rating No. 3 - indicates less than satisfactory earnings. Earnings are not commensurate with the risk associated with the fiduciary activities undertaken. Earnings may be erratic or exhibit downward trends, and future prospects are unfavorable. This rating may also be assigned if management processes for evaluating and monitoring earnings exhibit serious deficiencies, provided the deficiencies identified do not pose an immediate danger to either the overall financial condition of the institution or its ability to meet its fiduciary obligations.

Rating No. 4 - indicates earnings that are seriously deficient. Fiduciary activities have a significant adverse effect on the overall income of the institution and its ability to generate adequate capital to support the continued operation of its fiduciary activities. The institution is characterized by fiduciary earnings performance that is poor historically, or faces the prospect of significant losses in the future. Management processes for monitoring and evaluating earnings may be poor. The board of directors has not adopted appropriate measures to address significant deficiencies.

Rating No. 5 - indicates critically deficient earnings. In general, an institution with this rating is experiencing losses from fiduciary activities that have a significant negative impact on the overall institution, representing a distinct threat to its viability through the erosion of its capital. The board of directors has not implemented effective actions to address the situation.

Compliance

This rating reflects an institution's overall compliance with applicable laws, regulations, accepted standards of fiduciary conduct, governing account instruments, duties associated with account administration, and internally established policies and procedures. This component specifically incorporates an assessment of a fiduciary's duty of undivided loyalty and compliance with applicable laws, regulations, and accepted standards of fiduciary conduct related to self-dealing and other conflicts of interest.

The compliance component includes reviewing and evaluating the adequacy and soundness of adopted policies, procedures, and practices generally, and as they relate to specific transactions and accounts. It also includes reviewing policies, procedures, and practices to evaluate the sensitivity of management and the board of directors to refrain from self-dealing, minimize potential conflicts of interest, and resolve actual conflict situations in favor of the fiduciary account beneficiaries.

Risks associated with account administration are potentially unlimited because each account is a separate contractual relationship that contains specific obligations. Risks associated with account administration include: failure to comply with applicable laws, regulations or terms of the governing instrument; inadequate account administration practices; and inexperienced management or inadequately trained staff. Risks associated with a fiduciary's duty of undivided loyalty generally stem from engaging in self-dealing or other conflict of interest transactions. An institution may be exposed to compliance, strategic, financial and reputation risk related to account administration and conflicts of interest activities. The ability of management to identify, measure, monitor and control these risks is reflected in this rating. Policies, procedures and practices pertaining to account administration and conflicts of interest are evaluated in light of the size and character of an institution's fiduciary business.

The compliance rating is based upon, but not limited to, an assessment of the following evaluation factors:

Compliance with applicable federal and state statutes and regulations, including, but not limited to, federal and state fiduciary laws, the Employee Retirement Income Security Act of 1974, federal and state securities laws, state investment standards, state principal and income acts, and state probate codes;

Compliance with the terms of governing instruments;

The adequacy of overall policies, practices, and procedures governing compliance, considering the size, complexity, and risk profile of the institution's fiduciary activities;

The adequacy of policies and procedures addressing account administration;

The adequacy of policies and procedures addressing conflicts of interest, including those designed to prevent the improper use of “material inside information”;

The effectiveness of systems and controls in place to identify actual and potential conflicts of interest;

The adequacy of securities trading policies and practices relating to the allocation of brokerage business, the payment of services with “soft dollars” and the combining, crossing, and timing of trades;

The extent and permissibility of transactions with related parties, including, but not limited to, the volume of related commercial and fiduciary relationships and holdings of corporations in which directors, officers, or employees of the institution may be interested;

The decision making process used to accept, review, and terminate accounts; and,

The decision making process related to account administration duties, including cash balances, overdrafts, and discretionary distributions.

Compliance Ratings

Rating No. 1 - indicates strong compliance policies, procedures and practices. Policies and procedures covering conflicts of interest and account administration are appropriate in relation to the size and complexity of the institution's fiduciary activities. Accounts are administered in accordance with governing instruments, applicable laws and regulations, sound fiduciary principles, and internal policies and procedures. Any violations are isolated, technical in nature and easily correctable. All significant risks are consistently and effectively identified, measured, monitored and controlled.

Rating No. 2 - indicates fundamentally sound compliance policies, procedures and practices in relation to the size and complexity of the institution's fiduciary activities. Account administration may be flawed by moderate weaknesses in policies, procedures or practices. Management's practices indicate a determination to minimize the instances of conflicts of interest. Fiduciary activities are conducted in substantial compliance with laws and regulations, and any violations are generally technical in nature. Management corrects violations in a timely manner and without loss to fiduciary accounts. Significant risks are effectively identified, measured, monitored, and controlled.

Rating No. 3 - indicates compliance practices that are less than satisfactory in relation to the size and complexity of the institution's fiduciary activities. Policies, procedures and controls have not proven effective and require strengthening. Fiduciary activities may be in substantial noncompliance with laws, regulations or governing instruments, but losses are no worse than minimal. While management may have the ability to achieve compliance, the number of violations that exist, or the failure to correct prior violations, are indications that management has not devoted sufficient time and attention to its compliance responsibilities. Risk management practices generally need improvement.

Rating No. 4 - indicates an institution with deficient compliance practices in relation to the size and complexity of its fiduciary activities. Account administration is notably deficient. The institution makes little or no effort to minimize potential conflicts or refrain from self-dealing, and is confronted with a considerable number of potential or actual conflicts. Numerous substantive and technical violations of laws and regulations exist and many may remain uncorrected from previous examinations. Management has not exerted sufficient effort to effect compliance and may lack the ability to effectively administer fiduciary activities. The level of compliance problems is significant and, if left unchecked, may subject the institution to monetary losses or reputation risk. Risks are inadequately identified, measured, monitored and controlled.

Rating No. 5 - indicates critically deficient compliance practices. Account administration is critically deficient or incompetent and there is a flagrant disregard for the terms of the governing instruments and interests of account beneficiaries. The institution frequently engages in transactions that compromise its fundamental duty of undivided loyalty to account beneficiaries. There are flagrant or repeated violations of laws and regulations and significant departures from sound fiduciary principles. Management is unwilling or unable to operate within the scope of laws and regulations or within the terms of governing instruments and efforts to obtain voluntary compliance have been unsuccessful. The severity of noncompliance presents an imminent monetary threat to account beneficiaries and creates significant legal and financial exposure to the institution. Problems and significant risks are inadequately identified, measured, monitored, or controlled and now threaten the ability of management to continue engaging in fiduciary activities.

Asset Management

This rating reflects the risks associated with managing the assets (including cash) of others. Prudent portfolio management is based on an assessment of the needs and objectives of each account or portfolio. An evaluation of asset management should consider the adequacy of processes related to the investment of all discretionary accounts and portfolios, including collective investment funds, proprietary mutual funds, and investment advisory arrangements.

The institution's asset management activities subject it to reputation, compliance and strategic risks. In addition, each individual account or portfolio managed by the institution is subject to financial risks such as market, credit, liquidity, and interest rate risk, as well as transaction and compliance risk. The ability of management to identify, measure, monitor and control these risks is reflected in this rating.

The asset management rating is based upon, but not limited to, an assessment of the following evaluation factors:

The adequacy of overall policies, practices and procedures governing asset management, considering the size, complexity and risk profile of the institution's fiduciary activities.

The decision-making processes used for selection, retention and preservation of discretionary assets including adequacy of documentation, committee review and approval, and a system to review and approve exceptions.

The use of quantitative tools to measure the various financial risks in investment accounts and portfolios.

The existence of policies and procedures addressing the use of derivatives or other complex investment products.

The adequacy of procedures related to the purchase or retention of miscellaneous assets including real estate, notes, closely held companies, limited partnerships, mineral interests, insurance and other unique assets.

The extent and adequacy of periodic reviews of investment performance, taking into consideration the needs and objectives of each account or portfolio.

The monitoring of changes in the composition of fiduciary assets for trends and related risk exposure.

The quality of investment research used in the decision-making process and documentation of the research.

The due diligence process for evaluating investment advice received from vendors and/or brokers (including approved or focus lists of securities).

The due diligence process for reviewing and approving brokers and/or counter parties used by the institution.

Asset Management Ratings

This rating may not be applicable for some institutions because their operations do not include activities involving the management of any discretionary assets. Functions of this type would include, but not necessarily be limited to, directed agency relationships, securities clearing, non-fiduciary custody relationships, transfer agent and registrar activities. In institutions of this type, the rating for Asset Management may be omitted by the examiner in accordance with the examining agency's implementing guidelines. However, this component should be assigned when the institution provides investment advice, even though it does not have discretion over the account assets. An example of this type of activity would be where the institution selects or recommends the menu of mutual funds offered to participant directed 401(k) plans.

Rating No. 0 – indicates an institution that does not engage in any asset management. Functions that do not require management may include, but are not necessarily limited to: directed agency relationships, securities clearing, non-fiduciary custody relationships, and transfer agent and registrar activities. In institutions of this type, the Asset Management rating may be 0 if:

Operations do not include activities involving the management of any discretionary assets.

Investment advisory services are not offered.

There are no assets held on-site.

There are no unique assets, such as closely-held investments, real estate, limited partnerships, or notes receivable, that require special handling such as non-standard registration or insurance protection.

There is no discretion regarding the investment of cash balances.

Although administering a participant-directed plan, the institution does not select or recommend the menu of funds offered to the participants.

Rating No. 1 - indicates strong asset management practices. Identified weaknesses are minor in nature. Risk exposure is modest in relation to management's abilities and the size and complexity of the assets managed.

Rating No. 2 - indicates satisfactory asset management practices. Moderate weaknesses are present and are well within management's ability and willingness to correct. Risk exposure is commensurate with management's abilities and the size and complexity of the assets managed. Supervisory response is limited.

Rating No. 3 - indicates that asset management practices are less than satisfactory in relation to the size and complexity of the assets managed. Weaknesses may range from moderate to severe; however, they are not of such significance as to generally pose a threat to the interests of account beneficiaries. Asset management and risk management practices generally need to be improved. An elevated level of supervision is normally required.

Rating No. 4 - indicates deficient asset management practices in relation to the size and complexity of the assets managed. The levels of risk are significant and inadequately controlled. The problems pose a threat to account beneficiaries generally, and if left unchecked, may subject the institution to losses and could undermine the reputation of the institution.

Rating No. 5 - represents critically deficient asset management practices and a flagrant disregard of fiduciary duties. These practices jeopardize the interests of account beneficiaries, subject the institution to losses, and may pose a threat to the soundness of the institution.

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SUPERVISORY MEMORANDUM – 1003

March 15, 2016 (rev.)

TO: All State-Chartered Banks
All Bank and Trust Examining Personnel

FROM: Charles G. Cooper, Banking Commissioner

SUBJECT: Examination Frequency for State-chartered Banks[1]

BACKGROUND

Section 31.105 of the Texas Finance Code requires the banking commissioner to examine each state bank annually or on another periodic basis as may be required by rule or policy, or as the commissioner considers necessary to safeguard the interests of depositors, creditors, and shareholders, and efficiently enforce applicable law.

PURPOSE

The intent of this Supervisory Memorandum is to clearly communicate the Department of Banking's (Department) on-site examination timing requirements for state banks and trust departments of state banks and promote an efficient regulatory system. To promote competitive parity, the Department generally attempts to align its examination frequency policy for state-chartered banks with the examination frequency requirements applied by the federal bank supervisory agencies, as set forth in 12 U.S.C. 1820(d)(4) and implemented by 12 C.F.R. § 208.64 (for member banks) or § 337.12 (for nonmember banks), subject to safety and soundness considerations. This Supervisory Memorandum does not limit the authority of the banking commissioner to examine any state bank as frequently as deemed necessary.

BANK EXAMINATION FREQUENCY POLICY

The Department, in cooperation with the Federal Deposit Insurance Corporation (FDIC) and the Federal Reserve Bank of Dallas (FRB), has committed to coordinating examination efforts to reduce regulatory burden. The general practice of the agencies is to alternate examinations between the Department and the FDIC or, if the institution is a member bank, with the FRB. However, the Department will conduct an independent examination or a joint examination with the appropriate federal supervisory agency whenever deemed appropriate.

Banks which meet certain qualifying criteria (outlined below) may have the examination frequency extended to a maximum of 18 months. While the examination frequency for banks may change based on the criteria in the table below, the general practice of alternating examinations between the state and appropriate federal agency will continue.

EXAMINATION SCOPE

The scope of each examination is based upon circumstances of the individual financial institution. The Department utilizes five types of examination scopes: Level I Full Scope, Level II Full Scope, Continuous, Visitation, and Interim Risk Examination and Assessment.

- A Level I Full Scope Examination (Level I) is the most comprehensive with the Department's examiners completing procedures that are designed to assess the safety and soundness of the bank's operations and activities, resulting in the assignment of an appropriate CAMELS (Capital, Asset Quality, Management, Earnings, Liquidity, and Sensitivity to Market Risk) rating. A Report of Examination is produced for the bank to review.

1Current revisions include changes to the examination frequency table. Banks with total assets of $10 billion or greater qualify for a continuous examination program. Prior to this revision, banks with total assets of $20 billion or greater qualified for a continuous examination.

- A Level II Full Scope Examination (Level II) allows examiners to focus on the highest risk areas of the bank while excluding certain assignments determined to be of lower risk due to the nature of the bank's activities. Examiners complete risk-focused procedures and review all critical aspects of the bank's operations to the extent considered necessary to assign CAMELS ratings. Supervisory Memorandum 1025 details the requirements of a Level II Full Scope examination program. A Report of Examination is produced for the bank to review.
- A Visitation is a narrowly scoped examination which may focus on one or more CAMELS components, a specific risk area, or compliance with an enforcement action. The results of a Visitation will be documented with a Letter of Findings to the bank. The FDIC's use of a visitation may be different in scope than the visitation performed by the Department. The Department may accept risk assessment rating changes from a federal agency Visitation review conducted between annual Full Scope examinations.
- An Interim Risk Examination and Assessment Program (IREAP) is an examination that consists of risk-focused reviews of the CAMELS components, an assessment of compliance with enforcement actions, and a review of any significant criticisms noted at the last examination which affects a CAMELS component. At the conclusion of an IREAP, a CAMELS component or the overall CAMELS rating may be changed. Findings are documented in a Report of Examination when a CAMELS component or the overall CAMELS rating is changed. If no CAMELS component or overall rating is changed, then a Letter of Findings will be provided to the bank instead of a Report of Examination.
- A Continuous Examination Program (CEP) is primarily utilized in larger institutions and includes a series of targeted reviews conducted over an examination cycle generally covering a 12 month period. The targeted reviews focus on one or more specific risk areas of an institution's operations. Under the CEP, all CAMELS components are evaluated during the examination cycle. The results of targeted reviews are documented in a Letter of Findings. The results of targeted reviews performed during the examination cycle are utilized to assign a composite CAMELS rating for the institution which is documented in a formal Report of Examination.

The Level I and Level II examinations as well as the CEP meet the examination priorities of the Department and federal regulators. If at any time it becomes apparent that the planned scope of supervisory activity should be expanded, the Department will not hesitate to do so.

Examination Scope and Frequency Schedule

The following chart details the *general* criteria for determining examination frequency of state-chartered banks for Safety and Soundness examinations. The frequency and scope outlined in the Examination Scope and Frequency Schedule meet the examination priorities of the Department. Examinations started within 30 days from the date they are due are considered to meet the Department's performance measures.

EXAMINATION SCOPE AND FREQUENCY SCHEDULE

ASSET SIZE	COMPOSITE AND CAPITAL CRITERIA	EXAMINATION SCOPE AND FREQUENCY	FREQUENCY FOR PURPOSES OF ASSESSMENT CALCULATION UNDER RULE 3.37
$10 Billion or Greater[1]	1 or 2 Composite	Continuous Examination Program. A composite risk rating is assigned every 12 months.	12 Month

1 The Commissioner or Deputy Commissioner may designate any institution with total assets over $5 billion to be examined under the CEP.

ASSET SIZE	COMPOSITE AND CAPITAL CRITERIA	EXAMINATION SCOPE AND FREQUENCY	FREQUENCY FOR PURPOSES OF ASSESSMENT CALCULATION UNDER RULE 3.37
$10 Billion or Greater[1]	3, 4, or 5 Composite	Continuous Examination Program. A composite risk rating is assigned every six months.	6 Month
Greater Than $1 Billion But Less Than $10 Billion	1 or 2 Composite	Level I examination every 12 months.	12 Month
$1 Billion or Less	"Well capitalized" as defined by 12 C.F.R. 325.103 (b)(1) (member bank) or §325.103(b)(1) (nonmember bank) AND 1 or 2 Composite Rating with 1 or 2-Rated Management	Level I examination every 18 months; however, may be eligible for the Level II examination.	18 Month
$1 Billion or Less	1 or 2 Composite With Management Rating >2 OR Not "well capitalized" as defined by 12 C.F.R. 325.103(b)(2) and 1 or 2 Composite	Level I examination every 12 months.	12 Month
Any Size	De Novo and 1 or 2 Composite	Visitation within first six months of opening. Level I examination 12 months after opening and annually thereafter for the first five years of operation. Commissioner may alter this schedule to align with the applicable federal regulatory agency or Division policy.	12 Month
Less than $10 Billion	3, 4 or 5 Composite	Level I examination every 12 Months. FDIC Visitation or Interim Risk Examination and Assessment to be performed approximately six months after the Level I examination.	6 Month

Generally, Full Scope examinations of banks with total assets greater than $1 billion will be conducted jointly with the appropriate federal regulator. Full Scope examinations of 3, 4, and 5 rated institutions should be conducted jointly with the appropriate federal regulator. The examinations for 1 or 2 rated de novo institutions will be conducted jointly with the appropriate federal regulator for the first three years and then continue on an alternating basis.

An Information Technology (IT) review should be performed to coincide with the Full Scope examination as outlined in Supervisory Memorandum 1020.

EXCEPTIONS TO BANK EXAMINATION FREQUENCY SCHEDULE

Exceptions may be made to the examination frequency schedule of a bank depending upon the circumstances as determined by the Director of Bank and Trust Supervision, the Deputy Commissioner, or the Commissioner. The following addresses when an examination schedule may be shortened or lengthened temporarily and the authorization required.

Shortened Examination Frequency

Banks that qualify for an 18 month examination frequency cycle may be subject to a 12 month examination cycle as determined by the Director of Bank and Trust Supervision. A shortened examination cycle may be necessary for institutions operating under certain circumstances which include but are not limited to the following:

a. a change of control during the preceding 12 month period;
b. a Capital, Asset Quality, Earnings, Liquidity or Sensitivity to Market Risk component rating of “3”, “4”, or “5”as defined by the Uniform Financial Institutions Rating System; or
c. a formal or informal enforcement action.

Extended Examination Frequency

An extension to the examination frequency schedule for banks is permitted under certain circumstances. The reason(s) for the extension must be in writing, maintained with the institution’s records at the Department, and be approved by the Deputy Commissioner or Commissioner.

The Deputy Commissioner has authority to extend the date of any type of examination (Safety and Soundness, Information Technology, or Trust Department) up to six months predicated on extenuating circumstances including, but not limited to:

a. an anticipated merger or acquisition with another institution;
b. an anticipated change in charter;
c. a disruption in normal operations due a natural disaster or state of emergency; or
d. other significant reasons as determined by the Commissioner or Deputy Commissioner.

Authority to extend an examination beyond six months requires approval of the Commissioner.

TRUST DEPARTMENT EXAMINATION FREQUENCY POLICY

For banks with Trust departments, Trust examinations will be due within 120 days prior to the due date for each safety and soundness Full Scope examination. The flexible due date allows coordination with the bank to reduce the regulatory burden and preclude conflicts with safety and soundness examination procedures. Generally, banks eligible for an 18-month or subject to a 12-month safety and soundness examination cycle will require Trust Department examinations of a like frequency. However, banks subject to a 6-month safety and soundness examination cycle are eligible to have a Trust Department examination waived if the most recent Trust examination occurred within the last 12 months and the Trust composite risk rating is a “1” or “2”. In situations where the most recent composite risk rating is "3", "4" or "5", the scope and frequency of the next Trust Department review will be established by the Chief Trust Examiner and the Director of Bank and Trust Supervision.

The findings of the examination may be embedded into the bank safety and soundness Report of Examination or delivered under separate cover as an independent Report of Examination, as determined by the Chief Trust Examiner and applicable Regional Director. The examination frequency policy for Trust Companies is addressed in Supervisory Memorandum 1004.

CONTACT INFORMATION

Questions about this Supervisory Memorandum may be directed to the Director of Bank and Trust Supervision at 512-475-1300.

SUPERVISORY MEMORANDUM – 1004

September 30, 2015 (rev.)

TO: All State-Chartered Trust Companies
All Bank and Trust Examining Personnel

FROM: Charles G. Cooper, Banking Commissioner

SUBJECT: Examination Frequency for Trust Companies[1]

BACKGROUND

Section 181.104 of the Texas Finance Code (TFC) requires that the banking commissioner examine each state trust company annually, or on another periodic basis as may be required by rule or policy, or as the commissioner considers necessary to safeguard the interests of clients, creditors, shareholders, participants, or participant-transferees and efficiently enforce applicable law. Additionally, section 182.013 of the TFC allows the banking commissioner to examine or investigate an exempt[2] state trust company periodically, as necessary, to verify the annual certification required to be filed by an exempt state trust company.

PURPOSE

This Supervisory Memorandum specifically outlines the Department of Banking's (Department) examination priorities for trust companies and the types of examination scopes utilized. The applicability of this policy to exempt trust companies is specifically addressed in the Examination Scope and Frequency Schedule.

EXAMINATION FREQUENCY POLICY

The general policy of the Department is to conduct an on-site examination at every trust company at least annually. Trust companies which meet certain qualifying criteria may have the examination frequency extended to a maximum of 18 months. Qualifying criteria and examination frequency are outlined in the Examination Scope and Frequency Schedule included in this policy. Risk, and thus examination frequency, is generally determined by the supervisory ratings assigned to the trust company. Ratings definitions are found in Supervisory Memorandum 1002. Examinations performed by the Federal Deposit Insurance Corporation (FDIC) or Federal Reserve Bank (FRB) are considered acceptable for meeting these priorities when a trust company is an affiliate of a bank, under a bank holding company, or subject to FDIC or FRB review by federal statute.

EXAMINATION SCOPE

The scope of each examination is based upon circumstances of the individual trust company. The Department utilizes three types of examination scopes for trust companies: Level I Full Scope, Level II Full Scope, and Visitation. The Level I and Level II Full Scope examinations meet the requirements of the Department's examination priorities for measuring performance.

- A Level I Full Scope Examination (Level I) is the most comprehensive with the Department's examiners completing procedures that are designed to assess the safety and soundness of the trust company's operations and activities, resulting in an appropriate Trust Company Rating which includes Capital, Asset Quality, Management, Earnings, and Liquidity (CAMEL); and a Uniform Interagency

[1] Current revisions to this policy include the addition of the Extended Examination Frequency as allowed under the TFC Section 181.104 as revised by the 84th Legislature and the addition of the examination scope and frequency for trust companies with fiduciary assets of $10 billion or greater. The contact information for the Chief Trust Examiner was also updated.

[2] A state trust company may request in writing that it be exempted from specified provisions of the TFC related to trust companies. The banking commissioner may grant a trust company the exemption if the banking commissioner finds that the state trust company does not transact business with the public and meets the qualifications in TFC §182.011.

Trust Rating which covers Management; Operations, Internal Controls, and Audits; Earnings; Compliance; and Asset Management (MOECA). A formal Report of Examination is produced for the trust company to review.

- A Level II Full Scope Examination (Level II) allows examiners to focus on the highest risk areas of the trust company, while excluding certain assignments determined to be of lower risk due to the nature of the trust company's activities. Examiners complete risk-focused procedures and review all critical aspects of the trust company's operations to the extent considered necessary to assign CAMEL and MOECA ratings. A formal Report of Examination is produced for the trust company to review.

- A Visitation is a narrowly scoped examination which may focus on one or more Corporate or Fiduciary components, a specific risk area, or compliance with an enforcement action. The results of a Visitation will be documented with a Letter of Findings to the trust company.

If at any time it becomes apparent that the planned scope of supervisory activity should be expanded, the Department will not hesitate to do so.

EXAMINATION SCOPE AND FREQUENCY SCHEDULE

The following chart details the *general* criteria for determining the examination frequency of state-chartered trust companies for Safety and Soundness examinations. The frequency and scope outlined in the table meet the examination priorities of the Department. Examinations started within 30 days from the date they are due, are considered to meet the Department's performance measures.

EXAMINATION SCOPE AND FREQUENCY SCHEDULE FOR TRUST COMPANIES

COMPOSITE RATING AND CRITERIA	EXAMINATION SCOPE AND FREQUENCY
3, 4 or 5 CAMEL or 3, 4 or 5 MOECA	Level I examination annually. During the interim (i.e., at approximately 6 months), a Level II examination or visitation may be conducted. The level of examination will be at the discretion of the Director of Bank and Trust Supervision.
1 or 2 CAMEL or 1 or 2 MOECA and Fiduciary Assets less than $10 Billion	Level I examination every 18 months, however, may be eligible for a Level II examination at every other examination at the discretion of the Director of Bank and Trust Supervision.
1 or 2 CAMEL or 1 or 2 MOECA and Fiduciary Assets $10 Billion or more	Level I examination every 12 months.

COMPOSITE RATING AND CRITERIA	EXAMINATION SCOPE AND FREQUENCY
3-Rated Management and 1 or 2 CAMEL or 1 or 2 MOECA	Level I examination annually.
New Trust Company - Not Yet Rated	Visitation examination may occur within 6 months after opening at the discretion of the Director of Bank and Trust Supervision. Level I examinations will be conducted annually for the first five years.
EXEMPT TRUST COMPANY	**EXAMINATION SCOPE AND FREQUENCY**
Exempt under Statute - Texas Finance Code §182.011 No Ratings Assigned.	Examination annually to determine that the trust company meets the criteria for exempt status. An off-site review including an examination of the annual financial statement required under §181.107 of the Texas Trust Company Act[3] may be substituted for an on-site examination; however, an on-site examination of an active exempt trust company must be conducted at least every 24 months. Conducting two consecutive off-site examinations of an active exempt trust company will be at the discretion of the Deputy Commissioner or Commissioner. An inactive exempt trust company must have an on-site examination every three years.

An Information Technology (IT) review for a trust company should be performed to coincide with the Level I and Level II examinations as outlined in Supervisory Memorandum 1020. Trust companies exempt under TFC §182.011 do not receive an IT examination.

EXCEPTIONS TO EXAMINATION FREQUENCY SCHEDULE

Exceptions may be made to the examination frequency schedule of a trust company depending upon the circumstances as determined by the Chief Trust Examiner, Director of Bank and Trust Supervision, the Deputy Commissioner, or the Commissioner. The following addresses when an examination schedule may be shortened or lengthened temporarily and the authorization required.

Shortened Examination Frequency

A trust company that qualifies for an 18 month examination frequency cycle may have the next examination due date shortened as determined by the Chief Trust Examiner, Director of Bank and Trust Supervision, Deputy Commissioner or Commissioner. A shortened examination cycle may be necessary for institutions operating under certain circumstances which include but are not limited to the following:

a. a change of control during the preceding 12 month period;
b. a formal or informal enforcement action;
c. a Capital, Asset Quality, Earnings, or Liquidity component rating of “3”, “4”, or “5” as defined by the Uniform Financial Institutions Rating System; or

[3] Title 3, Subtitle F of the Texas Finance Code.

d. an Operations, Internal Controls, and Audits; Earnings; Compliance; or Asset Management rating of “3”,”4”, or “5” as defined by the Uniform Interagency Trust Rating System.

Extended Examination Frequency

An extension to the examination frequency schedule for trust companies is permitted under certain circumstances. The reason(s) for the extension must be in writing, maintained with the institution’s records at the Department, and be approved by the Deputy Commissioner or Commissioner.

The Deputy Commissioner has authority to extend the date of a Safety and Soundness or Information Technology examination up to six months predicated on extenuating circumstances including, but not limited to:

a. an anticipated merger or acquisition with another institution;
b. an anticipated change in charter;
c. a disruption in normal operations due a natural disaster or state of emergency; or
d. other significant reasons as determined by the Commissioner or Deputy Commissioner.

Extending an examination beyond six months requires approval of the Commissioner.

CONTACT INFORMATION

Questions regarding this Supervisory Memorandum may be directed to either Kurt Purdom, Director of Bank & Trust Supervision, at (512) 475-1333, or Mark Walker, Chief Trust Examiner, at (979) 213-0968.

SUPERVISORY MEMORANDUM – 1005

February 19, 2013 (rev.)

TO: All State-Chartered Banks
All Bank and Trust Examining Personnel

FROM: Charles G. Cooper, Banking Commissioner

SUBJECT: Policy on Enforcement Actions for State-Chartered Banks[1]

OVERVIEW

The purpose of this Memorandum is to set forth the circumstances under which enforcement actions are used by the Department of Banking (Department) with regard to the banks and bank holding companies[2] under its regulation, and to specify the general methodology which is followed. An enforcement action is designed to address and correct specific problems identified within the financial and operational affairs of banking institutions, and is an essential element of effective regulation.

PUBLIC DISCLOSURE OF ENFORCEMENT ACTIONS

Other than final Prohibition or Removal Orders, Department enforcement actions, whether informal or formal, are confidential. The Banking Commissioner has discretion to publicize final Cease and Desist Orders, final Administrative Penalty Orders, Supervision Orders, and Conservatorship Orders if the Commissioner concludes that the release would enhance effective enforcement of the order.

DEFINITIONS

"Management" includes bank officers as well as bank directors.

"Regulatory responses" are actions taken by the Department in response to particular conditions at a bank. They include informal communications as well as enforcement actions.

POLICY FOR IMPLEMENTING ENFORCEMENT ACTIONS

Regulatory responses are initiated whenever the Department becomes aware of situations or issues that weaken the safety and soundness of an institution, or that arise from non-compliance with policies, procedures, regulations, or laws.

To assure uniformity of action and to ensure that supervisory efforts are directed to banks exhibiting elevated risk profiles or other major deficiencies, the general policy of the Department is to initiate enforcement actions on banks with composite CAMELS ratings of "3," "4," or "5." The composite CAMELS ratings are explained below. Banks rated "1" or "2" generally do not warrant an enforcement action, although the Department may initiate one depending on the specific circumstances of the institution. In particular, banks have Information Technology examinations and Bank Secrecy Act examinations that may reveal the need for an enforcement action even though the bank has a composite rating of "1" or "2."

[1] This Policy Memorandum revises and supersedes the September 1, 1997, revision. The revisions generally update the policy due to changes in state banking statutes and practices.

[2] Pursuant to Texas Finance Code Sections 201.009(a) and 202.005(a)(2), the Commissioner may bring an enforcement action against a bank holding company that controls a Texas bank to the same extent as if the bank holding company were a Texas state bank. Therefore, statements in this Memorandum referring to state banks or persons associated with state banks also apply to bank holding companies or persons associated with bank holding companies.

Enforcement actions often set forth the practices, conditions, and violations giving rise to the particular problems or weaknesses identified. The actions also outline specific corrective measures, often including appropriate time frames and goals for achievement. Specific types of enforcement actions available to the Department are outlined below in the section, “Types of Enforcement Actions.”

The Department’s enforcement actions are not part of a hierarchy; they are not designed to build on one another. On a case by case basis, the Department thoroughly analyzes the situation at the bank and designs the action it believes to be the most effective in curing the bank’s adverse conditions.

BANK RATINGS

1-Rated Banks

A composite “1” rating implies that a bank is sound in all respects and that any weaknesses or deficiencies are so insignificant or immaterial that they pose no supervisory concern. Regulatory responses are generally limited to informal requests for future plans and/or a written response from the bank regarding the examiner's findings as indicated in the report of examination.

2-Rated Banks

Banks having a composite rating of “2” are fundamentally sound. Identified weaknesses or deficiencies are generally of a moderate nature and correction is attainable in the normal course of business. Regulatory responses are the same as for 1-rated banks; however, a Board Resolution may be initiated depending on specific circumstances encountered. In instances of repeated or willful law violations and/or continuing unsound banking practices, the issuance of a stronger enforcement action may be warranted.

3-Rated Banks

A composite “3” rating implies that a bank has weaknesses which, if not corrected, could worsen into a more severe situation. Regulatory responses will most likely be enforcement actions which require remedial action.

4 and 5-Rated Banks

Banks with composite ratings of “4” or “5,” by definition, have problems of sufficient severity to warrant a strong regulatory response. An enforcement action such as a Cease and Desist Order is issued when there is evidence of unsafe and unsound practices or conditions. Exceptions to this policy are considered only when the condition of the bank clearly reflects significant improvement resulting from an effective correction program or where individual circumstances militate against the appropriateness or feasibility of strong enforcement actions.

TYPES OF ENFORCEMENT ACTIONS

Enforcement actions are either formal or informal. With the exception of determination letters, informal enforcement actions are voluntary commitments made by bank management designed to correct identified deficiencies and ensure compliance. Formal enforcement actions are generally more severe and result in an order issued by the Commissioner. Banks have a statutory right of appeal from formal enforcement actions to which they have not agreed.

A. Informal Enforcement Actions

Board Resolutions: A Board Resolution is a statement adopted by the board of directors of a bank that specifies corrective actions the board of directors will take. It is issued either on management's own volition or at the request of the Department. Board Resolutions are accepted from banks that exhibit only modest regulatory concerns.

Memorandum of Understanding: A Memorandum of Understanding is an agreement between a bank and the Commissioner that sets forth specific corrective actions to be undertaken by the board of directors of a bank. This action is normally pursued with banks where management does not pose a significant regulatory concern, and where the Department believes management has the ability and the willingness to correct noted deficiencies. A Memorandum of Understanding is an agreement within the meaning of Texas Finance Code Sections 31.002(a)(29)(C) and 35.002(a)(5). Therefore, violation of a Memorandum of Understanding is grounds for issuance of a Cease and Desist Order, and, if other conditions are met, a Supervision or Conservatorship Order. A Memorandum of Understanding may occasionally have a different title.

Determination Letter: A Determination Letter is a warning issued pursuant to Section 35.001 of the Texas Finance Code that the practices or condition of a bank need immediate attention to avoid the issuance of an enforcement order under the Texas Finance Code. A Determination Letter includes a listing of the requirements to abate the Commissioner's determination. A Determination Letter is normally used in a bank where problems are of a serious nature, but the Commissioner believes that a more formal enforcement action may not be necessary to achieve correction.

A. Formal Enforcement Actions

Written Agreement: A Written Agreement between a bank and the Commissioner sets forth specific corrective actions to be undertaken by the board of directors of a bank and/or bank holding company. A Written Agreement is given a Commissioner's Order number. A Written Agreement is usually issued in conjunction with the Federal Reserve. The Commissioner will join with a federal agency in issuing a Written Agreement only after making the necessary findings to establish the action as a Cease and Desist Order under Texas Finance Code Sections 35.002, 201.009, and 202.005. Therefore, the Commissioner may publicize a Written Agreement pursuant to Section 35.012. Written Agreements entered into with the Federal Reserve are public under federal law. The Commissioner's decision to issue a joint Written Agreement with the Federal Reserve includes a conclusion that effective enforcement of such a Written Agreement will be enhanced by its publication.

Cease and Desist Order: A Cease and Desist Order is issued pursuant to Section 35.002 of the Texas Finance Code, demanding that an officer, employee, or director of a state bank, or the bank itself discontinue violations and/or unsafe and unsound banking practices, and take certain affirmative action as may be necessary to correct the conditions resulting from such violations or practices. A Cease and Desist Order is deemed necessary and appropriate for serious violations and unsafe practices. Management of a bank subject to such an order would normally have demonstrated a disregard for safe and sound banking practices and/or the lack of willingness or ability to correct deficiencies on their own. If a bank agrees to enter into such an order, the order is called a Consent Order. The Commissioner may publish a final Cease and Desist Order or Consent Order pursuant to Section 35.012. Cease and Desist Orders or Consent Orders entered into with the FDIC are public under federal law. Therefore, the Commissioner will join with a federal agency in issuing a joint Cease and Desist Order or Consent Order only after making the findings required by Section 35.012.

Order of Removal or Prohibition: A Removal or Prohibition Order is issued pursuant to Section 35.003 of the Texas Finance Code if the Commissioner finds that a present or former officer, director, employee, controlling shareholder, or other person participating in the affairs of a state bank has committed or participated in violations of law or agreements, and/or unsafe and unsound banking practices, or made false entries, which caused certain effects, and which were done in other than an inadvertent or unintentional manner. Such orders have the effect of removing a person from office or employment or prohibiting a person from office, employment, or any further participation in the affairs of a state bank or any other entity chartered, registered, permitted, or licensed by the Commissioner. The Commissioner must publish all final Removal and Prohibition Orders.

Order of Supervision: Pursuant to Section 35.101 of the Texas Finance Code, upon determining that a bank is in hazardous condition as defined by Texas Finance Code Section 31.002(a)(29), the Commissioner may issue an Order of Supervision without prior notice to appoint an individual as a supervisor of the bank. Supervision is generally used in situations where the Commissioner has little confidence in the ability or willingness of the management of the bank to follow safe and sound banking practices. The authority of a supervisor, (enumerated under Section 35.106), includes acting as the Commissioner's on-site observer and agent to assure, through approval authority and/or moral suasion, that the bank is operated properly and in accordance with law and the enforcement action.

Order of Conservatorship: A Conservatorship Order may be issued by the Commissioner pursuant to Section 35.102 of the Texas Finance Code when it is determined that a bank is in hazardous condition and immediate and irreparable harm is threatened to the bank, its depositors, creditors or shareholders, or the public. Under Section 35.107, the board of directors may not direct or participate in the affairs of the bank during conservatorship. An appointed conservator immediately takes charge of the bank, its property, books and records, and affairs on behalf of and at the direction and control of the Commissioner.

Administrative Penalties: If a bank or person commits applicable violations of law or a Commissioner's order (see Section 35.009), the Commissioner may seek to assess monetary fines or penalties. The bank or person is notified that a hearing will be held to determine whether administrative penalties will be assessed. Unless the violation is of a Commissioner's order, the bank or person will be given an opportunity to correct the action and reduce or avoid the penalty. Section 35.010(b) sets out factors the Commissioner must consider when setting the penalty and Section 35.010(c) sets out minimum and maximum penalty amounts.

PROCEDURE FOR IMPLEMENTING ENFORCEMENT ACTIONS

Board Resolutions, Memorandums of Understanding and Determination Letters are normally handled through written correspondence with the board of directors of a bank. Nevertheless, they may require a special meeting of the board of directors. Other enforcement actions usually require a special meeting of the directorate of the bank and generally such meetings are conducted by senior Department officials, including a member of the legal staff, at the Austin headquarters office. If an enforcement action is a joint action with a federal agency, the board meeting may occur at the federal agency's regional office.

Follow-up by examining personnel on enforcement actions is conducted in accordance with the Department's examination priorities unless variance from policy is deemed necessary. A bank that is placed under Supervision or Conservatorship will have the appointed supervisor or conservator assist in monitoring compliance with enforcement orders.

SUPERVISORY MEMORANDUM – 1006

May 31, 2013

TO: All Entities Regulated by the Texas Department of Banking
All Examining Personnel and Department Ombudsman

FROM: Charles G. Cooper, Banking Commissioner

SUBJECT: Request for Reconsideration of Examination Finding (REF)

POLICY

It is the policy of the Department to provide sound supervision of the entities it regulates through fair and unbiased examinations and monitoring. In the event that a material disagreement arises regarding an examination finding or rating, this policy addresses the proper process to request a Reconsideration of an Examination Finding (REF).

RECONSIDERATION OF EXAMINATION FINDING DURING AN EXAMINATION

If a material disagreement between Department examiners and an entity under examination arises regarding an examination finding, the entity should first attempt to resolve the dispute with the Examiner-In-Charge (EIC) of the examination. Entities are encouraged to discuss any conflicting issues during an examination with the EIC and to work closely with the EIC to ensure that all available information is received and fully explained.

If a satisfactory resolution is not reached, the entity may further pursue its concerns with the EIC's supervisor. For examinations conducted by the Bank and Trust Supervision Division, the Regional Director, Chief Trust Examiner, Chief IT Security Examiner or the Director of Bank & Trust Supervision may be contacted. For examinations conducted by the Special Audits Division, the Director of Special Audits may be contacted.

REQUEST FOR RECONSIDERATION OF REPORT OF EXAMINATION FINDING

If, after the Report of Examination is received and an entity continues to have an unresolved objection with one or more finding(s) or rating(s) in the Report of Examination, the entity may file a written request for review of the matter with the Banking Commissioner. The written request should be submitted to the Texas Department of Banking Ombudsman at 2601 N. Lamar Blvd., Austin, Texas 78705. A request for a REF should be submitted within 30 days after receipt of a Report of Examination and should include a full description of the matter in dispute, along with supporting documentation.

The objection(s) will be investigated by the Ombudsman who is appointed by the Commissioner. The Ombudsman may request additional information from the entity requesting the REF and obtain documents from the examining division. The Ombudsman performs an independent analysis and makes a recommendation to the Commissioner regarding the objection. The Commissioner will issue a final determination in the form of a written response to the entity. The supervised entity requesting the REF has no right to a hearing or further appeal after the Commissioner has rendered a decision.

As a general rule, supervisory decisions and actions continue in effect during this process. However, new supervisory decisions or actions based on examination findings associated with a REF may be suspended until the review is completed and the Commissioner makes a final determination.

WITHDRAWAL OF REQUEST

A REF may be withdrawn by an entity at any time during the review process by submitting a written request to the Ombudsman.

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SUPERVISORY MEMORANDUM – 1007

March 6, 2015 (rev.)

TO: All State-Chartered Banks
All Bank and Trust Examining Personnel

FROM: Charles G. Cooper, Banking Commissioner

SUBJECT: Policies Regarding Investment Securities[1]

BACKGROUND

With the passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank Act), regulatory changes have been implemented regarding the permissibility of certain investment activities. The Office of the Comptroller of the Currency (OCC) adopted a final rule and related guidance which removes references to external credit ratings and clarifies regulatory expectations regarding assessing a security's creditworthiness and ongoing due diligence consistent with requirements in the Dodd-Frank Act. Under part 362 of the Federal Deposit Insurance Corporation's regulations, insured state banks generally are prohibited from engaging in an investment activity that is not permissible for a national bank under OCC regulations. Under the Federal Reserve Act (12 USC 335) and the Federal Reserve's Regulation H (12 CFR 208.21), state member banks may purchase, sell, underwrite, or hold securities and stock as national banks under the National Banking Act. State member and nonmember banks must comply with the OCC regulations when investing in securities.

This Supervisory Memorandum reinforces the Department's endorsement and adoption of federal banking agencies' policies relating to the investment security standards and activities, consistent with the Dodd-Frank Act. This Memorandum also establishes the Department's policy regarding the classification and appraisal of municipal bonds.

POLICY

The investment guidance issued by the OCC and affirmed by the FDIC in Financial Institution Letter FIL-48-2012 and the Federal Reserve Board in SR letter 12-15, amends the definition of "investment grade" by removing references to external credit ratings and requires banks to make assessments of a security's creditworthiness to determine if it is "investment grade."[2] A security meets the "investment grade" regulatory standard for credit quality if the security has (1) low risk of default by the obligor, and (2) the full and timely repayment of principal and interest is expected over the life of the investment. Banks may continue to take into account external credit ratings and assessments as a valuable source of information; however, banks are expected to supplement these ratings with due diligence processes which consider the interest rate, credit, liquidity, price, size, complexity, and other risks presented by the investments. Additionally, ongoing analysis of the investment portfolio should continue to be performed to ensure that investments are appropriate for the bank's risk profile.

The Department concurs that state-chartered banks must comply with the federal regulations and guidance related to investment securities. The Department's policy regarding investment in municipal bonds, however, considers that if a bond is rated, it should be in the top four rating categories provided by Nationally Recognized Statistical Rating Organizations in order to be considered "investment grade." Per the federal guidance, independent credit analysis should still be performed by the bank on purchases of municipal revenue bonds. While it is not mandatory that general obligation bonds meeting the criteria for Type I bonds be subject to detailed credit analysis, an adequate

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[1] This memorandum revises and supersedes the policy issued on August 21, 1998 and addresses recent federal rules and guidance issued as a result of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010.
[2] For the OCC's final rules, see 77 FR 35253 (June 13, 2012), For the OCC's guidance, see 77 FR 35259 (June 13, 2012) and OCC Bulletin 2012-18 (June 26, 2012).

level of credit review is still expected as a safe and sound banking practice. If a bond is not rated, the bank's supplemental analysis should validate why the bond is considered to be of "investment grade." Banks must perform both pre-acquisition and ongoing periodic post–acquisition analysis of securities held to support the "investment grade" nature of the bonds held.

The Department also concurs with the Uniform Agreement on the Classification and Appraisal of Securities Held by Financial Institutions which was updated by federal regulatory authorities on October 29, 2013.

SUPERVISORY MEMORANDUM – 1008

October 18, 2013 (rev.)

TO: All State-Chartered Banks
All Bank and Trust Examining Personnel

FROM: Charles G. Cooper, Banking Commissioner

SUBJECT: Policy for Other Real Estate Owned (OREO) [1]

OVERVIEW

This policy statement interprets the state statutes and rules governing other real estate and defines the Department's classification policy for OREO. Section 34.003 of the Texas Finance Code authorizes a state bank to hold real estate other than its banking premises in limited circumstances. Section 34.004 further permits a state bank to hold nonparticipating royalty interests as personal property in specific instances. Title 7, Section 12.91 of the Texas Administrative Code (7 TAC §12.91) defines other real estate; describes the limited circumstances under which it can be lawfully acquired by a bank; outlines the appraisal/evaluation requirements; establishes a procedure whereby additional expenditures may be made; defines a maximum holding period for each parcel; and outlines the minimum criteria for disposition efforts by a bank.

ACCOUNTING FOR OREO

Initial Booking

Under 7 TAC §12.91 OREO must be accounted for in accordance with regulatory accounting principles,[2] defined in the Texas Finance Code as generally accepted accounting principles (GAAP) as modified by rules adopted under the Code or an applicable federal statute or regulation.

Each parcel of OREO should be recorded at the fair value less costs to sell the property, which becomes the "cost" of the foreclosed real estate. If the fair value (less the estimated costs to sell) exceeds the recorded amount of the loan, the excess should be reported as a recovery of a previous charge-off on the loan or in current earnings, as applicable.[3] If the recorded value of the loan exceeds the fair value of the foreclosed property minus estimated selling costs upon initial booking, the deficiency is a loss which should be charged to the Allowance for Loan and Lease Losses.[4] Further accounting guidance can be found in the Call Report Instructions, which require that OREO be accounted for in accordance with GAAP.

The recorded value is the outstanding principal balance of the loan plus any booked accrued and unpaid interest (not to exceed 90 days) plus any unamortized premium and loan acquisition costs, less previous write-downs, finance charges, and any unamortized discount. Direct costs incurred by the bank in a foreclosure, such as legal fees, should be expensed when they are incurred.

Accounting for Other Liens

In accordance with FASB ASC Topic 360 (formerly FASB 144, Accounting for the Impairment of Disposal of

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[1] This policy revises and supersedes the policy dated May 10, 2013 which clarified the definition of recorded value. Current revisions address the change in the holding period for former future expansion property and the treatment of OREO related to a merger, acquisition, or charter conversion.
[2] In general, the accounting and reporting standards for foreclosed real estate are set forth in Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) Topic 310-40, *Troubled Debt Restructurings by Creditors*, and ASC Topic 360-10-35, *Impairment or Disposal of Long-Lived Assets.*
[3] Instances of this are rare and would need to be supported by a strong appraisal and positive economic conditions.
[4] Also see FDIC FIL-62-2008.

Long-Lived Assets) the amount of any senior debt (principal and accrued interest) to which the other real estate is subject (even if not formally assumed by the bank) should be reported as a liability at the time of foreclosure. The carrying amount of the asset would, therefore, be increased by such amount; however, the resulting carrying amount cannot exceed the market value, net of estimated sales costs, of the property. Any subsequent payments of principal should reduce the liability. Interest that accrues after foreclosure should be recognized as interest expense and added to the liability account balance if left unpaid.

Subsequent Costs

Ongoing expenses not associated with acquiring clear title to the property (i.e., taxes, hazard insurance, utilities, etc.) should be expensed as incurred. Costs incurred to protect a bank's investment in OREO which is improved or under construction, and necessary to place a property in a saleable condition, may be capitalized in accordance with GAAP. Additional investments which alter the current status or intended use of the property or made for the purpose of speculating in real estate are not allowed under the law.

APPRAISALS AND EVALUATIONS

As provided in 7 TAC §12.91(d), when OREO is acquired, a state bank must substantiate the market value by obtaining a qualifying valuation (either an appraisal or an evaluation, depending upon which one applies), within 60 days from the date of the property’s acquisition by the bank. For purposes of this section, the term “qualifying valuation” will be used to mean either an “appraisal” or “evaluation.”

If the bank has already obtained a qualifying valuation within the year prior to foreclosure, as provided in 7 TAC §12.91(d) (2), then a new valuation is not yet required. Except for the initial 60 day grace period after acquisition, OREO properties must be supported at all times by a qualifying valuation prepared within the last year. Therefore, if a valuation was obtained six months prior to the foreclosure date, then an updated valuation is not required until six months after the foreclosure date.

An evaluation may be substituted for an appraisal if the recorded book value of OREO is less than $250,000.

An evaluation shall be made on all OREO at least once a year. An appraisal shall be made at least once every three years on OREO with a recorded book value in excess of $250,000.

If any subsequent qualifying valuation indicates a reduction in the value of a property below the current book value, FASB ASC 360 (formerly FASB 144) requires the bank to recognize the deficiency as a valuation allowance against the asset, which is created through a charge to expense. For reporting purposes, the reserve account should be netted against the book value of the OREO and is not considered as part of the bank's capital structure. The valuation allowance should thereafter be increased or decreased (but not below zero) through charges or credits to expense for changes in the asset’s value or estimated selling costs. In no event, however, should the carrying value of the property be increased to an amount greater than the original book value at the time of acquisition or transfer to the other real estate category.

Maintenance of a general reserve for losses on the sale of OREO and write-downs below appraised value are not consistent with generally accepted accounting principles. Write-downs below appraised value must be supported by documentation that indicates that the write-down was appropriate.

HOLDING PERIOD FOR OREO

Holding Period Limit

Texas statutes require that a state bank dispose of OREO within five years from the date the real property:

- is originally acquired or transferred to that asset category;
- ceases to be used as a bank facility; or

- ceases to be considered future expansion property as a bank facility as provided by Section 34.002(b).

When a state bank acquires OREO as the result of a merger with or an acquisition of another institution, the holding period of the newly acquired OREO commences on the date of merger or acquisition. If an entity converts to a state-charter, the OREO property held by the entity at the time of conversion will be considered acquired or transferred to OREO as of the conversion date.

The banking commissioner may grant an extension of time for disposing of an OREO property if, in the commissioner's opinion, the bank has made a good faith effort to dispose of the property, or if the commissioner determines that disposal of the property within the initial five-year period would be detrimental to the bank. Should the extension request be denied, failure to dispose of the property may result in citing a violation of 7 TAC §12.91 at the next examination. Examining personnel will review the bank's efforts to dispose of each property and evaluate compliance with the regulation. Continued noncompliance and/or absence of good faith efforts to dispose of the property may result in the issuance of an enforcement action to effect correction.

Criteria for Holding Period Extensions

All requests for extensions of holding periods must be in writing and should provide, at a minimum, the information outlined below. The form to assist in the request for an extension is in Appendix A.

Extensions for future expansion will be handled on a case-by-case basis. Primary factors that are considered by the Department in evaluating compliance with the law and in deciding whether to approve requests for extensions of holding periods include the following:

- Carrying value of the property in relation to current market value, asking price, and purchase offers received;
- Length of time the property has been held and reason(s) why it has not been sold;
- Income and expenses associated with ownership and maintenance of the property for: (i) all prior years; (ii) the current year; and, (iii) an estimate of next two years; and
- Potential or known contingent liabilities (e.g., environmental concerns, litigation, etc.) relative to the holding of the property.

Extensions for holding property, other than future expansion, are not normally granted if the extended time exceeds ten years from the original date of acquisition.

Holding Non-participating Royalty Interest Beyond Disposal Period

A non-participating royalty is an interest in the minerals that is non-possessory and does not entitle the owner to produce the minerals, join in a lease of the mineral estate to which the royalty is appurtenant, or share in bonuses or delay rentals that may be paid under the lease, but merely entitles the owner to a share of the production under the lease free of exploration and production expenses.

If acquired for the purpose of avoiding or minimizing a loss on a loan or investment previously made in good faith, under certain circumstances a bank may retain a limited interest in OREO in the form of a non-participating royalty interest, subject to Section 34.004 of the Texas Finance Code. The commissioner may order the bank to dispose of the interest if it is determined at any time that continued ownership is detrimental to the bank.

In order to own and retain any non-participating royalty interest beyond the disposal period for OREO, a written request must be submitted to the commissioner (See Appendix B). The written request must be accompanied by a copy of the instrument creating the royalty. Upon receiving approval by the Department, a letter application to the FDIC must be submitted requesting permission to hold the reclassified property at the bank level, pursuant to 12 CFR §362.3(b)(2)(i).

DISPOSAL OF OREO

Minimum Documentation Requirements

Under 7 TAC §12.91(g), banks are expected to maintain documentation showing compliance with the regulation and good faith efforts to dispose of each parcel of OREO. Required minimum documentation includes:

- Specific action plans for disposal of each parcel of OREO showing review and approval by the bank's board of directors or a designated committee thereof. Such action plans and reviews should be recorded in the official records of the board or committee meetings;
- Listing agreements executed with real estate agents/brokers detailing the asking price and terms of sale. If a property is not listed, adequate documentation showing the bank's own marketing efforts must be maintained;
- Documented reasonableness of the asking price relative to the appraised market value of the property;
- Records of all verbal and/or written inquiries and offers received for each property;
- Decisions made and actions taken by the board, or designated committee, on all verbal or written offers received; and
- Files of all advertising media employed, e.g., signs, publications, and broadcast media.

Bank Financing of OREO Purchases

It is not uncommon for a bank to provide financing upon sale of OREO to facilitate the orderly liquidation of such assets. The receivable resulting from the sale of the OREO should be reported as a loan when the full accrual, installment, cost recovery, reduced profit, or percentage of completion method of accounting under FASB ASC Topic 360-20 *Real Estate Sales* (formerly FAS 66) is being used. However, if the property is sold and accounted for under the deposit method[5] of accounting under ASC Topic 360-20, the property continues to be reported as OREO. The deposit method is used when a sale has not been consummated and when recovery of the carrying value of the property is not reasonably assured. Any dispositions which do not initially qualify for sales treatment should continue to be monitored for subsequent reclassification to a sale when the minimum criteria are met. Bankers and examiners should refer to ASC Topic 360-20 for additional guidance.

When a financed property is accounted for under the deposit method and remains OREO for reporting purposes, it is not subject to the disposal efforts and holding period limits incorporated in law and this policy. Also, §34.201(a)(15) of the Texas Finance Code specifically excludes the portion of a purchase money mortgage taken by a bank in consideration for the sale of OREO owned by the bank from the legal lending limit, if the sale was in the bank’s best interest.

Exchange, Acceptance or Additional Purchases

With the prior written approval of the banking commissioner, a state bank may exchange or acquire real estate or personal property in order to avoid or minimize loss potential on OREO. Alternate or additional real estate so acquired should be accounted for on the bank's books as OREO, and the initial holding period for such properties will be measured from the date legal title to the original OREO was first acquired by the bank. Disposal of personal property should be within 90 days of acquisition.

Criteria for Exchanging or Acquiring Additional OREO

The commissioner's decision to approve or deny requests for the exchange or acquisition of real estate will be made after considering all relevant factors of the transaction, particularly the following:

[5] Under the deposit method, the seller does not recognize any profit, does not record notes receivable, continues to report in its financial statements the property and the related existing debt even if it has been assumed by the buyer, and discloses that those items are subject to a sales contract.

- Has the bank demonstrated good faith efforts to dispose of the original OREO?
- Has the bank reduced its loss exposure as evidenced by current market value appraisals of the properties involved?
- Does the bank have specific plans to market the newly acquired property?
- What is the amount of cash to be received by the bank in connection with a transaction where the bank is accepting an alternate parcel of real estate as partial consideration in the sale of existing OREO?
- Will the nature of the original OREO be changed?
- What is the bank's aggregate investment in the existing OREO plus the property to be acquired in relation to equity capital?

Transfer of OREO to Subsidiary or Affiliate

Title 7, Sections 12.91(h) of the TAC addresses the various options for disposition of OREO. Among those options are transfers to a majority-owned subsidiary or sale to an affiliate.

Section 12.91(h) (4) provides that a bank may dispose of real estate by transferring the real estate to a majority-owned subsidiary. This is subject to compliance with FDIC regulation 12 CFR §362.4(b) (5) (i), which permits the transfer under certain conditions.

Section 12.91(h) (5) provides that a bank may dispose of real estate by transferring the real estate for market value to an affiliate. This is subject to Section 33.109 of the Texas Finance Code and applicable federal law, including 12 U.S.C. §§371c, 371c-1, and 1828(j) (relating to transactions with affiliates).

A bank may also dividend in kind the real property to an up-stream subsidiary or affiliate at the market value of the asset on the date of the dividend.

According to 12 C.F.R § 225.22 (d), the Federal Reserve Board may (upon request) permit a bank holding company or a nonbank subsidiary of the bank holding company that receives the real estate through sale, transfer, or dividend in kind from the bank, to hold the property for a maximum of 10 years. The holding period requirement is based upon the date that the property was acquired by the bank.

Classification Standards

The Department evaluates OREO in the same manner as any other bank-owned asset, utilizing the same criteria for assessing quality and propriety. As warranted, adverse criticism is assigned in a manner consistent with the uniform classification standards used by state and federal bank regulatory agencies.

Income producing properties may be excluded from classification provided the annual net cash flow from the property yields a market rate of return on the entire book amount. "Net cash flow" is defined by GAAP as gross cash receipts less the cost of insurance, taxes, management fees, and other operating costs. For purposes of the classification treatment outlined below, the market rate of return must equal or exceed the average yield on real estate loans as reflected in the bank’s most recent federal reports of condition and income plus 100 basis points. If book value is materially less than the market value of the property due to previous unsubstantiated write downs, for classification purposes the rate of return is calculated using the market value of the asset.

Suggested classification treatments are shown below and assume that the examiner has no material reservations with the validity of the appraisal or its assumptions. In the case of income producing properties, the assumption is also made that there are no significant reservations about the quality and continued viability of the future cash flow stream of the property. However, if an examiner has reasonable cause to question the appraisal, its assumptions, or the future cash flow stream, more severe classifications than those shown may be assigned.

Income Producing Properties

- **Pass** - Market rate of return equals or exceeds the average yield of the bank's real estate loans plus 100 basis points.
- **Substandard** - Market rate of return does not equal or exceed the average yield of the bank's real estate loans plus 100 basis points.
- **Doubtful** - N.A. (this classification is generally not appropriate).
- **Loss** - Excess of book value over current appraised value.

Non-income Producing Properties

- **Substandard** - Current appraised value.
- **Doubtful** - N.A. (this classification is generally not appropriate).
- **Loss** - Excess of book value over current appraised value.

Appendix A
Application to Extend Holding Period on
Other Real Estate Owned (OREO)
(October 2013)

BANK / TRUST COMPANY NAME:	DATE:
CITY:	CHARTER NO.:
OREO NAME:	
DESCRIPTION OF PROPERTY AND IMPROVEMENTS:	
DATE ACQUIRED:	ORIGINAL BOOK VALUE:
ACQUIRED THROUGH MERGER, ACQUISITION, OR CONVERSION? YES ____ NO_____	LESS: WRITE DOWNS
PERCENT OWNED: %	SALES:
OTHER OWNERS AND % OWNED	RESERVES:
NAME: / %	
NAME: / %	CURRENT BOOK VALUE:

SUPERIOR LIEN:		
NAME:		AMOUNT:
TYPE:	TERMS:	
CONTINGENT LIABILITIES:		
AMOUNT:	DESCRIPTION:	
AMOUNT:	DESCRIPTION:	

INCOME DATA: *(EXCLUDE AMOUNTS CHARGED-OFF OR EXPENSED FOR SPECIFIC RESERVES)*

	DATES	INCOME	EXPENSES	NET
2 YEAR PROJECTION				
1 YEAR PROJECTION				
YEAR TO DATE				
LAST 12 MONTHS				
TOTAL OF PRIOR YRS				

DESCRIBE TYPE OF ANY INCOME RECEIVED:

DESCRIBE LEASES OR CONTRACTS

Appendix A
Application to Extend Holding Period on Other Real Estate Owned (OREO) (October 2013)

APPRAISAL HISTORY: *(LIST THE THREE MOST RECENT APPRAISALS)*

NAME OF APPRAISER	DATE	VALUE

MARKETING INFORMATION: *(INCLUDE THE LAST THREE LISTING AGENTS AND ASKING PRICES)*

AGENT(S)	LISTING PERIOD	ASKING PRICE

DESCRIBE OTHER INTERNAL OR EXTERNAL MARKETING EFFORTS:
(INCLUDE DATES AND TYPES OF MEDIA ADVERTISING)

INQUIRIES AND OFFERS:

WHO	DATE	AMOUNT	REASON REJECTED

Appendix B

Application to Hold Non-Participating Royalty Interest as Personal Property

Instructions:

1. Review Texas Finance Code §34.004 to determine whether your property qualifies as a non-participating royalty interest.*
2. Complete each category.
3. Attach a copy of the instrument creating the royalty and any additional supporting documentation.
4. After approval by the Department of Banking, you must submit a letter application to the FDIC requesting permission to hold the reclassified property at the bank level (See 12 CFR 362.3(b)(2)(i)).

BANK NAME:	**DATE:**
CITY:	**CHARTER NO:**
ROYALTY INTEREST NAME:	
DESCRIPTION OF PROPERTY:	
DATE ACQUIRED:	**ORIGINAL BOOK VALUE:**
PERCENT OWNED: %	**CURRENT BOOK VALUE:**
OTHER OWNERS	
NAMES:	**PERCENT OWNED:** %
NAMES:	**PERCENT OWNED:** %
LIEN: ☐ **YES** ☐ **NO**	
NAME:	
AMOUNT:	
TYPE:	
TERMS:	

* Texas Finance Code §34.004(a) by its terms applies to "nonparticipating royalty interests." The required standards for eligibility and approval, demonstrate the key attributes of a nonparticipating royalty. These standards refer to the inherent nature or attributes of the title held, and cannot be created after acquisition. For example, indemnification in a lease agreement will not satisfy the requirements of §34.004(a)(2) (the interest must not be subject to expenses of exploration, development, production, operation, maintenance, or abandonment).

INCOME DATA:	INCOME		INCOME
LAST 12 MONTHS		1 YEAR PROJECTION	
TOTAL OF PRIOR 10 YEARS		2 YEAR PROJECTION	

	YES	NO
HAS THE BANK EVER BEEN ASKED TO SIGN A LEASE FOR EXPLORATION AND DEVELOPMENT?		
HAS THE BANK EVER RECEIVED A BONUS OR LEASE PAYMENT OTHER THAN A ROYALTY PAYMENT?		
HAS THE BANK EVER INCURRED ANY EXPENSE ASSOCIATED WITH THE INTEREST?		
IS THE INTEREST CURRENTLY SUBJECT TO A LEASE?		

APPRAISAL HISTORY: *(LIST THE MOST RECENT APPRAISAL OR PROPERTY TAX ASSESMENT)*

NAME OF APPRAISER	DATE	VALUE

DESCRIBE OTHER INTERNAL OR EXTERNAL MARKETING EFFORTS OR OFFERS:
(INCLUDE DATES AND TYPES OF MEDIA ADVERTISING)

SUPERVISORY MEMORANDUM – 1009

April 3, 2014 (rev.)

TO: All State-Chartered Banks and Trust Companies
All Bank and Trust Examining Personnel

FROM: Charles G. Cooper, Commissioner

SUBJECT: Business Plans and Strategic Planning[1]

BACKGROUND

This Supervisory Memorandum reinforces the Department's position on the importance of business plans and strategic planning for de novo banks and trust companies as well as for those institutions that have already been established. Clearly defined business plans and annual strategic planning are essential for the continuing success of an institution. This policy provides an overview of the components of a business plan and the strategic planning process, and addresses when a written business or strategic plan is required by the Department.

The Department considers a business plan to be primarily an externally focused document that provides detailed information on the proposed development of an organization. A strategic plan is an ongoing and internally focused plan which guides an organization's board of directors and employees on achieving the goals and objectives of the entity while adhering to its overarching mission.

BUSINESS PLANS AND STRATEGIC PLANNING

Business Plans

The Department of Banking believes that a clearly defined business plan is an important ingredient to the initial success of any commercial enterprise. A business plan serves several purposes, specifically it: assists organizers and the board of directors to focus on their overall mission and goals; provides a means for the board of directors to communicate their objectives and strategies to management and staff; provides guidance to management in setting specific targets and business objectives; serves as a reference point for measuring performance; and assists potential investors and regulators in evaluating the organization's prospects.

A business plan is considered especially important when a new bank or trust company is being organized or when significant changes are contemplated or occurring. A detailed and comprehensive business plan should address the following:

- Marketing Plan
  - planned products and services;
  - market analysis;
  - economic analysis; and
  - competitive analysis;
- Management Plan
  - board of directors, senior executive officers and committee structure

[1] This revision replaces the November 29, 2010 issuance of Supervisory Memorandum 1009. Current changes include the increased emphasis on the importance of business plans and strategic plans and the removal of forms from the policy.

- Operations Plan
  - risk management
    - policies, procedures and internal controls;
    - internal and external audit;
    - compliance management;
  - use of technology and electronic processing systems; and
  - use of vendors;
- Financial Objectives and Projections; and
- Monitoring and Revising the Plan.

The plan must reflect sound business principals and demonstrate a realistic assessment of risk given the economic and competitive conditions in the market to be served. A strong business plan can be achieved with in-depth planning by the institution's organizers and management.

Business plans submitted with corporate applications should provide at least three years' operating projections and should contain sufficient information to demonstrate a reasonable likelihood of success. The plan should identify the proposed markets to be served, products and services to be offered, projected profitability and capital adequacy, information technology infrastructure requirements, and managerial resources and capabilities. Pro-forma statements should include a detailed breakdown of all assumptions utilized in preparation of the data.

Generally, the business plan guidelines and financial projections and balance sheet format included in the Interagency Charter and Federal Deposit Insurance Application will be accepted in transactions involving a bank. Trust applicants should utilize the Proforma Financial Statements form found on the Department's website under the Trust Company section of the Forms page to support projections.

Strategic Planning

An on-going strategic planning process is important to all institutions for setting direction, goals, and objectives and establishing strategies for reaching goals and objectives. At the core of sound strategic planning are four basic components which should be addressed:

1) Where are we now?
2) Where do we want to be?
3) How do we get there?
4) How do we measure our progress?

Sound strategic decisions are essential for an institution to compete and be profitable. Well executed strategic planning provides management with the tools needed to confirm goals and assess progress toward a desired outcome (such as asset and capital growth), evaluate what is effective and what is not, and adjust strategies to improve performance especially when adding new business lines or products. An effective strategic planning process is dynamic and allows management to adapt to changing market, business and technology needs. Thus, the Department strongly recommends that all banks and trust companies engage in regular, formal strategic planning sessions on at least an annual basis as a means of ensuring that the institution's actions are in alignment with its mission and goals.

APPLICATIONS REQUIRING A BUSINESS OR STRATEGIC PLAN

Business Plan*s*

A business plan is critical to the Department's decision of whether to approve the organizer's charter proposal. A well-defined business plan including financial projections, analysis of risk, and planned risk management systems and controls enables chartering authorities to more effectively gauge the probability of success of a proposed entity. Business plans are required for certain types of corporate applications submitted to the Department, and may be requested with other types of applications.

A business plan is **required** by the Department on all new charters, including:

- De novo applications; or
- Applications to change from exempt to nonexempt status or vice versa for a trust company.

If an institution encounters difficulties, a business plan provides a means for regulators and boards of directors to coordinate an effective improvement program. Thus, a business plan also may be required as part of administrative actions or enforcement orders involving troubled institutions.

Strategic Plan

Depending on the **significance** of the proposed change for the entity, the Department **may also require** a strategic plan be submitted with applications involving:

- Bank/Trust Company conversions;
- New branches;
- Change of control;
- Change of home office:
- Mergers; or
- Purchase and assumption transactions.

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SUPERVISORY MEMORANDUM – 1010

February 24, 2004 (rev.)

TO: All State-Chartered Banks
All Bank and Trust Examining Personnel

FROM: Randall S. James, Banking Commissioner

SUBJECT: Bank-Owned Life Insurance (BOLI)

I. INTENT OF ISSUANCE

This supervisory memorandum establishes guidelines and best practices for Texas state-chartered banks that purchase or hold life insurance products and is designed to ensure that such activities are consistent with safe and sound banking practices. A bank's board should be active in the pre-purchase and post-purchase monitoring of all BOLI plans.

This issuance completely revises Policy Memorandum 1010 issued on September 1, 1997, and is similar to bulletins issued by federal regulatory agencies (OCC Bulletin 2000-23 issued by the Office of the Comptroller of the Currency, Regulatory Bulletin 32-26 issued by the Office of Thrift Supervision, and FDIC Financial Institutions Letter 16-2004).

II. IMPLEMENTATION

This memorandum provides for bank management's initial and ongoing assessment of its ownership of life insurance products. Appendixes A and B should be completed by all banks before their initial purchase of life insurance on employees or directors and annually thereafter. For banks that already hold life insurance products, an initial review for compliance with this memorandum should be performed before August 31, 2004.

III. BACKGROUND

BOLI includes all forms of life insurance that a state-chartered bank purchases, and owns, or has a beneficial interest in. With prudent planning and analysis, along with adequate monitoring and controls, BOLI can afford certain protections and enhance an institution's overall value. However, BOLI transactions can be complicated and often represent activities substantially different than traditional bank products or services. BOLI transactions introduce unique risk characteristics that some state-chartered banks have entered into without fully understanding and/or contrary to sound banking practices.

This supervisory memorandum is designed to aid state-chartered banks in making informed decisions consistent with safe and sound banking practices. Bankers should acquire a thorough understanding of the nature and characteristics of any BOLI product before committing bank resources and ensure that the transaction meets the minimum guidelines set out in this memorandum. BOLI should only be regarded as a method to control risks rather than an investment substitute or method to unjustly fund insider incentives.

IV. LEGAL AUTHORITY

The purchase of life insurance will be subject to supervisory review and must be consistent with safe and sound banking practices. Generally, Texas state-chartered banks may purchase BOLI as an exercise of incidental powers under Texas Finance Code §32.001(b)(6). The Department views the following purchases of life insurance to be incidental to banking:

- Key-person insurance;
- Life insurance on borrowers (this memorandum does not address disability insurance or debt waiver coverage);

- Life insurance purchased in direct connection with and to support the funding needs of employee[1] compensation and benefit plans; and
- Insurance taken as security for loans.

In addition, the Department may approve other uses of BOLI on a case-by-case basis subject to a finding that the purchases address a legitimate need of the bank.[2] Generally, life insurance should not be purchased to generate funds for a bank's normal operations, for speculation, or for primarily providing estate-planning benefits for bank insiders unless it is part of a reasonable compensation package.

Texas law requires that an employer have an insurable interest in the employee's life before purchasing life insurance on the employee that benefits the employer. Employment alone does not give an employer an insurable interest. Banks considering life insurance purchases are encouraged to review the Texas court cases relating to BOLI and consult the Texas Department of Insurance regarding unusual or difficult to understand terms and conditions of a contemplated insurance product.

V. SUPERVISORY POLICY

A comprehensive understanding of the nature, characteristics and risks should be achieved before bank resources are committed to any BOLI product. All BOLI transactions should meet the guidelines set out in this memorandum. BOLI should only be regarded as a method to control risks rather than an investment substitute or method to unjustly fund insider incentives.

Cash value life insurance is a long-term, illiquid, nonamortizing asset that is an unsecured obligation of the insurance carrier. Bank transactions of this nature are subject to credit, liquidity, and interest rate risks. Additionally, the bank should be aware of several other risks including: transaction; compliance; and price risks. Banks holding life insurance in a manner inconsistent with safe and sound banking practices may be subject to supervisory actions that could include, but are not limited to, partial surrender or divestiture of affected policies.

Bank management and the board should complete a thorough analysis **before** purchasing material amounts of BOLI and acquire a comprehensive understanding of the contemplated transaction. This supervisory memorandum includes minimum standards for prepurchase analysis, purchase limits, appropriate approvals, and postpurchase monitoring.

Grandfather Provision: Banks with BOLI values in excess of the "Individual" and "Concentration" limits detailed in section V(A)(9) of this memorandum as of February 20, 2004, shall: (i) divest of their interest in an amount sufficient to comply with the applicable limits, or (ii) seek approval from the commissioner to exceed the applicable limits. Banks needing to exercise one of these two options have until August 31, 2004, to establish compliance with this memorandum.

A. Prepurchase Analysis

The safe and sound use of cash value life insurance depends on effective senior management knowledge and board oversight. Regardless of the institution's financial capacity and risk profile, the board must understand the role BOLI plays in the overall business strategies of the institution. The board's role in analyzing and overseeing cash value life insurance should be commensurate with the size, complexity, and risk inherent in the transaction. Although the board may delegate decision-making authority related to the purchase of life insurance to management, the board remains responsible for ensuring that such purchases: (i) are consistent with safe and sound banking practices; (ii) are in compliance with applicable laws and regulations; and (iii) are appropriate for the needs of the institution.

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1 The term "employee" as used in this memorandum includes all forms of employees that perform services for the institution, including but not limited to direct, contract, agent, and leased employees.
2 Approval from the commissioner is subject to representations made in a bank's original Request for Approval and should any material condition or circumstance subsequently change, the approval would terminate without notice, and the institution would need to submit a new Request for Approval based upon the new conditions.

The objective of the prepurchase analysis is to help ensure that bank management and the board understand the risks, rewards, and unique characteristics of BOLI. In most instances, banks should consider both the best and worst case scenarios and the probability of such occurrences during prepurchase analysis. At a minimum, the prepurchase analysis should consider the following standards.

1. Determination of the Need for Insurance

The institution should determine the need for insurance by identifying the specific risk of loss or obligation against which it is insuring. The existence of a risk of loss or an obligation does not necessarily mean that a bank can purchase or hold an interest in life insurance. For example, a bank may not purchase life insurance on a borrower as a mechanism for recovering obligations that the bank has charged off, or expects to charge off, for reasons other than the borrower's death. Also, a bank should surrender or otherwise liquidate cash value insurance acquired through debts previously contracted within a short time, generally 90 days, of obtaining control of the policy.

The purchase of insurance to indemnify a bank against a specific risk does not relieve it from other responsibilities related to managing that risk. As an example, a bank may purchase life insurance to indemnify itself from the loss of a "key person". However, banks should not use "key-person" life insurance in place of, nor does it diminish the need for, "key-person" succession planning.

A bank's authority to hold life insurance on a key person lapses if the individual is no longer a key person for the institution. Specifically, the key person's retirement, resignation, discharge, or a change in the person's responsibilities could cause the nature of the transaction to no longer be viewed as incidental to banking.

Banks may purchase life insurance on employees that are not "key officers" if the purchase is in direct connection with and to support the funding needs of employee compensation and benefit plans. As a best practice[3], banks should not purchase BOLI on any employee that does not benefit from the purchase, either directly benefiting, or through a split-dollar arrangement or from their participation in a group benefit or compensation. Written permission should also be obtained from the employee. Banks should avoid the appearance of taking advantage of lesser paid employees - the so-called "janitor policies" - and limit purchases to employees in the top 35% of the organization's salary structure. Lesser paid employees can still benefit from policies purchased on employees in the top 35%, but this reduces the reputation risk to the organization and the perception that bank management is taking advantage of these employees

The Department has reviewed the merits regarding the practice of an institution holding life insurance on directors, officers, or employees that are no longer employed or associated with the institution, either because of termination or retirement. Generally, the Department believes that this practice could subject the bank to unnecessary reputation and compliance risks. As a best practice, banks should consider insurance products that allow substitutions of the insured parties with subsequent recalculation of premiums and benefits. Additionally, the Department also recognizes that the bank may have an ongoing obligation or liability to directors, officers, or employees beyond termination of employment or service due to their eligibility for benefits in the deferred compensation or retirement plan. In these cases, the bank is considered to have a continuing interest and could maintain an insured interest on these individuals after their association with the bank. **Therefore, banks may continue to hold insurance on former employees or directors in order to offset a future obligation related to that former key employee or to offset a future obligation of an employee group in which the employee is a participant.**

As a best practice, banks should obtain the written approval from the employee **before** a BOLI policy is purchased covering that employee. This is especially important if the employee is not receiving a direct benefit from the BOLI policy, and the bank is purchasing the policy to meet a future obligation under a broad employee benefit program. If the bank has a continuing interest in a deferred compensation or retirement plan as described above, the employee's written consent should acknowledge and grant permission for the BOLI policy to continue even after employment with the bank is terminated.

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3 "Best practice(s)" as used throughout this memorandum means a recommended practice or control. Though not a requirement, implementation of best practices will be reviewed by examiners in assessing the bank's overall controls over BOLI programs. Best practices are subject to modification and refinement as needed.

Texas law generally recognizes that a lender has an insurable interest in the life of a borrower to the extent of the borrower's obligation to the lender. Banks may protect themselves against risk of loss from the death of a borrower. That protection may take the form of debt cancellation contracts or by the purchase of life insurance policies on borrowers. A lender's insurable interest may equal the borrower's obligation plus the cost of insurance and time value of money.

Holding life insurance in an amount in excess of the bank's credit risk of loss may constitute an unsafe and unsound practice. Once a credit is repaid, otherwise satisfied in full, or charged off, the risk of loss is eliminated. Therefore, banks should surrender or otherwise dispose of life insurance on individual borrowers under these circumstances. For this reason, the economic consequence of terminating the insurance should be considered in selecting the type of insurance and the structure of the policy.

2. Quantifying the Amount of Insurance Needed

Banks contemplating BOLI should estimate the size of the obligation or the risk of loss and ensure that the institution is not purchasing an excessive amount of insurance. To calculate such estimates, banks may include the cost of insurance and the time value of money in determining the amount of insurance needed. The bank should base the estimate of the amount of insurance needed on reasonable financial and actuarial assumptions. In situations where a bank purchases life insurance on a group of employees or a homogenous group of borrowers, it can estimate the size of the obligation or the risk of loss for the group on an aggregate basis. The bank can then compare the aggregate obligation or risk of loss to the aggregate amount of insurance purchased.

Purchasing or holding excessive permanent insurance may be an unsafe and unsound practice if it subjects the institution to unwarranted risk. BOLI subjects a bank to several risks which may be significant. These risks are further explained below in section V(C) - Risks Associated with BOLI.

3. Vendor Selection

While the majority of BOLI purchases are made through vendors, either brokers/consultants or agents, it is also possible to purchase BOLI directly from insurance carriers without using a vendor. Should an institution decide not to utilize the services of a vendor, the following items should be considered:

- The bank's knowledge of BOLI;
- The resources the bank can, and is willing to, spend on servicing and administering the BOLI; and
- The benefits a vendor may provide.

Depending on the vendor's role, the vendor's services can be extensive and critical to successful implementation and operation of a BOLI plan. If the institution uses a vendor, it should make appropriate inquiries to satisfy itself about the vendor's ability to honor its commitments and the vendor's general reputation, experience, and financial capacity. The institution should base its review on the size and complexity of the potential BOLI purchase. Furthermore, the institution should analyze and compare the qualifications and merits of several vendors to enhance the objectivity of the prepurchase analysis.

Good corporate governance practices should be implemented. If the institution uses a vendor that is associated with the bank in any capacity such as a director, officer, employee, principal shareholder or an affiliate, as defined under sections 23A and 23B of the Federal Reserve Act[4], the board should fully and formally disclose such information along with appropriate analysis and support. The board must ensure that transactions of this nature are in compliance with internal conflicts of interest policies and laws addressing insider and affiliate transactions. For additional information about compliance with applicable laws see section V(D) below – Other Considerations.

4 Regulation W (12 CFR 223) implements sections 23A and 23B of the Federal Reserve Act for state member banks. The Federal Deposit Insurance Act (12 USC 1828(j)) applies sections 23A and 23B to state nonmember banks.

4. *Carrier Selection*

BOLI plans are typically of long duration and may represent significant risks for the institution. Therefore, carrier selection is a critical step in a BOLI purchase. The institution should review the product design, pricing, exit options, and administrative costs and services of the carrier(s) and compare them with the institution's needs. In addition, the institution should review the carrier's ratings (e.g., A.M. Best Company), general reputation, experience in the market place, and past performance. A broker or consultant, if used, may assist the institution in this area, and bank management should ascertain the reasonableness of costs charged by the broker or consultant for services rendered.

Before purchasing a life insurance product, the institution should perform a credit analysis on the selected carrier(s) in a manner consistent with safe and sound banking practices for commercial lending. The carrier should exhibit a sound financial position, high level of experience, and history of safe operations with its supervisory agencies.

5. *Review the Characteristics of the Available Insurance Products*

There are a few basic types of life insurance products in the market place. However, providers can combine and modify these products in many different ways. The resulting final product can be quite complex. The institution must review the characteristics of the various insurance products available. It should select the product or products with characteristics that match the institution's objectives and needs. To accomplish this, the institution should thoroughly analyze and understand the products under consideration.

When purchasing insurance on "key persons" and individual borrowers, the institution should consider that the institution's need for the insurance will likely disappear before the insured individual dies. In such cases, term or declining term insurance is often the most appropriate form of life insurance.

6. *Assess the Benefits*

The bank should analyze the benefits of contemplated BOLI purchases against the risks enumerated in section V(C) - Risks Associated with BOLI. While the analysis should include an assessment of how the purchase will accomplish the objective specified in V(A)(1) - Determination of the Need for Insurance, the analysis should also consider the long-term financial ramifications and requirements to the bank. The analysis should include an assessment of the anticipated financial performance of the insurance product, including the interest crediting rate and the policy's net accumulation rate.[5] While the projected yield on some single-premium life insurance policies may seem attractive, the actual yield may be much lower. Also, insurance and administrative costs the issuer builds into the policy further reduce such yields, and life insurance becomes more expensive as the insured person ages. Often insurance costs will greatly reduce a high stated yield on a cash value product. The bank should ascertain yields before and after these costs.

One of the more common methods used to analyze future benefits and values of an insurance product is "pro forma" analysis. Often this involves assigning projected rates of return, along with expected holding costs and estimated tax benefits, for a proposed BOLI product as compared to more traditional bank investments. The rationale used in deriving the assumptions of a pro forma analysis should be well documented and supported. Banks should also consider assigning percentages of probability with each pro forma scenario along with forecasting best and worst case scenarios.

7. *Determine the Reasonableness of Compensation Provided to the Insured Employee if the Insurance Results in Additional Compensation*

Split-dollar insurance arrangements typically provide additional compensation and/or other benefits to the

5 The interest-crediting rate refers to the gross yield on the investment in the insurance policy. That is the rate at which the cash value increases before considering any deductions for mortality costs, load charges, or other costs the issuer periodically charges against the policy's cash value. Insurance companies frequently disclose a current interest-crediting rate and a guaranteed minimum interest-crediting rate. The guaranteed rate may be less than the current rate. As a result, the potential exists for future declines in the interest-crediting rate. The net accumulation rate is the rate at which the policy increases after all costs are deducted, which may be materially less than the interest-crediting rate.

employee. Before a bank enters into a split-dollar arrangement, it should identify and quantify the compensation objective, and ensure that the arrangement is consistent with the stated objective. Also, the institution should combine the compensation provided by the split-dollar arrangement with all other compensation to ensure that total compensation is not excessive. The Department views excessive compensation as an unsafe and unsound practice. Nonmember state-chartered banks should refer to Appendix A, Part 364 of the FDIC Rules and Regulations and state-chartered member banks should refer to Appendix D-1, 12 CFR Part 208 for guidelines on determining excessive compensation.

8. Analyze the Associated Risks and the Institution's Ability to Monitor and Respond to those Risks

Ownership of or beneficial interests in BOLI may subject a bank to several types of risk that may include: transaction; credit; interest rate; liquidity; compliance; and price issues. A bank's prepurchase analysis should include a thorough evaluation of these risks. Furthermore, the prepurchase analysis should allow a bank to determine whether the transaction is consistent with safe and sound banking practices. In making this determination, a bank should consider, among other things, the:

- Complexity of the transaction;
- Size of the transaction relative to the institution's capital;
- Diversification of the credit risk;
- Financial capacity of the institution, including the ability to hold BOLI for the anticipated period of time;
- Financial capacity of the insurance carrier(s); and
- Institution's ability to identify, measure, monitor, and control the associated risks.

9. Volume Limitations

In assessing the size of the transaction, bank management should consider the cash surrender value (CSV)[6] relative to its capital levels at the time of purchase. The institution should also consider projected increases in the CSV and projected changes in capital levels for the duration of the contract. Consistent with prudent risk management practices, a bank should establish internal quantitative guidelines. These guidelines should generally limit the aggregate CSV of policies from any one insurance company and the aggregate CSV of policies from all insurance companies. Note: The actual amount received may be substantially affected by the tax considerations. Banks should know these implications prior to a policy's acquisition.

The Finance Commission of Texas has adopted a maximum investment limit for BOLI carried on the books of state-chartered banks from a single insurance issuer.

- ***Individual Limit to a Single Insurance Issuer*** - As prescribed in 7 TAC §12.3(a)(9) a bank must limit its investment in the CSV of life insurance from any one issuer to 25% of capital and certified surplus.

In conjunction, this memorandum establishes an aggregate concentration limit for all BOLI policies carried on the books of a state-chartered bank.

- ***Concentration Limit to All Insurance Issuers*** – A bank should limit its aggregate investment in the CSV of life insurance to all issuers to 25% of Tier 1 Capital. An institution however, should not automatically assume that a concentration level as high as 25% is acceptable, as any investment level must be justified and supported as discussed in this policy statement.

  State-chartered banks desiring to exceed the concentration limit must receive the prior written approval of the commissioner to do so. Such requests should enumerate what steps the bank has taken to mitigate the

6 The liquidation value of the insurance policy if terminated by the policyholder. In the first few years of the policy's life there may be a significant difference between the stated policy value and the cash surrender value due to early cancellation penalties or surrender charges.

risks involved.

Application of Limits to Separate Account BOLI – The above maximum investment and concentration limits apply to all BOLI, including separate account BOLI, even when the insurance carrier identifies such investments as separate accounts made up solely of high quality investments. This is because control over the investment and lack of liquidity associated with BOLI apply to both separate account and general account products.

Exception: *For certain separate account BOLI, however, a bank may look through to the underlying asset for determining applicability of the "Individual" limit in 7 TAC §12.3. To qualify for separate treatment of the "Individual" limit, a bank must evaluate the issuer's controls over its separate account assets such as internal and external audits of the assets and activities of the separate accounts, segregation of duties of staff managing the accounts, and a review of fund reporting requirements. The bank must determine that such controls are sufficient to prevent any accidental or illicit misuse of assets in the underlying investments, and the institution's evaluation of the sufficiency of the insurance company's internal and external controls over the separate accounts. In the absence of a thorough review by the bank demonstrating a reliable and bankruptcy remote separation of such accounts by a financially sound and well-managed issuer, the limitation of 7 TAC §12.3 will apply.*

The bank should also obtain a legal opinion stating that such separate account assets are insulated by statute or otherwise from other unrelated liabilities (such as in bankruptcy) of the insurance company.

9. Evaluate Alternatives

Some BOLI purchases involve indemnifying the institution against a specific risk. For example, banks sometimes purchase BOLI to indemnify the institution against the potential for loss arising from the untimely death of a "key person." As an alternative to purchasing BOLI, an institution may choose to self-insure against this risk. Other uses of BOLI purchases are to recover costs or provide for employee benefit plans. In these cases, instead of purchasing BOLI, an institution may choose to invest the money in other assets. Regardless of the purpose of BOLI, a complete prepurchase analysis will include an assessment of the alternatives.

10. Exit Strategy

An important part of a bank's preplanning and decision process is the development of a well thought-out exit strategy in the event that the bank needs to prematurely divest of its ownership interest in the BOLI product. The board should fully analyze the financial ramifications to the bank should divesture become a necessity or a choice. Furthermore, the exit strategy should describe the methods and means with which divestiture would occur in order to minimize asset value loss or liability recognition - including income tax consequences. The exit strategy should be updated annually with each performance review of the BOLI program.

Banks should be cautious about the practice of replacing one BOLI product with another, especially in the absence of a legitimate need to address material risk concerns. As previously discussed, premature divesture of a BOLI product can involve significant asset value loss or income tax liability recognition. In some cases insurance vendors or company providers promote such practices as a means to increase their premium income, usually to the detriment of the bank. Regardless, the bank should consider the practice of replacing one or more BOLI product as a material event requiring comprehensive prepurchase analysis and study as discussed in this policy.

11. Approval and Documentation

The board of directors should approve the initial BOLI program and any subsequent changes. A bank should maintain adequate documentation to show that the institution made an informed decision. For additional information about the ongoing review of a BOLI program, see section V(E) – Postpurchase Monitoring.

B. FINANCIAL CONSIDERATIONS

Bank management should understand and analyze how BOLI will affect the institution's financial condition. Management should analyze the effect the anticipated performance of the insurance will have on the institution's earnings, capital, cash flows, and liquidity. Management should also consider the impact that surrender of the insurance (before maturity at the death of the insured) would have on the institution's earnings and capital. This might occur if the institution had a credit quality concern relating to the issuer, if the tax treatment changed, or if the institution had other needs or uses for the invested funds.

C. RISKS ASSOCIATED WITH BOLI

Examiners will assess risk relative to its effect on capital and earnings. The applicable risks associated with BOLI are: Transaction; Credit; Interest Rate; Liquidity; Compliance; and Price. An analysis of each of these risks is set forth in the following paragraphs.

1. Transaction Risk

The degree of transaction risk associated with BOLI is a function of a bank not fully understanding or properly implementing a transaction. In addition to following the other guidelines included in this memorandum, banks should take two additional steps to help reduce transaction risk. Management should have a thorough understanding of how the insurance product works and the variables that dictate the product's performance. The variables most likely to affect product performance are the policy's interest crediting rate, mortality cost,[7] and other expense charges. Typically, the most significant variable is the interest-crediting rate, followed by the mortality cost. Therefore, before purchasing BOLI, a bank should analyze projected policy values (CSV and death benefits) from multiple illustrations provided by the carrier. Banks should consider using different interest-crediting rates and mortality costs assumptions for each illustration. Management should also understand and analyze how BOLI will affect the bank's financial condition. Given the anticipated performance of the insurance, management should analyze the effect on the institution's earnings, capital, and liquidity. Management should consider the impact on the institution's earnings and capital should the bank, for any reason, surrender the insurance before maturity. Other administrative costs related to legal, accounting, and tax issues, as discussed in V(D) Other Considerations, should also be considered.

2. Credit Risk

All life insurance policyholders are exposed to credit risk. The credit quality of the insurance company and duration of the contract are key variables. With term insurance, credit risk arises from the insurance carrier's contractual obligation to pay death benefits upon the death of the insured. Credit risk is primarily a function of the insurance carrier's ability (financial condition) and willingness to pay death benefits as promised. Credit risk may be reduced by the support provided by state insurance guaranty associations or funds. A bank's credit exposure through the ownership of term life insurance is not reflected on the bank's balance sheet.

With permanent insurance, credit risk arises from the insurance carrier's obligation to pay death benefits upon death of the insured and from its obligation to return the CSV to the policyholder upon request. The risk is similar to that with term insurance, but there are a few differences. With most permanent insurance BOLI plans, the expected time for collection of death proceeds is extremely long. Additionally, the CSV is an unsecured, long-term, and nonamortizing obligation of the insurance carrier.

Before purchasing life insurance, management should evaluate the financial condition of the insurance company and continue to monitor its condition on an ongoing basis. In addition to reviewing the insurance carrier's ratings, the bank should conduct an independent financial analysis consistent with safe and sound banking practices for commercial lending. As with lending, the depth and frequency of the analysis should be a function of the relative size and complexity of the transaction.

3. Interest Rate Risk

General account[8] products expose the policyholder to interest rate risk. The interest rate risk of these products is primarily a function of the policy's interest-crediting rate. The insurance carrier establishes interest-crediting rates.

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7 Mortality cost represents the cost imposed on the policyholder by the insurance company to cover the amount of pure insurance protection for which the insurance company is at risk.

8 General account life insurance products include whole life insurance or annuities where the policyholder's cash value and any income is supported by the general assets and credit of the issuing insurance company.

Over the long term, interest-crediting rates are primarily a function of the carrier's investment portfolio performance. The policy's CSV grows at a slower rate with a declining interest-crediting rate. Since a bank's investment in permanent insurance is recorded at the policy's CSV, the bank's earnings decline as the policy's interest-crediting rate declines. Due to the interest rate risk inherent in this product, it is particularly important that management fully understand the risk before purchasing the policy. Before purchasing permanent insurance, management should:

- Review the policy's past performance over various business cycles;
- Analyze projected policy values (CSV and death benefits); and
- Consider having the carrier use a different interest crediting rate for each set of policy projections.

Variable or separate account[9] products may also expose the bank to interest rate risk depending on the types of assets held in the separate account. For example, if the separate account assets consist solely of Treasury securities, the bank is exposed to interest rate risk in the same way as holding Treasury securities directly in its investment portfolio. However, because the bank does not control the separate account assets, it is more difficult for the bank to control this risk. Therefore, before purchasing a separate account product, management should thoroughly review and understand the instruments governing the investment policy and management of the separate account. Management should understand the risk inherent within the separate account and ensure that the risk is appropriate for the bank. Also, the bank should establish monitoring and reporting systems that will enable the bank to monitor and respond to price fluctuations.

4. Liquidity Risk

Usually, life insurance policies are illiquid and unmarketable. A secondary market for life insurance does not exist. Although the CSV of policies can be accessed quickly, it typically involves substantial loss. To access the CSV, the bank must withdraw from or borrow against the policy. This may subject the bank to surrender charges, taxes on the gain, and a tax penalty. In addition, the policyholder generally does not receive any cash flow until the death benefit is paid. The lack of liquidity in the product is more significant given that banks normally purchase life insurance policies through a conversion of a liquid asset (cash or marketable securities).

Before purchasing permanent insurance, management should recognize the illiquid nature of the product and ensure the bank has the long-term financial flexibility to hold this asset in accordance with its expected use. The inability of a bank to hold the life insurance until maturity (collection of death benefits) may compromise the success of the BOLI plan. The bank's pre-purchase analysis should include an exit strategy to minimize asset value loss and liability recognition if premature disposal of BOLI become necessary.

5. Compliance Risk

Failure to comply with applicable laws, rules, regulations, and prescribed practices (including this memorandum) could compromise the success of a BOLI program and result in significant losses for the bank as a result of fines, penalties, or loss of tax benefits. For this reason, a thorough compliance review is needed before BOLI products are purchased. Consideration should be given to any formal or informal contracts with the executives for deferred compensation or other benefit payments linked to the insurance arrangements. Any other bank contracts that may be related to BOLI products should also be reviewed. Additional legal and regulatory considerations are more fully discussed in section V(D) - Other Considerations in this memorandum.

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9 Variable or separate account life insurance products may take the form of universal life insurance or annuities where the policyholder's cash value and income is supported by assets held by the insurance company in assets that are segregated from the general assets of the carrier. The policyholder assumes all investment and price risk, and the insurer serves to manage the assets for the policyholder and administer the policy. Generally, assets in separate accounts can only be used for payment of insurance and administration costs related to the policy and policyholder benefits.

6. Price Risk

Typically, price risk is associated with separate account BOLI. The policyholder selects an asset or group of assets to invest in and assumes all of the price risk associated with the investments within the separate account. In general, neither the CSV nor the interest-crediting rate on separate account products is guaranteed by the carrier. The amount of price risk is dependent upon the type of asset(s) held within the separate account. The owner of separate account BOLI may elect to invest in very high quality assets or low quality assets. However, a bank may only invest in separate account BOLI investments that the institution may invest in directly.

Because the bank does not have direct control of the separate account assets, it is more difficult for the bank to control price or other risks. Therefore, before purchasing a separate account life insurance product, management should thoroughly review and understand the instruments governing the investment policy and management of the separate account. Management should understand the risk inherent in the separate account and ensure that the risk is appropriate for the bank. Also, bank management should establish monitoring and reporting systems that will enable them to monitor and respond to price fluctuations.

Banks may purchase separate account insurance products that hold equity securities only for the purpose of hedging their obligations under employee compensation and benefit plans.[10] This lessens the effect of price risk on the bank's financial statements because changes in the amount of the bank's liability will be hedged by changes in the value of the separate account assets. An example of such a relationship would be where the amount of the bank's deferred compensation obligation is measured by the value of a stock market index, and the separate account contains a stock mutual fund that mirrors the performance of that index. If the insurance cannot be characterized as an effective hedging transaction, the presence of equity securities in a separate account is impermissible.

In addition to the general considerations discussed above, which are applicable to any separate account product, further analysis should be performed when purchasing a separate account product involving equity securities. At a minimum, banks should:

- Analyze the bank liability being hedged (e.g., deferred compensation) and the equity securities to be held as a hedge in the separate account. Such an analysis usually documents the correlation between the liability and the equity securities, expected returns for the securities (including standard deviation of returns), and current and projected asset and liability balances.
- Determine a target hedge effectiveness ratio and establish a method for measuring hedge effectiveness. Establish a process for altering the program if hedge effectiveness drops below acceptable levels. Consideration should be given to the potential costs of program changes.
- Establish a process for analyzing and reporting the effect of the hedge on the bank's income statement and capital ratios. Such an analysis usually shows results, both with and without the hedging transaction.

D. OTHER CONSIDERATIONS

Before BOLI is purchased, bank management must fully analyze and understand the legal, accounting, call report, and tax implications of these significant purchases. Due to the complexity of these issues, outside advice and counsel may be needed. This guidance addresses many of the issues that are involved in BOLI purchases, but it is certainly not all-inclusive. Unusual circumstances and variations of standard BOLI products will require additional research and specialized assistance.

1. Accounting and Call Report

Banks should follow generally accepted accounting principles (GAAP) for financial reporting purposes. Financial Accounting Standards Board (FASB) Technical Bulletin 85-4, Accounting for Purchases of Life Insurance,

10 An economic hedge exists when an institution offsets changes in the value of the liability or other risk exposure being hedged by counterbalancing changes in the value of the hedging investment.

discusses how to account for investments in life insurance. The guidance set forth in Technical Bulletin 85-4 is generally appropriate for most forms of BOLI.

Under Technical Bulletin 85-4, a state-chartered bank should record its interest in the policy's cash surrender value as an "other asset." The increase in the cash value over time should be recorded as "other noninterest income." In accordance with Call Report requirements, the bank should update its interest in cash value at least quarterly.

Sometimes the institution receives all the benefits, but separately agrees to provide those benefits to an employee as deferred compensation. In this case, the bank should account for any cash surrender value in accordance with Technical Bulletin 85-4. Also, the bank should record a deferred liability for any deferred compensation arrangements in accordance with Accounting Principles Board (APB) Opinion No. 12, Omnibus Opinion-1967, as amended by Statement of Financial Accounting Standards (SFAS) No. 106, Employers' Accounting for Postretirement Benefits Other than Pensions.

Split-Dollar Arrangements - Under employee benefit split-dollar policies, the bank and the employee agree to share in the policy's cash surrender value and/or death benefits. In some circumstances, the bank may not be accruing a separate liability for the employee benefit. In such instances, the institution should record an asset for its investment in the policy equal to the lower of one of the following values:

- The policy's cash surrender value, determined in accordance with FASB Technical Bulletin 85-4; and
- The present value of the future cash flow(s) the bank expects to receive discounted at an appropriate interest rate in accordance with Accounting Principles Board Opinion No. 21.

The bank should immediately record the amount exceeding the investment as an employee benefit expense. The institution may also, where appropriate, record it in other assets as a deferred charge. The bank must amortize the asset as an employee benefit expense in a systematic and rational manner over the time remaining until the employee's full eligibility date. The institution should update its interest in the CSV at least quarterly.

Accounting for Indexed Retirement Plans - Indexed Retirement Plans (IRPs) are one type of deferred compensation agreement that institutions enter into with selected employees. IRPs are typically designed so that the spread each year, if any, between the tax-equivalent earnings on the BOLI covering an individual employee and a hypothetical earnings calculation is deferred and paid to the employee as a postretirement benefit. This spread is commonly referred to as "excess earnings." The hypothetical earnings are computed based upon a predefined variable index rate (e.g., cost of funds or federal funds rate) times a notional amount. The notional amount is typically the amount the institution initially invested to purchase the BOLI plus subsequent after-tax benefit payments actually made to the employee. By including the after-tax benefit payments and the amount initially invested to purchase the BOLI in the notional amount, the hypothetical earnings reflect an estimate of what the institution could have earned if it had not invested in the BOLI or entered into the IRP with the employee. Each employee's IRP may have a different notional amount upon which the index is based. The individual IRP agreements also specify the retirement age and vesting provisions, which can vary from employee to employee.

An IRP agreement typically requires the excess earnings that accrue before an employee's retirement to be recorded in a separate liability account. Once the employee retires, the balance in the liability account is generally paid to the employee in equal, annual installments over a set number of years (e.g., 10 or 15 years). These payments are commonly referred to as the "primary benefit" or "preretirement benefit."

The employee may also receive the excess earnings that are earned after retirement. This benefit may continue until his or her death and is commonly referred to as the "secondary benefit" or "postretirement benefit." The secondary benefit is paid annually, once the employee has retired, in addition to the primary benefit.

Deferred compensation agreements with select employees under individual contracts generally do not constitute postretirement income plans (i.e., pension plans) or postretirement health and welfare benefit plans. The accounting for individual contracts that, when taken together, do not represent a postretirement plan should follow APB Opinion No. 12. If the individual contracts, taken together, are equivalent to a plan, the plan should be accounted for under Statement of Financial Accounting Standards No. 87, Employers' Accounting for Pensions, or SFAS 106.

APB Opinion No. 12 requires that an employer's obligation under a deferred compensation agreement be accrued according to the terms of the individual contract over the required service period to the date the employee is fully eligible to receive the benefits, i.e., the "full eligibility date." Depending on the individual contract, the full eligibility date may be the employee's expected retirement date, the date the employee entered into the contract, or a date between these two dates. APB Opinion No.12 does not prescribe a specific accrual method for the benefits under deferred compensation contracts, stating only that the "cost of those benefits shall be accrued over that period of the employee's service in a systematic and rational manner." The amounts to be accrued each period should result in a deferred compensation liability at the full eligibility date that equals the then present value of the estimated benefit payments to be made under the individual contract.

For each IRP, an institution should calculate the present value of the expected future benefit payments under the IRP at the employee's full eligibility date. The expected future benefit payments can be reasonably estimated, should be based on reasonable and supportable assumptions, and should include both the primary benefit and, if the employee is entitled to excess earnings that are earned after retirement, the secondary benefit. The estimated amount of these benefit payments should be discounted because the benefits will be paid in periodic installments after the employee retires. The number of periods the primary and any secondary benefit payments should be discounted may differ because the discount period for each type of benefit payment should be based upon the length of time during which each type of benefit will be paid as specified in the IRP.

After the present value of the expected future benefit payments has been determined, the institution should accrue an amount of compensation expense and a liability each year from the date the employee enters into the IRP until the full eligibility date. The amount of these annual accruals should be sufficient to ensure that a deferred compensation liability equal to the present value of the expected benefit payments is recorded by the full eligibility date. Any method of deferred compensation accounting that does not recognize some expense for the primary benefit and any secondary benefit in each year from the date the employee enters into the IRP until the full eligibility date, is not systematic and rational.

TB 85-4 addresses the accounting for BOLI. Only the amount that could be realized under the insurance contract as of the balance sheet date (i.e., the cash surrender value reported to the institution by the insurance carrier less any applicable surrender charges not reflected by the insurance carrier in the reported cash surrender value) is reported as an asset. Because there is no right of offset, an investment in BOLI should be reported as an asset separately from the deferred compensation liability.

Institutions should follow Accounting Principles Board Opinion No. 20, Accounting Changes (APB 20), if a change in their accounting for deferred compensation agreements, including IRPs, is necessary. APB 20 defines various types of accounting changes and addresses the reporting of corrections of errors in previously issued financial statements. APB 20 states that "errors in financial statements result from mathematical mistakes, mistakes in the application of accounting principles, or oversight or misuse of facts that existed at the time the financial statements were prepared."

For Call Report purposes, an institution must determine whether the reason for a change in its accounting for deferred compensation agreements meets the APB 20 definition of an accounting error. If the reason for the change meets this definition, the error should be reported as a prior period adjustment in the Call Report if the amount is material. Otherwise, the effect of the correction of the error should be reported in current earnings. For more detailed information about IRPs, refer to FDIC Financial Institutions Letter 16-2004 entitled Interagency Advisory on Accounting for Deferred Compensation Agreements and Bank-owned Life Insurance.

2. *Legal and Regulatory*

Banks must ensure that BOLI programs comply with all laws, rules, regulations, and prescribed practices (including those discussed in this memorandum). A compliance review should be performed before purchase and annually thereafter to ensure continued conformity. The Department will evaluate all significant holdings and future purchases of life insurance by banks in light of these guidelines.

The bank should ensure execution of the appropriate policy endorsements, assignments, and related agreements. The institution should also determine if the policy provides adequate safeguards and controls to protect its interest in the policy. Lastly, management should ensure that the bank's share of any cash surrender value and death benefits are appropriately endorsed or assigned to the institution.

Due to the complexity of this review, advice of qualified counsel may be necessary. In particular, the following areas should be reviewed:

- Affiliate transactions - sections 23A and 23B of the Federal Reserve Act;
- Insider transactions -12 CFR Part 215 (Regulation O) and Section 402 of the Sarbanes-Oxley Act of 2002;
- Insider compensation - Part 364 of the FDIC Rules and Regulations – Standards for Safety and Soundness and 12 CFR Part 208.
- Employee retirement plans – Employee Retirement Income Security Act of 1974 (ERISA);

Affiliate Transactions - Banks should determine the applicability of, and ensure compliance with sections 23A and 23B of the Federal Reserve Act. For example, split-dollar life insurance arrangements may be subject to Section 23A of the Federal Reserve Act when a bank purchases an insurance policy, and the beneficiary is its holding company or a management official of the holding company. This will be considered an unsecured extension of credit because the bank pays the holding company's portion of the premium and the holding company will not fully reimburse the institution for its payment until some time in the future. State-chartered banks may not make unsecured loans to affiliates.

In other cases, the parent holding company may actually own the insurance policy and pay the entire premium. A subsidiary bank may make annual loans to the holding company in an amount equal to the premiums paid or, equal to the annual increase in the cash surrender value of the policy, with the insurance policy serving as collateral for the loan. The holding company repays the loans upon either the termination of employment or death of the insured employee. These loans are subject to the quantitative restrictions of section 23A, including the collateral requirements -130 percent of the amount of the loan in this case. The transactions must also comply with the provisions of section 23B of the Federal Reserve Act.

Insider Transactions - Certain insurance arrangements may be subject to Regulation O. In cases where the bank purchases the insurance to provide a fringe benefit to an executive officer of the bank and the institution pays the cost of the policy, the officer should either:

- Reimburse the bank for the amount of the premiums; or

- Report the economic value of the insurance benefit to the Internal Revenue Service as additional taxable or deferred income.

If the officer is responsible to reimburse all or a portion of the value of the insurance benefit, the obligation represents a loan by the bank to the executive officer and may be subject to Regulation O. In addition, certain insider loans may be restricted by the Sarbanes-Oxley Act of 2002 which amended Section 13 of the Securities and Exchange Act of 1934.

Tax Treatment - Since the tax benefits are critical to the success of most BOLI programs, management should ensure that BOLI plans comply with all applicable tax law. Changes in tax law may influence management's determination to continue or expand the bank's BOLI program. Consequently, an initial and ongoing assessment of the tax implications is a necessary part of effective administration of a BOLI program.

The tax treatment relating to split-dollar life insurance arrangements is addressed in 26 CFR Parts 1, 31, and 602 of the Internal Revenue Code and is effective September 17, 2003. The Internal Revenue Service regulations provide for two mutually exclusive regimes—an economic benefit regime and a loan regime--for determining the tax treatment of split-dollar life insurance arrangements. Ownership of the life insurance contract determines which regime applies. Generally, in a split-dollar life insurance, when the employer provides an employee with economic benefits, the employee would take those economic benefits into account by reporting them as compensation on the employee's Federal income tax return for the year in which the benefits are provided, and the employer would take the economic benefits into account by reporting them on the appropriate employment tax and information returns. Due to the complexity of these tax laws, it is recommended that the bank consult with a specialist to determine the appropriate tax reporting method.

E. POSTPURCHASE MONITORING

The institution's board of directors should continue to monitor ownership and purchases of BOLI based upon the standards set forth in this memorandum.

With respect to individual BOLI policies purchased, the board should receive an annual report detailing the:

- Face and cash surrender values of policies purchased for each officer;
- Aggregate amount of all compensation, including purchases of BOLI policies, for each officer; and
- Continued designation of the insured person as a key officer, if applicable.

Appendix A provides an example to assist banks in compliance with this section.

With respect to the aggregate of all BOLI policies purchased, the board should approve no less than annually a report detailing the:

- Continued ability of BOLI to meet the bank's goals and objectives;
- Material changes in policies or coverage;
- Adequacy of documentation, including written authorization from employees consenting to the BOLI purchase;
- Aggregate face and cash surrender values of policies purchased;
- Relationship of the face and surrender values to bank capital;
- Before and after tax rate of return of the policies;
- Liquidity and surrender value aspects of the policies;
- Changes in law and regulatory guidelines, including tax law;
- Financial condition of each insurance company and its continued ability to honor claims;
- Rating of each insurance company; and
- If separate account products are held, the price risk of the underlying investments.

Appendix B provides an example to assist banks in compliance with this section.

V. CONTACT INFORMATION

For further information about this memorandum, contact the Regional Director assigned to your institution or a member of the Bank and Trust's review staff in Austin (512-475-1300).

APPENDIX - A

Banks may purchase BOLI to protect the bank from the loss of a key officer or to compensate employees, officers, or directors as part of a reasonable compensation package. It is important that board members know how much BOLI is purchased on each employee and how purchases relate to the employee's overall compensation. The following table is provided to assist banks in the Postpurchase Monitoring of BOLI programs. This table provides a reminder of some of the issues that banks should consider on an annual basis.

Review of BOLI Policies Purchased for Individual Employees (Example)

Employee Information		
Name / Title	*Smith, John / Vice President*	
Designated as "Key Officer?"	*No*	
Still employed by bank?	*No – Retired 3 Months Ago*	
Compensation Information		
Standard Compensation: Salary / Bonus / Other / Total	*$28,000 / $2,000 / $500 / $30,500*	
BOLI Compensation: Direct economic benefit provided to employee from BOLI policies (last calendar year)	*None*	
If the plan is a direct economic benefit to the employee, what is the estimated present value of the bank's future liability to the employee? (Exclude Group Benefits)	**Next Year**	*None*
	Total	*None*
Is compensation excessive? (Standard plus BOLI)	*No*	
Split-Dollar program?	*No*	
Is compensation in the top one-third of employees?	*Yes*	
Insurance Policy Information		
Reason(s) for Purchase: See (1) Below	*EC - Purchased to offset the bank's future liability for retirement benefits offered to all employees.*	
Insurance company name	*ABC Insurance Company, Austin, Texas*	
Type of Policy / Cash Value / Face Value / Loss Payee	*Whole Life / $50,000 / $200,000 / First Bank, Anywhere*	
Written authorization from employee before purchase?	*Yes*	
Loans from insurance company secured by CV:	*None*	
Estimated rate of return on policy / tax equivalent yield*** / annual cost?	*3% / 5% / $1,750*	

(1) Key Person (KP) ; Employee Compensation or Benefit Plan (EC)

*** = Tax Equivalent Yield is the estimated yield that a taxable investment would need to return to equal the return of this tax-exempt investment after consideration of the bank's income tax status.

APPENDIX - B

Banks must monitor BOLI products after purchase. It is important that board members know how much BOLI is purchased from each insurance company and whether the investments are within the allowed limits. It is also important to assess the continued ability of BOLI to meet the bank's needs and whether there have been any significant changes in laws and regulatory guidance. The following table is provided to assist banks in the Post-purchase Monitoring of BOLI programs.

Review of Company Limits

Insurance Company Information			Performance Information			Policy Information			
Company Name	Reason for Purchase: See (1) Below	Publicly Traded?	Financial Condition Reviewed as of:	Rating	Other	Cash Value / Face Value / Loss Payee	Cash Value as Percent of: Capital and Certified Surplus / Tier 1 Capital **	Rate of Return / Tax Equivalent Yield***	Separate Account BOLI? (Y/N)
ABC Insurance Company (Example)	*EC*	*Yes*	*12-31-02*	*A++ A.M. Best*	*Good Reputation*	*$420,000 / $4,000,000 FS Bank*	*5% / 4%*	*2% / 5%*	*No*
XYZ Insurance Company (Example)	*KP*	*Yes*	*12-31-02*	*A+ A.M. Best*	*Established Company (1905)*	*$500,000 / $5,000,000 FS Bank*	*6% / 5%*	*2.3% / 5.4%*	*No*
DEF Insurance Company (Example)	*EC Split-Dollar*	*Yes*	*12-31-02*	*A+ A.M. Best*	*Good Reputation*	*$300,000 / $3,000,000 FS Bank and Officers*	*3.5% / 3%*	*2.3% / 5.4%*	*No*
					Totals for All Policies	*$1,220,000 $12,000,000*	*14.5% / 12%*	*2.1% / 5.2%*	

(1) Key Person (KP) ; Employee Compensation or Benefit Plan (EC)

** = Investment in individual policies must not exceed 25% of capital stock and certified surplus. Investment in all BOLI policies should not exceed 25% of Tier 1 Capital.

*** = Tax Equivalent Yield is the estimated yield that a taxable investment would need to return to equal the return of this tax-exempt investment after consideration of the bank's income tax status

SUPERVISORY MEMORANDUM – 1011

July 31, 1996

TO: All State-Chartered Banks
All Bank and Trust Examining Personnel

FROM: Catherine A. Ghiglieri, Commissioner

SUBJECT: Policy for Temporary Mortgage Purchase Programs

BACKGROUND

This Policy Memorandum revises and supersedes Numbered Memorandum 94-04. Numbered Memorandum 94-04 has been under review by the Department since August 1994, at which time its enforcement was temporarily suspended. In February 1996, the Finance Commission revised the legal lending limit rule (7 TAC §12) to incorporate guidelines for determining the difference between a loan purchase versus a loan financing transaction. Therefore, the revised policy does not address legal lending limit issues, but instead expands upon the significant safety and soundness issues arising from this activity. The policy parallels new examination procedures issued by the Department for examiner review of Temporary Mortgage Purchase Programs.

PURPOSE

A growing number of banks have become involved in the temporary funding of residential mortgage loans awaiting sale to the secondary market. This may be done through a traditional line of credit to the originating mortgage company, or the temporary purchase of the loans from the mortgage company. This Memorandum is only directed toward the latter activity, for which limited industry guidance currently is available. Temporary purchase programs generally present greater risk to the bank than a warehouse line due to the more direct loss exposure and higher volume of activity. This latter element, when combined with an otherwise minor deficiency or control weakness, can represent a substantial threat to bank capital if left undetected or uncorrected. Therefore, the board of directors of any bank operating a temporary purchase program must demonstrate heightened awareness and supervision to avoid undue risks to capital.

This Memorandum covers the following topics as they apply to temporary purchase programs: (1) an overview of the activity; (2) the potential risks; and, (3) minimum standards for a well-run program.

OVERVIEW OF ACTIVITY

"Temporary mortgage purchase program" is the name given to activity whereby banks purchase single family residential mortgages originated by mortgage companies, while the loans are awaiting resale to investors in the secondary market. In practice, much of the activity parallels traditional warehousing arrangements. However, an essential element of the program is that the bank takes an ownership position in the loan, thus avoiding aggregation of the individual loans under an extension of credit to the originator. While temporary purchase programs may be employed in a variety of circumstances, they are most frequently associated with lower tier originators who do not qualify for warehouse lines of sufficient size to handle the volume of their activity.

In most temporary purchase programs, the bank's purchase occurs simultaneous with the loan's funding and loan documents are closed in the mortgage company's name. Ownership is assigned to the bank at closing, as is the purchase commitment from the secondary market investor which has been arranged by the originator.

A loan is normally owned less than 60 days pending the investor's final review. During this period, loan documents may be held by a variety of parties depending on the specific agreement between the bank and the originating mortgage company. However, a true purchase cannot legally occur unless documents evidencing ownership are within the bank's possession or control, either directly or through some type of bailee or custodial agreement with an independent third party. During the time a loan is owned by the bank, any payments on the note are likely to be collected by a third party and remitted to the bank, or held by an agent on the bank's behalf. The bank normally receives interest at the face rate on the mortgage loan purchased as well as a flat fee, which varies widely.

When the investor purchases a loan, the bank recovers the principal, plus interest and fees. Any excess over the purchase price is forwarded to the originator as compensation for their services. If an investor rejects a loan or fails to honor its purchase commitment, the bank owning the mortgage is responsible for regaining the original loan documents, carrying the loan, correcting any deficiencies, and reselling the asset if possible.

POTENTIAL RISKS

Due to the success reported by many institutions engaged in temporary mortgage purchase programs, bankers and boards of directors may incorrectly believe that there is little risk in the activity. In fact, however, there are numerous incidents of banks sustaining high losses when temporary mortgage purchasing programs are not prudently controlled. **Due to the fact that much of the profit is derived from high volume, even minor deficiencies may represent a significant threat to bank capital if left undetected and allowed to compound.** Banks that attempt to operate temporary purchase programs without sufficient expertise and controls may be cited for unsafe and unsound activity by the Department of Banking, and risk the imposition of administrative action.

Risk of Fraud

Fraud in a temporary mortgage purchase program presents the largest risk to capital. This is particularly true to the extent that concentrations exist with any one mortgage originator. While the vast majority of mortgage companies perform their business legitimately, the ease of entry into the mortgage business and the emphasis on volume and quick inventory turnover make the industry susceptible to unscrupulous individuals. The weaker the financial condition of the mortgage company and the less effective a bank's controls, the greater the likelihood of fraud occurring through: (1) multiple sales of the same loan to several parties; (2) alteration or misrepresentation of the credit quality of a borrower; (3) use of fictitious borrowers; or (4) misapplication of funds from the sale or amortization of the loan. Permanent investors do not have to honor commitments on fraudulent credits, and VA and FHA guarantees would not be enforceable. Therefore, any fraud is usually a total loss to the bank.

Credit Risk

The nature of the temporary purchase program is such that a bank will have exposure to credit risk in a number of forms. In the ordinary course of the transaction, credit exposure to the mortgage borrower is limited due to the fact that the bank's period of ownership is confined. However, this exposure increases dramatically when a bank is forced to repurchase or retain a loan due to early payment default or documentation deficiencies, since the bank has acquired a longer term exposure in the face of mounting credit and market risk.

A bank also must evaluate the credit and reputation of the originating mortgage company due to its reliance on that entity to underwrite and document the purchased loans. If a mortgage company is experiencing financial difficulties, cutbacks in personnel and controls may materially affect the quality of the loans being originated, as well as contribute to a failure to meet prescribed due dates. Also, the possibility of fraud increases in desperate financial situations.

Finally, another source of credit risk is that resulting from reliance on the secondary market investor to buy out the bank's position. Investors under financial stress or experiencing liquidity problems may default on their purchase commitments, particularly if they have failed to hedge their purchase commitments.

Concentrations

The high volume nature of temporary purchase programs often creates asset concentrations many times the level of capital, which amplifies all other risk aspects discussed in this section. Concentrations in loans from one originator, sold to any one investor, or from any geographic region should be closely monitored and controlled. Banks also should control the volume of mortgages and outstanding funding commitments from a liquidity and balance sheet management perspective.

Out-of-Area Lending

In order to achieve a sizable volume of mortgage loan activity, a temporary mortgage purchase program may rely on a large volume of out-of-area loans, which by their very nature, increase the risks associated with the general program. The fact that a mortgage company is unable to obtain favorable financing within its own market may signal concern. A bank that purchases loans from a mortgage company which is out of its area is also more susceptible to fraud due to the lack of local market knowledge of the company and its principals, and the absence of day-to-day contact. In addition, a bank purchasing mortgage loans outside of the state may be not familiar with any particular disclosure or usury laws which would be applicable to the mortgage and possibly render it defective. Finally, should the ultimate sale of a purchased loan fall through and result in the bank holding a long-term asset, there may be substantial difficulty and expense in holding a loan on property outside of its standard lending area.

Funding

Ideally, banks should fund assets with deposits. However, many banks engaged in temporary purchase programs approach a volume and cyclical demand for funding which exceeds their capacity to generate from local deposits. Such banks may be tempted to reach out to higher cost and more volatile funding sources, which may adversely impact earnings and liquidity. Also, banks which rely on more expensive funds are more likely to compromise prudent standards of underwriting or controls in an effort to compensate for the higher priced funding. To the extent that maturities or repricing intervals are not aligned between the assets and underlying funding, the bank also may be susceptible to interest rate risk.

Interest Rate Risk

Direct interest rate risk is minimal in a well-run temporary purchase program under which loans are pre sold to a strong investor, who in turn has hedged their position. However, any bank which purchases loans that have not been pre sold is effectively speculating on interest rate movements. This could have a dramatic impact on capital through required mark to market accounting in an adverse environment. Indirect interest rate risk is also evident to the extent that investors are more likely to renege on a commitment in a rising rate environment. Finally, because fee income and the value of servicing rights swing widely based on interest rates, the effect of a changing rate environment on the financial condition of mortgage companies should not be ignored.

Documentation/Market Risk

The structure of most temporary purchase programs is such that the bank will not have direct control of the loan documents for much of the ownership period. This leaves the bank highly reliant upon third parties to recognize and protect its ownership rights. Failure to adequately control this aspect of the transaction can subject the bank to either a complete loss of a negotiable asset through misappropriation, or partial loss of value if only a portion of the original documents can be assembled in the case where the asset must be re-sold.

Documentation risk also arises through poor underwriting, or lost or defective supporting documents. These loans are likely to be rejected by the secondary market investor. In that case, the bank must either hold the defective loan as a permanent investment, or attempt to correct deficiencies and resale it. Unless a bank has "designated endorser" status or independent market contacts, it is likely to realize less than the full market price of the loan if forced to sell. In other instances, a bank may not be in a position to permanently own any volume of mortgage loans due to the potential strain on its balance sheet and loan servicing personnel.

Funds Transmittal Risk

Funds are transmitted twice during the typical life cycle of a temporarily purchased loan: from the bank to the closing agent at the time the loan is originated; and from the investor to the bank when the loan is purchased. If a bank does not sufficiently control these transmittals, it runs the risk of the funds being misappropriated by either the originator or the closing agent. There are instances when closing agents have colluded with mortgage originators and used loan proceeds in a manner other than represented to the bank, or allowed a loan to be sold to multiple purchasers. Also, mortgage originators may have the ability to override a bank's wiring instructions to an investor, especially if the investor is a government-sponsored agency which provides the originator access to a portion of their data base. Therefore, unless precautions are exercised, the originator could directly receive purchase proceeds from the investor and not notify the bank of loan sales.

MINIMUM STANDARDS FOR A WELL-RUN PROGRAM

The following criteria are outlined to provide a set of standards which should be employed by bank management and the board of directors in establishing and/or reviewing a temporary purchase program. Due to the nature of risk, strong oversight should be evident for any bank engaging in a temporary purchase program. Above all, it is essential that the board ensure that adequate and competent staffing has been employed to oversee mortgage purchasing operations. Policies, comprehensive management information systems, quality control programs, and strategic and contingency planning are also essential to adequately protect capital.

Written Policy

A formal policy with specific limitations and control procedures is important to a well-run program. Components which should be included in such a policy include investment limitations, authorized loan products, maintenance of a list of approved mortgage companies and investors, limits on the purchase of loans which have not been pre-sold, and requirements for periodic reports to the board. Minimum requirements for participating originators, underwriting standards for loans purchased, and controls over the loan funding and sale transactions should also be addressed in a comprehensive policy.

Credit Approval Standards

A bank should review and approve each loan prior to its purchase. The review should be sufficient to document the bank's determination that the prospective borrower qualifies for the requested mortgage, and that debt service and collateral coverage are sufficient for bank and investor requirements. Beyond a credit analysis of the borrower and a check of the accuracy of calculations, the documents should be subjected to some limited verification to determine their accuracy and authenticity. This could include a call to the borrower's employer, and contact with the appraiser to verify the estimated value of the property. The extent and scope of verification will depend on the strength of, and the bank's experience with, a particular originator.

A thorough credit review should be performed at least annually on each mortgage company selling to the bank, along with periodic monitoring through interim reports. In reviewing and approving mortgage companies, consideration should be given to: site visits by bank officers; analysis of both audited and interim financial statements; review of credit reports on the company and its owners; verification of fidelity bond and errors and omissions insurance coverage; verification of state license; review of the "master sales commitment" agreements between the mortgage company and secondary market investors; verification of HUD/FNMA/FHLMC investor status; and review of HUD/FNMA/FHLMC quality control audits if applicable. To the extent that historic performance and rejection information may be available, this would also provide an important insight into a company's capacity to perform.

An analysis of the permanent investors to whom loans are sold is also prudent. Considerations appropriate to this review could include a review of a company's ratings under third party rating services; an analysis of audited annual financial statements; and/or the company's performance under past purchase commitments. The investor's willingness or ability to honor the bank's bailee letters and comply with prudent sale closing standards (such as responding to verification requests and direct wiring of remittance funds), also should be strongly weighed.

Written Agreements with the Mortgage Company

In order to specifically define the rights and responsibilities between the bank and selling mortgage companies, a board approved written agreement should be in place for each company selling loans to the bank. The agreement should address items such as: minimum standards for participating in the program (licensing, bonding, etc.); procedures for handling mortgage loan deficiencies; provisions for acquiring copies of important agreements between the mortgage company and other third parties; procedures for timing and submission of documents to the bank to facilitate pre-purchase review; and the responsibilities of each party in regard to mortgage loan defaults.

Mortgage Closing Standards

Most closings under a temporary purchase program are "table funded" by the bank at an independent title company or title attorney's office. Internal control over the closing process is very important to safeguard the bank's interests. Steps which should be taken include: direct (telephonic) confirmation with the investor of the purchase commitment; direct or indirect receipt of the original endorsed note and assignment, and certified copies of other documents prior to funding; receipt of an insured closing protection letter verifying fidelity and errors and omissions coverage on the closing agent; acknowledged wiring instructions to the closing agent; and limitation of disbursement at closing to less than the full secondary market price (to avoid pre-paying the originator's and closing agent's fees). Temporary purchase programs which fund loans from outside of the state must exercise special caution due to the differences in state laws. Certain states allow "wet funding," wherein document execution and loan disbursement occur simultaneously. This increases the bank's risk in the transaction. In "wet funding" states, documents should be received by facsimile prior to disbursement, with original/copies sent by overnight mail after funding.

Sale Closing Standards

Banks should insist that they receive direct payment of sale proceeds by the investor. To ensure against stale inventory or potential misappropriation of sales proceeds, banks also should carefully monitor any loan on the books for over sixty days, and follow up on any sales which do not occur on or before the target purchase date.

Quality Control Program

Banks engaging in a temporary purchase program should have a system of quality control which provides a means to identify potential weaknesses and risks in the program. Included in the system would be an independent audit of a portion of loans purchased, the scope and extent of which would vary depending on: the types of loans being purchased; the bank's knowledge of the loan originator; and the financial condition and historical performance of the originator. An audit of up to 10-15% of the loans purchased is an industry norm, with a larger sample employed for a new originator, or one experiencing financial difficulties. The audit should verify that all elements of the transaction complied with the bank's policies and procedures, as well as re-verify elements of the purchased loan.

Originators participating in government-sponsored programs already undergo a quality control audit to meet the specifications of the sponsoring entity. The audits typically include independent re underwriting and reverification of at least 10% of the originations, as well as reappraisal of properties on 10% of the sample (10% of 10%). A case may therefore be made for a lower sample on mortgage companies engaging in these programs when the bank has a copy of the external quality control audit.

Management Information Systems

Comprehensive management information systems are essential to the smooth operation of a temporary purchase program. Bank management should have detailed and timely reports for supervising daily activity, while the board of directors should receive periodic summary reports on the volume of activity, exceptions, and profitability. It is also important to track: historic data on failed sales; the number and dollar volume of loans rejected by investors; and, documentation/underwriting exceptions by loan production source.

Contingency Planning

Board-approved contingency plans are strongly recommended for programs of any material size to provide a basis for responding to potential interruptions in the program. The "temporary" ownership may become long-term should loans be rejected by investors. Any legal or implied recourse from the investor to the bank should be considered as well. The bank's ability to retain some portion of the loans awaiting resale should be evaluated based on a reasonable "worst case" scenario (such as maximum exposure to any one investor). To the extent any actual recourse exists, the bank should identify funding mechanisms and liquidity sources to buy ineligible loans back from the secondary market if necessary.

Reserve Standards

The Allowance for Loan and Lease Losses should provide coverage for any risk of credit loss from the mortgages owned by the bank. In determining how much should be allocated, historic loss experience may be one consideration. Other items which may be assessed include: the risk of investor default; the impact of interest rates on borrowers' repayment capacity on adjustable rate mortgages; and the level of government-sponsored loans. If any loans are sold with recourse to the bank, separate recourse reserves should be established.

Accounting Standards

The bank should ensure that accounting techniques comply with generally accepted accounting principles and that activity is correctly reported in regulatory reports. Formal systems should be in place to: document the proposed disposition of each loan at the time of purchase; ensure that loans are recorded as "held for sale" and reported at the lower of cost or market in accordance with Financial Accounting Statement (FAS) 65 (Accounting for Certain Mortgage Banking Activities); and, defer loan fees in excess of cost in accordance with FAS 91 (Accounting for Non-refundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases).

CONCLUSION

The Banking Department supports state bank involvement in the mortgage lending process. Not only does the public benefit from increased credit availability, but banks operating with sufficient controls are able to acquire relatively low-risk assets at favorable yields. Temporary mortgage purchase programs allow banks to participate in the mortgage market without having to develop and staff internal origination operations. However, because of the high volume of most programs and a substantial element of risk involved, strong board and management oversight is essential.

SUPERVISORY MEMORANDUM – 1012

July 31, 1996

TO: All State-Chartered Banks and Trust Companies
All Bank and Trust Examining Personnel

FROM: Catherine A. Ghiglieri, Commissioner

SUBJECT: Communication with External Auditors

BACKGROUND

This Policy Memorandum revises and supersedes Numbered Memorandum 87-11. The revision clarifies that the policy applies to trust companies, and formalizes the Department's request that Regional Offices be copied with external audit reports when they are received by the regulated institution.

POLICY TO COMMUNICATE AND COORDINATE EXAMINATION WORK WITH AUDITORS

It is the policy of the Department of Banking to foster open and ongoing communications between its examining staff and the external auditors of the entities under its supervision. The Department recognizes that the cooperative efforts of examiners, banking and fiduciary officers, and external auditors are essential to conducting a thorough examination. The sharing of information and discussions of the methodologies used enable examiners and auditors alike to develop a more complete understanding of the condition of an individual entity. Further, this cooperation allows both parties to maximize the effectiveness of their resources by utilizing each other's work. This is particularly important since the Department is seeking to reduce regulatory burden by tailoring the scope of examinations to avoid unnecessary duplication of the work of external auditors.

ROLE OF REGULATED ENTITIES

The Department encourages state banks and trust companies to contact their external auditors when an examination begins, advising them that any and all dialogue between the examiners and the auditors is both welcomed and encouraged. The auditors should also be invited to attend wrap-up exit meetings with the board and management. Finally, it is important that the Department receive a copy of any audit, directors' examination, or other special report, including especially a copy of the "management letter," upon completion of an audit engagement. This information should be copied to the appropriate Regional Office upon its receipt by the regulated entity. This facilitates the examination planning process and enhances the Department's ability to monitor the condition of regulated entities between examinations.

POLICY ON AUDIT REQUIREMENTS

In 1993, the FDIC adopted a rule (12 CFR 363) which requires independent outside audits for all insured institutions having total assets greater than $500 million. The FDIC has a separate policy statement which advocates an external audit program for all banks.

The Texas Department of Banking similarly encourages banks and trust companies to consider the benefits that an external audit provides. The examination function has evolved to focus on safety and soundness matters, and does not consistently include a detailed verification of account balances or internal controls. The Department may require an independent external audit in instances where: (i) significant internal operating deficiencies are noted; (ii) the fidelity bond has expired or been canceled; or, (iii) where other circumstances are involved which necessitate verification and review by a qualified accounting firm.

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SUPERVISORY MEMORANDUM – 1016

May 3, 2016

TO: Texas State-Chartered Banks
Foreign Bank Branches and Agencies
Texas Trust Companies
All Bank and Trust Examination Personnel

FROM: Charles G. Cooper, Banking Commissioner

SUBJECT: Providing Consumer Complaint Notices

PURPOSE

This Memorandum clarifies certain circumstances under which a bank, trust company, or other entity subject to Texas Administrative Code, Title 7, §11.37 is not required to provide to consumers information regarding filing a complaint with the Texas Department of Banking.

OVERVIEW

Texas Administrative Code Title 7, §11.37, "How Do I Provide Information to Consumers on How to File a Complaint?" (TAC §11.37) requires a bank, foreign bank, bank holding company, or trust company (collectively, an entity) chartered, licensed, or registered by the Texas Department of Banking (Department) to provide notice to a consumer of how to file a complaint with the Department[1]. The rule was adopted to ensure that consumers are aware that contacting the Department is one available method of helping to resolve an issue they have with an entity.

Entities as Financial Agents

Entities occasionally enter into agreements with government agencies to act as the government's financial agent or fiduciary in order for the government agency to carry out its goal of providing certain financial services or benefits to the public. How these joint entity-government programs are to operate is largely dictated by the contracting government agency overseeing the program. The Department is not a party to these agreements and the terms are established by the entity and the government agency, not the Department.

When the Department receives a question or concern from a consumer regarding a government program being operated by an entity as the government's financial agent, the Department does not have the authority or the knowledge of the details of the program necessary to assist the consumer. This results in the Department only being able to direct the consumer to the appropriate government agency providing the program, rather than providing substantive assistance.

Who is a "consumer"?

TAC §11.37 requires that complaint notices be given to a "consumer" of an entity, which is defined as "an individual who obtains or has obtained a product or service from [an entity] that is to be used primarily for personal, family, or household purposes." In the situation described above, the individual obtains the product or service from the government agency, not from the fiduciary agent or entity. Therefore, an individual receiving a product or service from a government's financial agent or fiduciary is not a "consumer" within the meaning of TAC §11.37.

CONCLUSION

An entity acting as a financial agent or fiduciary on behalf of a government agency is not required to provide information regarding filing a complaint with the Department with all privacy statements issued to those individuals,

[1]Regulatory Guidance 3005 provides further guidance on implementation of the notice.

but the entity is encouraged to provide information regarding filing a complaint with the appropriate government agency overseeing the program.

SUPERVISORY MEMORANDUM – 1020

March 15, 2016 (rev.)

TO: All State-Chartered Banks, Trust Companies, and Technology Service Providers; and All Bank and Trust Examining Personnel

FROM: Charles G. Cooper, Banking Commissioner

SUBJECT: Information Technology Examination Frequency and Ratings[1]

PURPOSE

This Supervisory Memorandum (Memorandum) sets forth the Information Technology (IT) examination frequency guidelines for banks, trust companies, and technology service providers. The Memorandum also addresses which entities receive individual component ratings for IT examinations and which receive only an overall composite rating. The four types of examination scopes utilized by the Department for IT reviews are defined in this policy.

This policy has been revised to update the IT examination scope and frequency table for state-chartered banks. The table was revised as follows: (1) banks with total assets of $10 billion or greater qualify for a continuous examination program; and (2) banks with total assets of $1 billion or less may qualify for an 18 month examination cycle.

IT EXAMINATION RATINGS

Banks and Trust Companies

In general, the Department issues only an overall composite IT rating for banks and trust companies. The overall rating is determined based on a review of IT risk-focused examination work procedures centered on managerial oversight including: establishment of policies and procedures; assessment of IT risks; testing of key controls; providing for business continuity after a disaster; and safeguarding of customer information. Banks under the continuous supervision examination program, however, may have component ratings issued along with the composite rating.

Technology Service Providers (TSPs)

The Department issues component and composite ratings for TSPs. The focus for the review is on four functional IT "component" areas: Audit, Management, Development & Acquisition, and Support & Delivery. The component and composite rating practices as established in Supervisory Memorandum 1001 apply to TSPs.

SCOPE OF EXAMINATIONS

The scope or depth of each IT review will be determined based on the assessed IT risks of each institution as directed by the Chief IT Security Examiner. The Department utilizes four types of examination scopes for IT reviews: Level I Full Scope, Level II Full Scope, Visitation, and Continuous.

- A Level I Full Scope Examination (Level I) is the most comprehensive with the Department's IT specialists completing procedures that are designed to assess the entity's IT risks and controls. An overall rating will be issued and included in a Report of Examination produced for the entity.

[1] This Supervisory Memorandum supersedes the November 1, 2012 issuance which revised the policy to provide more flexibility with the IT examination frequency by allowing the IT examination to commence after the safety and soundness examination begins for state-chartered banks and trust companies, with concurrence by the Director of Bank and Trust Supervision. The revision also established three examination frequency tiers for technology service providers.

- A Level II Full Scope Examination (Level II) allows IT specialists to focus on the highest risk areas of the entity, while excluding certain assignments determined to be of lower risk. IT Specialists will continue to review all critical aspects of the IT operations to the extent needed to assign an overall rating. An overall rating will be issued and included in a Report of Examination produced for the entity.
- A Visitation is a narrowly scoped examination which may focus on one or more specific risk areas. The results of a Visitation will be documented with a Letter of Findings to the entity.
- A Continuous Examination Program (CEP) is primarily utilized in larger institutions and includes a series of targeted reviews conducted over an examination cycle generally covering a 12 month period. The targeted reviews focus on one or more specific areas of the institution’s IT operations. The results of targeted reviews are documented in a Letter of Findings. The results of the IT targeted reviews performed during the examination cycle are utilized to assign a composite CAMELS rating for the institution which is documented in a Report of Examination.

The Level I and Level II examinations as well as the CEP meet the examination priorities of the Department and federal regulators. As with any functional area of a financial institution, if there are supervisory concerns about IT related risks, then interim examinations, on-site visits, and off-site monitoring may be performed as recommended by the Chief IT Security Examiner in collaboration with the applicable Regional Director or Chief Trust Examiner. These reviews and scope determinations will be performed under the direction of the Chief IT Security Examiner who can expand the scope of the examination when necessary.

The findings of the IT examinations may be embedded into the safety and soundness Report of Examination for the bank or trust company or delivered under separate cover as an independent Report of Examination or Letter of Findings as determined by the Chief IT Security Examiner and applicable Regional Director or Chief Trust Examiner.

EXAMINATION FREQUENCY

State-Chartered Banks

The frequency of an IT examination generally follows the frequency of safety and soundness examinations for state-chartered banks, with the IT examination due within 120 days prior to the due date of the safety and soundness examination. The examination may be delayed up to 60 days after the safety and soundness examination start date, with the concurrence of the Director of Bank and Trust Supervision. The frequency of safety and soundness examinations for state-chartered banks is addressed in Supervisory Memorandum 1003.

The following chart details the *general* criteria for determining the IT examination frequency for state-chartered banks.

IT EXAMINATION SCOPE AND FREQUENCY SCHEDULE FOR BANKS

BANK ASSET SIZE	BANK COMPOSITE AND CAPITAL CRITERIA	BANK EXAMINATION FREQUENCY	IT EXAMINATION RATING	IT EXAMINATION SCOPE AND FREQUENCY
$10 Billion or Greater[1]	1 or 2 Composite	Continuous Examination Program. A composite risk rating is assigned every 12 months.	1 or 2	12 months; Continuous Examination Program. A composite risk rating is assigned every 12 months.

BANK ASSET SIZE	BANK COMPOSITE AND CAPITAL CRITERIA	BANK EXAMINATION FREQUENCY	IT EXAMINATION RATING	IT EXAMINATION SCOPE AND FREQUENCY
$10 Billion or Greater[1]	3, 4, or 5 Composite	Continuous Examination Program. A composite risk rating is assigned every six months.	3, 4, or 5	Continuous Examination Program. A composite risk rating is assigned every 6 months. Additional monitoring of targeted areas in the interim.
Greater Than $1 Billion But Less Than $10 Billion	1 or 2 Composite	12 months.	1 or 2	Level I or Level II every 12 months.
Greater Than $1 Billion But Less Than $10 Billion	1 or 2 Composite	12 months.	3, 4, or 5	Level I every 12 months; Mid-point in the examination cycle, perform a Level I examination, Visitation or Off-site review.
$1 Billion or Less	"Well capitalized" as defined by 12 C.F.R. 325.103 (b)(1) (member bank) or §325.103(b)(1) (nonmember bank) AND 1 or 2 Composite Rating with 1 or 2-Rated Management	18 months.	1 or 2	Level I or Level II every 18 months.

BANK ASSET SIZE	BANK COMPOSITE AND CAPITAL CRITERIA	BANK EXAMINATION FREQUENCY	IT EXAMINATION RATING	IT EXAMINATION SCOPE AND FREQUENCY
$1 Billion or Less	“Well capitalized” as defined by 12 C.F.R. 325.103 (b)(1) (member bank) or §325.103(b)(1) (nonmember bank) AND 1 or 2 Composite Rating with 1 or 2-Rated Management	18 months.	3, 4, or 5	Level I every 18 months; Mid-point in the examination cycle, perform a Level I examination, Visitation or Off-site review.
$1 Billion or Less	1 or 2 Composite With Management Rating >2 OR Not "well capitalized" as defined by 12 C.F.R. 325.103(b)(2) and 1 or 2 Composite	12 months.	1 or 2	Level I or Level II every 12 months.
$1 Billion or Less	1 or 2 Composite With Management Rating >2 OR Not "well capitalized" as defined by 12 C.F.R. 325.103(b)(2) and 1 or 2 Composite	12 months.	3, 4, or 5	Level I every 12 months; Mid-point in the examination cycle, perform a Level I examination, Visitation or Off-site review.

BANK ASSET SIZE	BANK COMPOSITE AND CAPITAL CRITERIA	BANK EXAMINATION FREQUENCY	IT EXAMINATION RATING	IT EXAMINATION SCOPE AND FREQUENCY
Any Size	De Novo and 1 or 2 Composite	Visitation within first six months of opening. Level I examination 12 months after opening and annually thereafter for the first five years of operation. Commissioner may alter this schedule to align with the applicable federal regulatory agency or division policy.	De Novo and 1 or 2	Visitation within first 6 months of opening. Level I or Level II Examination 12 months after opening and annually thereafter for the first five years of operation. Commissioner may alter this schedule to align with the applicable federal regulatory agency or division policy.
Less than $10 Billion	3, 4 or 5 Composite	Level I examination every 12 Months. FDIC Visitation or Interim Risk Examination and Assessment (IREAP) to be performed approximately six months after the Level I examination.	1 or 2	Level I or Level II every 12 months. IT exam not required with the bank IREAP
Less than $10 Billion	3, 4 or 5 Composite	Level I examination every 12 Months. FDIC Visitation or Interim Risk Examination and Assessment (IREAP) to be performed approximately six months after the Level I examination.	3, 4, or 5	Level I every 12 months; Mid-point in the examination cycle, perform a Level I examination, Visitation or Off-site review. IT exam not required with the bank IREAP

(1) The Commissioner or Deputy Commissioner may designate any institution with total assets over $5 billion to be examined under the CEP.

In situations where the most recent composite IT rating is 3, 4 or 5, the IT examination frequency will continue to coincide with the safety and soundness examination frequency; however, during the interim, a Level I examination, Visitation, or an off-site review will be performed 90 days before or 90 days after the mid-point in the safety and soundness examination cycle. The scope and timing of the interim examination will be determined by the Chief IT Security Examiner based on factors such as severity of weaknesses, management's capability, and information in progress reports. A composite IT rating will be assigned at a Level I examination and a Report of Examination will be provided to the bank. If a visitation is performed, then no rating will be assigned and a Letter of Findings will be provided to the bank.

Exceptions to the IT Examination Frequency

Change in Scope of Safety and Soundness Examination:

If the safety and soundness IREAP examination is converted to a Level I Full Scope examination and the Bank Composite Rating is subsequently upgraded to allow for an 18 month examination cycle, then:

- If the IT Rating is a 1 or 2:
  - A Level I or II Full Scope IT exam will be performed approximately 6 months after the converted Full Scope exam. The IT examination frequency will then follow the 18 month cycle; or
- If the IT Rating is a 3, 4, or 5:
  - A Level I Full Scope IT examination will be performed approximately 6 months after the converted examination followed by a Level I examination, Visitation, or Off-site review in 12 months. The IT examination frequency will then follow the 18 month cycle.

Change in Safety and Soundness Examination Frequency

- In the event the financial institution's safety and soundness examination frequency increases, if the most recent IT composite risk rating is a 1 or 2, then the IT examination may be delayed up to 6 months after the safety and soundness examination due date.
- If the safety and soundness examination is delayed for any reason, the IT examination may be delayed as well with the goal of beginning the IT examination no later than during the safety and soundness examination. The flexible due date allows coordination with the bank to reduce regulatory burden, to preclude conflicts with safety and soundness examination procedures, and to provide the option for the IT examination information to be collected closer to the date of the safety and soundness examination.

Trust Companies

The frequency of an IT examination generally follows the frequency of safety and soundness examinations for trust companies, with the IT examination due within 120 days prior to the due date for the trust company examination. The examination may be delayed up to 60 days after the safety and soundness examination start date, with concurrence by the Director of Bank and Trust Supervision. Trust companies exempt under Texas Finance Code §182.011, do not receive an IT examination. The frequency of safety and soundness examinations for trust companies is addressed in Supervisory Memorandum 1004.

The following chart details the *general* criteria for determining the IT examination frequency of state-chartered trust companies.

IT EXAMINATION SCOPE AND FREQUENCY SCHEDULE FOR TRUST COMPANIES

TRUST COMPANY COMPOSITE RATING AND CRITERIA	TRUST COMPANY FREQUENCY	IT EXAMINATION RATING	IT EXAMINATION SCOPE AND FREQUENCY
1 or 2 CAMEL or 1 or 2 UITRS	18 Months	1 or 2	Level I or Level II every 18 Months.
		3, 4, or 5	Level I every 18 months; Mid-point in the examination cycle, perform a Level I, Visitation examination, or Off-site review.
3, 4 or 5 CAMEL or 3, 4 or 5 UITRS **-OR-** 3-Rated Management and 1 or 2 CAMEL or 1 or 2 UITRS	12 Months	1 or 2	Level I or Level II every 12 months.
		3, 4, or 5	Level I every 12 months; Mid-point in the examination cycle, perform a Level I, Visitation examination or Off-site review.
New Trust Company - Not Yet Rated	Initial exam in six to 12 months, then every 12 months for three years.	1, 2, 3, 4, or 5	Level I or II within six to 12 months and annually thereafter. May perform Level I or visitation in interim during first five years.

In situations where the most recent composite IT rating is 3, 4 or 5, the IT examination frequency will continue to coincide with the safety and soundness examination frequency; however, during the interim, a Level I examination, Visitation, or an Off-site review will be performed 90 days before or 90 days after the mid-point in the safety and soundness examination cycle. The scope and timing of the interim examination will be determined by the Chief IT Security Examiner based on factors such as severity of weaknesses, management's capability, and information in progress reports. A composite IT rating will be assigned at a Level I examination and a Report of Examination will be provided to the trust company. If a Visitation is performed, then no rating will be assigned and a Letter of Findings will be provided to the trust company.

Exceptions to the IT Examination Frequency

Change in Safety and Soundness Examination Frequency

- In the event the trust companies' safety and soundness examination frequency increases, if the most recent IT composite risk rating is a 1 or 2, then the IT examination may be delayed up to 6 months after the safety and soundness examination due date.
- If the safety and soundness examination is delayed for any reason, the IT examination may be delayed also, with a goal of beginning the IT examination no later than during the safety and soundness examination. The flexible due date allows coordination with the trust company to reduce the regulatory burden, to preclude conflicts with safety and soundness examination procedures, and to provide the option for the IT examination information to be collected closer to the date of the safety and soundness examination.

Technology Service Providers (TSPs)

TSPs are assigned to one of three examination frequency tiers by the Chief IT Security Examiner. The tier assigned to each TSP will be based on a variety of factors including complexity of the TSP, the number of state-chartered banks and trust companies that they service, the type of information technology service they provide, their affiliation with state-chartered banks, and if they are subject to examination by other regulatory agencies.

Only Tier 1 TSPs are subject to routine IT examinations by the Department. Tier 2 and Tier 3 TSPs are not subject to routine examination by the Department and are generally either part of the FFIEC Multi-Regional Data Processing Servicers (MDPS) program or provide only ancillary (non-critical) data processing service.

The three tiers are defined as follows:

Tier 1

These TSPs are generally owned, controlled, or otherwise affiliated with a bank that provides processing for affiliated banks. Tier 1 TSPs will be examined on a frequency as determined by the FFIEC Risk-Based Examination Priority Ranking in the Federal Regulatory Agencies' Administrative Guidelines: Implementation of Interagency Programs for the Supervision of Technology Service Providers. The FFIEC Risk-Based Examination Priority Ranking form will be completed at the conclusion of each IT examination of a TSP. For 1 and 2 rated Tier 1 TSPs, the Chief IT Security Examiner may establish more frequent examinations than as determined by the Examination Priority Ranking as long as the frequency is not more often than the safety and soundness examination of the lead affiliated bank. (Often TSPs and their affiliated banks share IT control policies and procedures. Conducting an IT examination of the TSP that coincides with IT examinations of the affiliated banks can result in a substantial reduction in regulatory burden.)

In situations where the most recent composite IT rating is 3, 4 or 5, the examination frequency will follow the FFIEC examination frequency; however, during the interim, a Level I or visitation examination may be performed. The scope and timing of the interim examination will be determined by the Chief IT Security Examiner based on factors such as severity of weaknesses, management's capability, and information in progress reports.

The findings of TSP examinations will be conveyed through an IT Report of Examination.

Tier 2

These TSPs are generally companies that are included in the FFIEC's Multi-Regional Data Processing Servicers (MDPS) Program, such as large national data processing companies. Tier 2 TSPs are examined by FFIEC member agencies under a prescribed frequency and are not subject to routine examination by the Department, although staff may participate in the examination of these entities with federal agencies. Due to the type of service they provide and number of banks they service, the Department monitors examination data received from the FFIEC member agencies.

Tier 3

These TSPs generally provide only ancillary (non-critical) technology services and/or provide services to only a small number of state-chartered banks. Tier 3 TSPs are generally located out of state and are not subject to routine examinations by the Department. Tier 3 TSPs are subject to examinations on a case by case basis. The Department monitors examination data on Tier 3 TSPs received from the FFIEC member agencies.

COOPERATIVE EXAMINATION PROGRAM – BANKS AND TECHNOLOGY SERVICE PROVIDERS

The Department of Banking in cooperation with the Federal Reserve Bank of Dallas (FRB) and the Federal Deposit Insurance Corporation (FDIC), has committed to coordinating examination efforts to reduce regulatory burden. As a result, the general practice of the agencies is to alternate examinations between the Department and the FDIC or, if the institution is a member bank, with the FRB. However, the Department will conduct a separate examination, or a joint examination with the appropriate federal supervisory agency, whenever deemed appropriate. IT examinations of commercial banks performed by federal banking agencies will be accepted in meeting the Department's examination priority guidelines.

CONTACT INFORMATION:

Questions about this policy may be directed to the Department's Chief IT Security Examiner, Linda Pearson, at 210-271-3923.

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SUPERVISORY MEMORANDUM – 1025

March 15, 2016 (rev.)

TO: Chief Executive Officers of State-Chartered Banks
All Bank and Trust Examining Personnel

FROM: Charles G. Cooper, Banking Commissioner

SUBJECT: Level II Full Scope Examinations

PURPOSE

The purpose of this Supervisory Memorandum is to provide written guidelines under which a Level II Full Scope Examination (Level II) utilizing risk focused examination procedures may be conducted and considered acceptable to meet the Texas Department of Banking (Department) examination requirements of Texas Finance Code §31.105 and Supervisory Memorandum 1003 - Examination Frequency for State-Chartered Banks. Under a Level II program, qualifying institutions that are determined to present a low risk profile based on specific criteria, may receive an examination focusing on the highest risk areas in lieu of the more comprehensive, Level I Full Scope Examination (Level I). The Department has determined that this program can be implemented without materially jeopardizing the agency's mission to ensure that Texas state-chartered banks are operating in a safe and sound manner and in compliance with applicable banking statutes and supervisory guidelines.

Current revisions to this Memorandum include (1) modifying an eligibility requirement regarding the size of an institution; and (2) expanding the examination scope. Specifically, an institution with total assets of $1 billion or less may be eligible for a Level II examination and the examination scope should include a thorough and comprehensive review of the bank's unclaimed property procedures and reporting practices.

OVERVIEW

The Level II examination program was implemented to help ensure that Department resources are appropriately allocated to focus on the highest risk institutions and that supervisory priorities and requirements continue to be met.

On-site examinations in combination with the agency's off-site monitoring program and the in-between examination call program ensure that the inherent risks in the banking system and individual institutions are assessed and monitored. These supervisory methods have also allowed the Department to identify institutions that present a low risk profile. These institutions have historically been rated a composite CAMELS rating of 1 and exhibit management practices that are risk adverse and which consistently adhere to safe and sound banking practices and procedures. The Department has reviewed and considered other factors such as an institution's, longevity and quality of leadership, current business plan and regulatory history in determining characteristics conducive to an institution receiving a Level II examination.

ELIGIBILITY

Institutions that generally meet the below criteria are eligible to receive a Level II examination as determined by the Regional Directors.

1) The institution has received a composite CAMELS rating of 1 at the last two examinations and is not subject to an administrative or enforcement action of any type;
2) There has been no change in the ownership or executive officers, or a significant change in board composition within the last 12 months;

3) The institution does not exceed $1billion in total assets as of its last call report;
4) The institution is not a de novo bank and has been operating for at least seven years; and
5) The institution is not under any type of special monitoring or has become a concern to the Department through its off-site monitoring program, a substantial change in its business plan, or other factor as determined by the Commissioner.
6) The previous examination performed by the Department was a Level I examination.

WHAT TO EXPECT

Institutions selected for a Level II examination will be informed by the Examiner-in-Charge (EIC) before the examination begins and will receive a reduced list of required examination documents. The length of the on-site portion of the examination should be reduced as well as the number of Department personnel participating in the examination. The examination will follow the Department's pattern of regular communication including a management exit meeting to review the findings in detail and a Board meeting to review the overall conclusions of the examination. A written examination report will be issued as usual. No adjustments in assessments will be implemented.

EXAMINATION SCOPE

The Level I examination is the Department's most comprehensive examination program conducted. The Level I examination follows the Department's standard risk-focused procedures. Under the Level II program, examiners follow the standard risk-focused procedures but will focus on the highest risk areas of the bank while excluding certain operational assignments determined to be of lower risk to the safety and soundness of the institution. Examiners will continue to review all critical aspects of the banks operations to the extent needed to assign an appropriate CAMELS rating.

Areas that will receive a thorough and comprehensive review under the Level I and Level II examination programs include.

- Audit
- Credit Review, including the adequacy of the internal and external Loan Review and Allowance for Loan and Lease Losses;
- Investment Activities;
- Capital;
- Earnings;
- Liquidity;
- Sensitivity to Market Risk;
- Management and Board Supervision; and
- Other Supervisory Issues – Unclaimed Property

During the planning and risk assessment process for a Level II exam, the EIC may determine that the following operational areas should receive a review focusing on specific, higher-risk areas or activities within the functions listed below. In a Level I exam, these functions would receive a more thorough and comprehensive review.

- BSA/AML Compliance[1];
- Other Real Estate Owned; and

[1] Refer to Examiner Bulletin on Risk Focused BSA/AML Examinations. May perform the minimum procedures in a lower-risk bank that is well managed, otherwise expanded sections may need to be performed.

- Overdrafts, Kite Suspect, and Cuts.

The following areas may be omitted from the scope or review at the discretion of the EIC under the Level II examination, if determined to be of low risk:

- Cash and Cash Items;
- Collections, Consigned Items, Safekeeping, and Safe Deposit;
- Insurance and Risk Management;
- Interbank Liabilities;
- Other Assets;
- Other Liabilities;
- Premises and Equipment;
- Related Organizations;
- Retail Sale of Nondeposit Investment Products;
- Temporary Mortgage Purchase Program; and
- Other Supervisory Issues – other than Unclaimed Property.

If at any point during a Level II examination, the Department's review findings indicate increased risk, less than satisfactory compliance or additional exposure, the scope of the examination will be expanded to thoroughly assess the areas of concern.

Questions regarding this guidance may be directed to the Director of Bank & Trust Supervision, at (512) 475-1300.

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SUPERVISORY MEMORANDUM – 1029

January 9, 2012

TO: All State-Chartered Banks; All Bank and Trust Examining Personnel

FROM: Charles G. Cooper, Banking Commissioner

SUBJECT: Standards for the Risk Management of Corporate Account Takeovers

PURPOSE

This Supervisory Memorandum establishes minimum standards for a risk management program to specifically minimize the risks of Corporate Account Takeovers. Texas banks and their corporate customers have not been immune to electronic theft through Corporate Account Takeovers. Municipalities, school districts, churches, large non-profit organizations, corporate businesses, and any customers that perform electronic transfers are potential targets of cyber thieves. This type of theft can cause significant financial harm on its victims and impact entire communities and financial institutions. This Supervisory Memorandum reinforces the Department's position that all banks should be aware of the growing risk of electronic crimes, and the need to identify, develop, and implement appropriate risk management measures.

BACKGROUND

Corporate Account Takeover is a form of corporate identity theft where cyber thieves gain control of a business' bank account by stealing employee passwords and other valid credentials. Thieves can then initiate fraudulent wire and ACH transactions to accounts controlled by the thieves. Businesses with limited or no internal computer safeguards and disbursement controls for use with the bank's online banking system are vulnerable to theft when cyber thieves gain access to their computer systems, typically through malicious software (malware). Malware infects a business' computer system not just through 'infected' documents attached to an email but also simply when an infected Web site is visited.

Businesses across the United States have suffered large financial losses over the last few years from electronic crimes through the banking system. In Texas, electronic thefts through banks have ranged from a few thousand to several million dollars[1]. These thefts have occurred in banks of all sizes and locations and may not be covered by the bank's insurance. Along with the financial impact, there is also a very high level of reputation risk for financial institutions.

As a result of these growing thefts, the Department, in cooperation with the United States Secret Service, formed the Texas Bankers Electronic Crimes Task Force (Task Force). This Task Force is composed of operational executives from a diverse group of banks in terms of size, complexity, and market environment. Members also include the Independent Bankers Association of Texas, the Texas Bankers Association, and SWACHA. The Department's Chief IT Security Examiner serves as a liaison member.

OVERVIEW

The Task Force developed a list of recommended processes and controls which expanded on a three-part risk management framework of: 1) Protect; 2) Detect; and 3) Respond developed by the United States Secret Service, the Federal Bureau of Investigation, the Internet Crime Complaint Center (IC3), and the Financial Services Information Sharing and Analysis Center (FS-ISAC)[2]. The Task Force also developed *Best Practices for Reducing the Risks of*

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[1] The amount of electronic thefts based on incidents reported to the Texas Department of Banking over the last 36 months.
[2] Refer to the jointly issued "Fraud Advisory for Businesses: Corporate Account Takeover" available on the IC3 website (http://www.ic3.gov/media/2010/corporateaccounttakeover.pdf) or the FS-ISAC website (http://www.fsisac.com/files/public/db/p265.pdf).

Corporate Account Takeovers (*Best Practices*) to help banks establish specific practices to implement the recommended processes and controls. The *Best Practices* document is a valuable resource to effectively reduce risk.

As the Task Force was concluding its work related to Corporate Account Takeover, the Federal Financial Institutions Examination Council (FFIEC) released *Supplement to Authentication in an Internet Banking Environment* (FFIEC Supplemental Guidance). The FFIEC Supplemental Guidance, issued on June 28, 2011, reinforces previous FFIEC guidance related to risk management of online transactions and updates regulatory expectations regarding customer authentication, layered security, and other controls related to online activity. The Task Forces' recommended three-part Corporate Account Takeover risk management framework and related controls are similar to controls in the FFIEC Supplemental Guidance and include the minimum expectations conveyed in the FFIEC guidance. The Task Force guidance differs from the FFIEC Supplemental Guidance in that it has a more specific focus on reducing the risk of Corporate Account Takeovers and therefore provides additional steps to implement.

MINIMUM STANDARDS FOR A RISK MANAGEMENT PROGRAM TO MITIGATE RISKS OF CORPORATE ACCOUNT TAKEOVER

There are nineteen processes and controls (components) to support the three-part risk management framework of Protect, Detect, and Respond. Bank management and the board of directors must address each of these nineteen components in a risk management program to mitigate the risk of Corporate Account Takeover. Since the Task Force includes both small and large bank representatives, the required components are broad enough to accommodate the unique needs of every bank and its customers utilizing online banking services. Banks may adopt any practices to implement the components of Protect, Detect, and Respond. Although the use of the *Best Practices* developed by the Task Force is optional, using these practices as a starting point will greatly assist most banks in implementing appropriate practices. The *Best Practices* are cross referenced to each of the components listed below and are attached. If your bank does not have any business customers that send electronic instructions to transfer funds, you would only need to complete the risk assessment mentioned in P1 below of this Supervisory Memorandum.

The minimum standards for a risk management program to mitigate the risk of Corporate Account Takeover are as follows:

Protect

Implement processes and controls to protect the financial institution and corporate customers.

- **P1**. Expand the risk assessment to include corporate account takeover.
- **P2.** Rate each customer (or type of customer) that performs online transactions.
- **P3**. Outline to the Board of Directors the Corporate Account Takeover issues.
- **P4**. Communicate basic online security practices for corporate online banking customers.
- **P5**. Implement/Enhance customer security awareness education for retail and high risk business account holders.
- **P6**. Establish bank controls to mitigate risks of corporate accounts being taken over.
- **P7**. Review customer agreements.
- **P8.** Contact your vendors to regularly receive information regarding reducing the risk of Corporate Account Takeovers.

Detect

Establish monitoring systems to detect electronic theft and educate employees and customers on how to detect a theft in progress.

D1. Establish automated or manual monitoring systems.

D2. Educate bank employees of warning signs that a theft may be in progress.

D3. Educate account holders of warning signs of potentially compromised computer systems.

Respond

Prepare to respond to an incident as quickly as possible (measured in minutes, not hours) to increase the chance of recovering the money for your customer.

R1. Update incident response plans to include Corporate Account Takeover.

R2. Immediately verify if a suspicious transaction is fraudulent.

R3. Immediately attempt to reverse all suspected fraudulent transactions.

R4. Send a “Fraudulent File Alert” through FedLine.

R5. Immediately notify the receiving bank(s) of the fraudulent transactions and ask them to hold or return the funds.

R6. Implement a contingency plan to recover or suspend any systems suspected of being compromised.

R7. Contact law enforcement and regulatory agencies once the initial recovery efforts have concluded.

R8. Implement procedures for customer relations and documentation of recovery efforts.

The Department has adopted the above components supporting the Protect, Detect, and Respond framework in setting the minimum standards for a risk management program to mitigate the risks of Corporate Account Takeover. The Department’s Information Technology Security Examiners will review implementation efforts for reducing the risks of these electronic crimes through both on-site and off-site examinations. These reviews will focus on the nineteen components in this Memorandum as well as the FFIEC Supplemental Guidance. Examination staff reviews will begin March 2012.

For further information about this memorandum, contact Phillip Hinkle, Chief IT Security Examiner at (817) 640-4050.

Attachment

ATTACHMENT

BEST PRACTICES
REDUCING THE RISKS OF CORPORATE ACCOUNT TAKEOVERS

The Texas Bankers Electronic Crimes Task Force (Task Force) was formed by the Texas Banking Commissioner in cooperation with the United States Secret Service to develop recommended practices to mitigate the risks of electronic crimes such as Corporate Account Takeover. The Task Force developed a list of nineteen recommended processes and controls for reducing the risks of Corporate Account Takeovers. These processes and controls expand upon a three-part risk management framework developed by the United States Secret Service, the Federal Bureau of Investigation, the Internet Crime Complaint Center (IC3), and the Financial Services Information Sharing and Analysis Center (FS-ISAC)[3]. Fundamentally, a bank should develop processes and controls centered on these three core elements:

- Protect
- Detect
- Respond

A set of best practices has been compiled for each of the recommended processes and controls under the Protect, Detect, and Respond framework. These best practices are not an all-inclusive list and are provided as guidance to assist in implementing the nineteen processes and controls needed to reduce the risk of Corporate Account Takeover thefts. The Federal Financial Institutions Examination Council's (FFIEC) *Supplement to Authentication in an Internet Banking Environment*[4] (FFIEC Supplemental Guidance) issued on June 28, 2011, conveys minimum expectations which are noted within this document. It is important to remember that electronic crimes are dynamic as cyber criminals continually change their techniques. Additional changes in risk management processes and controls will be necessary as this type of theft continues to evolve.

I. PROTECT

P1. Expand the risk assessment to incorporate Corporate Account Takeover.

The risk assessment should include risks of Corporate Account Takeovers and be reviewed/updated at least annually for threats and risks related to online payment services. After the risk assessment is updated, an analysis should be made to identify the bank's existing controls that need to be updated or controls that need to be implemented to achieve compliance with regulatory guidance. A sample Corporate Account Takeover risk assessment is available electronically on the Electronic Crimes Task Force page of the Texas Department of Banking website, www.ectf.dob.texas.gov.

An effective risk management assessment should:

1. Define the scope and complexity of the institution's payment and online banking services, noting any changes since the prior risk assessment;
2. Identify what functionality is offered or has changed regarding:
    a. Online wire transfers;
    b. Online ACH origination;
    c. Online bill payments;

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[3] Refer to the jointly issued "Fraud Advisory for Businesses: Corporate Account Takeover" available on the IC3 and FS-ISAC websites (http://www.ic3.gov/media/2010/corporateaccounttakeover.pdf) or the FS-ISAC website (http://www.fsisac.com/files/public/db/p265.pdf).

[4] The FFIEC Guidance is available at http://www.ffiec.gov/pdf/Auth-ITS-Final%206-22-11%20(FFIEC%20Formated).pdf

   d. Delivery channels (such as mobile banking or remote deposit capture);

3. Assess if transaction limits have been set within the automated system and if those limits are appropriate;
4. Present a clear understanding of the bank's:
   a. Customer segmentation (e.g., number of business customers or types of customers adopting online banking) and any changes that have occurred;
   b. Customer utilization of online banking services - type and extent; and
   c. Expected electronic payment volumes (size and frequency of wires and ACH origination files – both the average and peak volumes);
5. Assess reliance on third-party service providers for electronic payment processing and delivery of online banking services[5];
6. Determine and assess on-going customer education and training practices;
7. Identify and assess all "automated pass-through" payment processing activities (e.g. online, real-time instructions for wire/ACH transactions that are automatically passed to the payment system operator, usually the Federal Reserve Bank, for processing or that are automatically passed to a bill payment system) and assess practices for reviewing automated anomaly detection alerts;
8. Identify and assess manual controls (and/or any automated anomaly detection) used to evaluate transactions that are not automatically sent to processor;
9. Determine the ability of corporate customers to correct, update, or change ("uninitiate") a transaction without further confirmation/authentication of the final transaction's instruction;
10. Assess the training and awareness of bank employees that process incoming transfer instructions, as well as the adequacy of staffing for these activities;
11. Assess the competency of bank staff responsible for sustaining adequate risk management practices related to ever evolving electronic payment risks, which includes considering available resources such as service providers and security and audit vendors;
12. Identify the most significant types of fraud being experienced by the industry and the emerging threats;
13. Evaluate the degree to which IT security training is provided to all employees including bank managers and front line customer contact employees. (Is there a strong corporate culture of security?); and
14. Assess the need for electronic theft insurance. If this type of insurance has been purchased, contact insurance carrier to determine if there are any required controls. Evaluate compliance with those controls.

P2. Rate each customer (or type of customer) that performs online transactions.

It is important to know the level of risk associated with customers using online banking services and especially to know those customers that are high risk. While the focus of these best practices are on corporate accounts that perform online wire and ACH transactions, any customer with any online transaction capability (including bill payments) should be evaluated for risk. Additionally, the FFIEC Supplemental Guidance applies to both business and consumer accounts. Reviews for risk rating customers should be conducted at least annually and documented. There are many different methods and formats that can be used based on the bank's size and resources. A bank may choose to simply rate all consumer customers using bill payment services with low transaction amounts and a low volume limit at a lower risk category than corporate customers. Another option would be to rate as high risk all corporate customers with certain online capabilities. In this case, "individually documented" reviews to determine the risk rating of each customer would not be necessary. However, banks with a moderate or small number of corporate customers may choose to rate their customers individually.

The following criteria could be used for risk rating a customer:

1. Type of business:
   a. Domestic versus International; and
   b. Retail versus wholesale;
2. Average Account Balances (loans and deposits);

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[5] Obtain the vendor's assessment of potential weaknesses of their delivery services as well as the controls they recommend and evaluate any mitigation services they provide. (The vendor's analysis is only one part of the bank's own analysis.)

3. Services Utilized:

   a. Wire transfer;
   b. ACH debit origination files[6];
   c. ACH credit origination files; and
   d. Bill payment;

4. Standard Entry Class (SEC) codes assigned to customer's transactions[7];
5. Volume of transactions[8];
6. File Limits/Frequency[9];
7. Security measures the business account holders utilize (see section P4 below); and
8. Business account holder's administrative controls over their users and system configurations.[10]

P3. Outline to the Board of Directors the Corporate Account Takeover issues.

The Board of Directors should be informed of the risks and controls related to Corporate Account Takeovers and provided with examples of the highest risk customers. This can be accomplished through the following actions.

1. Provide a general description of this crime, how it occurs, and losses experienced in Texas and the United States[11].
2. Provide a list of high risk business account holders with their estimated exposure.

   a. If all account holders have not been risk rated when the report to the Board is made, specify a few of the business customers at greatest risk or list an approximate number of business account customers in the bank's highest category of risk.
   b. If the list of applicable account holders is large, provide summary information and a few examples.

3. Describe the primary measures the bank will be implementing, or has already implemented within the Protect, Detect, and Respond framework.
4. Discuss the action plan and time frames for fully implementing each portion of the Protect, Detect, and Respond framework and for implementing the controls that are needed to meet the minimum expectations in the FFIEC Supplemental Guidance.

P4. Communicate basic online security practices for corporate online banking customers.

The vast majority of cyber thefts begin with the thieves compromising the computer(s) of the business account holders. Perpetrators often monitor the customer's email messages and other activities for days or weeks prior to committing the crime. The corporate customer is most vulnerable just before a holiday when key employees are on vacation. Another risk period is on a day the business office is relocating or installing new computer equipment. Employees may be distracted and think a problem conducting online banking is due to a new network or equipment. Therefore it is important and necessary for the corporate customer's employees to follow established security practices. The bank should periodically communicate to the business account holders some or all of the following security practices that the business can implement to reduce their risks of theft. Basic practices to implement include:

1. Provide continuous communication and education to employees using online banking systems. Providing enhanced security awareness training will help ensure employees understand the security risks related to their duties;

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[6] Debit files could be used to "fund" a theft from the same account.
[7] SEC codes such as PPD (Prearranged Payment and Deposit Entry) and CCD (Cash Concentration and Disbursement) could have more risk than other transaction codes.
[8] Thefts are easier to hide among a high volume of transactions.
[9] Establishing file limits and frequency are a NACHA requirement and help quantify financial exposure.
[10] FFIEC supplemental guidance establishes a minimum expectation regarding enhanced controls for system administration. See section P6 for further details. Administrative controls are of such extremely high risk that if a bank chooses to permit a customer to make administrative changes such as adding new general users, adding administrative users, changing transaction and approval limits, changing passwords, changing customer contact number or method, and disabling notification options, the changes should not be implemented without verification by the bank or at least without notification to the customer (preferable by an out-of-band method) that a change has been made.
[11] An Internet search for "account takeover law suits" will provide numerous articles with examples of these thefts.

2. Update anti-virus and anti-malware programs frequently;
3. Update, on a regular basis, all computer software to protect against new security vulnerabilities (patch management practices);
4. Communicate to employees that passwords should be strong and should not be stored on the device used to access online banking;
5. Adhere to dual control procedures;
6. Use separate devices to originate and transmit wire/ACH instructions;
7. Transmit wire transfer and ACH instructions via a dedicated and isolated device[12];
8. Practice ongoing account monitoring and reconciliation, especially near the end of the day;
9. Adopt advanced security measures by working with consultants or dedicated IT staff; and
10. Utilize resources provided by trade organizations and agencies that specialize in helping small businesses. See Appendix A for a list of resources.

P5. Implement/Enhance customer security awareness education for retail and high risk business account holders.

The FFIEC Supplemental Guidance states that security awareness education should address both business and retail account holders. The effectiveness of the education program and the need for updates due to changes in technology products and security threats should be evaluated at least annually, if not more frequently due to the ever evolving nature of cyber-crime. The extent of security awareness education may vary between customers with different risk ratings. Options for contacting customers include one-on-one or small group meetings, postal mail, email, notices on the bank's website, and telephone calls. Presentations at civic organizations will also be beneficial. Several security and audit vendors as well as trade associations in Texas have already developed presentation programs. Additionally, a sample presentation developed by the Task Force for educating account holders is available at www.ectf.dob.texas.gov.

In addition to the basic online security practices mentioned in section P4 above, security awareness education for both retail and business customers could include:

1. Procedures or user guidelines for using the bank's corporate internet banking service;
2. System security features that are available and/or that have been implemented;
3. Procedures to alert bank staff (including specific phone numbers and departments) when the account holder suspects a problem;
4. Bank policy regarding when, why and how the bank will contact online banking customers[13];
5. Protections provided and applicability of Regulation E to electronic funds transfers and the types of accounts with Internet access[14];
6. Common security threats and actions to take in order to prevent, detect, and respond to those cyber threats (See Appendix B for examples);
7. Security education resources for the customer (See Appendix A) and resources that help customers keep abreast of new and emerging issues, such as online security magazines and security vendor websites;
8. Developing an incident response plan (See Appendix C)**;** and
9. Applicability of laws and regulations to business owners to safeguard information. (See Appendix D).

Additionally, high risk customers should be specifically contacted and made aware of their exposure to electronic theft. In particular, they should be made aware of:

1. Corporate account takeovers and cyber thieves;
2. Exposure risks;
3. Recommended minimum security measures to implement (See P4 above);
4. Benefits of the business performing a risk assessment regarding online payment services;
5. Insurance coverage needs related to electronic thefts; and
6. Other resources available on this topic are found in Appendix A.

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[12] Block access to web surfing, social network sites, and external e-mail and any activity not related to banking.

[13] Reiterate that the bank will not request account holders to click on links, install software, or require changes to established procedures without securely communicated notification. (Ensure that a bank policy prohibiting this practice has been adopted to help ensure conformance.)

[14] It is critical that customers understand the different applicability for business/commercial accounts versus personal accounts.

P6. Establish bank controls to mitigate risks of corporate account takeovers.

It is important to remember that no single control is effective. The FFIEC Supplemental Guidance establishes expectations for layered security controls which should include, at a minimum, the following two elements for both business and consumer accounts.

1. Processes to detect anomalies and respond to suspicious activity[15] related to:
   a. Initial login and authentication for access to online banking; and
   b. Initiation of transactions to transfer funds to other parties.
2. Enhanced controls for system administrators who can change access privileges, add users, change or reset passwords, add new payees, change transaction limits, change time of day access, register new access devices, etc.

Banks will need to work with their IT vendors to ensure that these two elements are in place or will be within a satisfactory time period.

Layered security consists of multiple controls, which may include:

1. Enhanced controls over account administration (an FFIEC minimum expectation) may include:
   a. Requiring an additional authentication prior to implementing the change;
   b. Requiring verification/confirmation of changes prior to implementing them;
   c. Providing automatic customer notification (such as a text message or automated voice call to a cell phone) immediately after implementing an administrative change;
   d. Preventing account holders from creating administrative users without bank approval; and
   e. Eliminating all self-administration if the corporate customer doesn't meet minimum security standards established by the bank.
2. Screen display that shows customers the number of failed logins since the prior successful login and the date and time of their last login;
3. Fraud-detection and monitoring systems;
4. Dual customer authorization through different access devices;
5. Out-of-band verification of transactions (to/from a different access device);
6. Techniques to restrict transactions such as debit blocks, and debit filters;
7. Restrictions on account activity such as reasonable limits (based on historic activity) on transaction values, daily limits, who may receive funds, and time of day (and day of week) that high risk transactions such as wires and ACH originations may be initiated;
8. Tools that block connection from IP addresses known or suspected to be associated with fraudulent activities;
9. Policies to address potentially compromised customer equipment;
10. Enhanced controls (similar to those in #1 above) over account maintenance activities such as changes to postal and email addresses, phone numbers, and passwords, regardless if they are performed online, by mail, or by phone;
11. Customer security awareness education;
12. Use of USB devices that are read only and which function independently of the customer's computer's operating system, ensuring a secure connection to the bank's network; and
13. Enhanced challenge questions[16] which would:
    a. Use sophisticated questions ("out of wallet" information that isn't publically available);
    b. Require more than one question be answered correctly;
    c. Include "trap" questions which the customer would recognize as nonsensical and clearly know the answer but a thief could easily guess a wrong answer[17];

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[15] Account monitoring and fraud detection systems should flag transactions for further review. These systems could consider customer transaction history and transaction behavior, including pattern recognition that compares transactions to historical files, unusual amounts, unusual destinations (especially foreign recipients if the customer does not engage in international business), and changes in routing and account numbers of usual recipients (even when the recipient name is not changed). Changes to established cumulative daily limits or transactions in excess of established limits should also be identified by fraud systems as potentially fraudulent activity.

[16] The FFIEC's Supplemental Guidance on Internet authentication dated June 28, 2011 states that financial institutions should no longer consider basic challenge questions an effective primary control.

d. Establish a large pool of challenge questions; and
e. Prohibit the exposure of all challenge questions during one session.

For internal protection, the bank should ensure, at a minimum, the following controls:

1. An effective firewall and a process to evaluate, monitor, and validate firewall settings (and revise if necessary) on an appropriate schedule;
2. An effective patch management program that assesses patch effectiveness and implementation at least monthly; and
3. Additional security measures for computers used internally to access or manage the cash management system should include many of the controls recommended for customers that are listed in section P4.

P7. Review customer agreements.

Signed written agreements should be maintained with corporate customers using online banking services. Given the growing risks of corporate account takeovers, banks should have legal counsel that is familiar with corporate account takeover risks review their written agreements and consider including the following:

1. Roles and responsibilities for processing transaction requests and dispute resolution;
2. Minimum security standards that the bank requires the corporate account holder to use[18];
3. A disclaimer and acknowledgement that no list of security practices can be all inclusive and foolproof for preventing theft;
4. The establishment of exposure limits through transaction limits, transaction frequencies, and types of payments that can be processed during the customer's normal course of business. Also consider:
   a. Including the process for changing limits;
   b. Including a provision authorizing the bank to not honor a transaction request if the bank in its sole discretion believes not processing it will protect the account holder from fraud (include examples that might indicate a transaction is fraudulent); and
   c. Making an annual disclosure of the account agreement terms, mentioning any changes, and including a pamphlet on security awareness;
5. A disclaimer (absent any warranty or indemnification) that the risk of loss resides with the account holder if a fraudulent payment order is received by the bank in compliance with the bank's normal security procedures;
6. Requirement that the customer provide a list of the employees that are authorized to initiate files, or if the account holder is controlling account administration and accessibility then an acknowledgement from the customer of their responsibility and liability; and
7. Provisions for settling contract disputes. Consider requiring arbitration to settle contract disputes, or include a provision that provides the account holder with warranties or indemnification against corporate account takeover thefts, providing the account holder has followed specific practices.

P8. Contact your vendors to regularly receive information regarding reducing the risk of corporate account takeovers.

Corporate account takeovers are a persistent threat and the techniques to commit this crime will continue to be modified. Annually ask your vendors what controls they offer to reduce account takeover risks. Document this as part of the bank's annual risk assessment.

II. DETECT

Detection primarily occurs through:

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[17] A trap question (also known as a "Red Herring" question) could be something like the following for a customer that never lived in Dallas, Texas: *When did you live in Dallas, Texas? A) 1976; B) 1980; C) 1983; D) None of the above*. Any answer other than D is a strong indication that the customer's account has been compromised and appropriate bank and customer personnel should be alerted.

[18] The written agreement could also include security procedures offered to the customer.

1. Automated or manual monitoring systems;
2. Bank employee awareness; and
3. Notification from customers (that are aware of symptoms of computer breaches).

Management should evaluate all detection options to implement those which are most practical. Detection is closely associated with protection, as some measures to protect against electronic theft will also be an indication that a theft is being attempted.

D1. Establish automated or manual monitoring systems.

Account monitoring can help detect a theft before money is actually transferred. The most effective automated monitoring systems implement behavior-based transaction monitoring, sometimes called pattern recognition. As outlined in P6 above, the FFIEC Supplemental Guidance expects banks to implement, at a minimum, processes to detect anomalies related to initial login to online banking and initiation of transactions to transfer funds to other parties.

Things to evaluate:

1. Is the volume of corporate online banking transactions low enough for manual reviews?
    a. If so, are sufficient personnel (both as primary and as backup) available?
    b. Can bank personnel develop manual procedures in a reasonable time period that evaluates key red flags listed in section D2 below?
2. Do current vendors offer or plan to offer automated transaction monitoring?
    a. If so, will the monitoring detect the possible red flags listed in section D2 below?
    b. What additional features or benefits do the vendors provide?
    c. Can services be implemented within a reasonable time period?
    d. How long does it take for the system to build a reliable pattern (predictive analytics) of activity to identify an anomaly?
    e. Although less reliable than predictive analytics, is rule based fraud analysis available until a behavior pattern of data is established?
    f. Does any behavior pattern analysis include monitoring account holder online behavior, such as keystroke speed, in addition to time of day activity or transaction based factors.
    g. Is potential structuring of transactions above preset limits detected as well as unusual frequency of transactions and abnormal time of activity (day of week and time of day)?
3. If current vendors do not offer automated monitoring, are there third-party vendor systems that will integrate with the bank's current systems?
4. How are bank personnel notified if an automated system detects an anomaly?
    a. Are "suspicious" transactions blocked until an employee releases them?
    b. Do employees receive notification in a timely manner?

Transaction monitoring for large transactions is one of the most effective techniques for detecting fraudulent transactions. Banks with a limited number of corporate account holders can implement manual reviews and block suspicious transactions (or obtain further confirmation from their customer). A checklist of characteristics to review, such as those in D2, should be part of any manual review procedures to help ensure consistent evaluations.

D2. Educate bank employees of warning signs that a theft may be in progress.

Employee awareness is essential in the detection of fraudulent account activity. Employees are generally the first and last line of defense. Employees with corporate account holder contact and especially those that process ACH and wire transactions need to know the types of customer inquiries and other warning signs that could indicate a theft is underway. They should be aware that any problems customers are having accessing or contacting the bank electronically might be a multi-prong attack to either divert the bank's attention from a theft in progress or to disrupt communications between the customer and the bank while the theft is occurring. Reviewing transaction security reports for unusual volume and dollar amounts is helpful and should be performed at least daily as some thefts occur over multiple days. However, this method only identifies a fraud after funds have left the bank.

A sample presentation to aid in educating bank employees was developed by the Task Force and is available at www.ectf.dob.texas.gov.

Red flags visible to the bank of a possible takeover of a business account include:

1. Configuration changes to cash management/online banking profiles:
    a. New user accounts added;
    b. New ACH batches or wire templates with new payees;
    c. Changes to personal information;
    d. Disabling or changing notifications; and
    e. Changes to the online account access profile;
2. Unusual customer activity[19]:
    a. Unfamiliar IP log-on address (especially if a foreign IP address);
    b. Device ID not recognized during any previous log-on;
    c. Log-on and/or viewing of balance or transaction history during unusual times of days;
    d. Unusually small transaction amounts (example: $1.00 ACH, bill pay, or other transactions – especially if made at unusual time of day);
    e. Unusual non-monetary request from customer via fax, email, or cash management system.
    f. Unusual (non-typical) transfer of funds, especially if out of the bank. One-time bill pay to new payees;
    g. ACH or wires to new payees or receivers and/or with unusual amounts.
    h. Changes to the account and routing numbers of existing payees, not just a new payee name;
    i. Unusual timing of transactions (based on the established transaction schedule of the corporate customer or random transactions submitted between traditional transactions);
    j. Larger than usual transactions; and
    k. Overseas transfers;
3. Compromised internal systems used by bank employees resulting in:
    a. Inability to log into online banking system (thieves could be blocking the bank's access while they are making modifications to account settings);
    b. Dramatic loss of computer speed;
    c. Changes in the way web pages, graphics, text or icons appear;
    d. Computer lock up so the user is unable to perform any functions;
    e. Unexpected rebooting or restarting of computer;
    f. Unexpected request for a one time password (or token) in the middle of an online session;
    g. Unusual pop-up messages, such as "try back later" or "system is undergoing maintenance";
    h. New or unexpected toolbars and/or icons; and
    i. Inability to shut down or restart.

In the event that any of the above items are noted, the bank's network administrator and/or the online banking system operator should be contacted for further investigation.

D3. Educate account holders of warning signs of potentially compromised computer systems. (This is similar to educating bank employees.)

Account holders should be the most vigilant in monitoring account activity. They have the ability to detect anomalies or potential fraud prior to or early into an electronic robbery. If your bank offers some of the automated notification features mentioned in P6, remind your customers those are designed as flags for them to notify you if they think they may have been compromised. Business account holders should be alert for the same red flags related to computer and network anomalies as bank employees.

Warning signs visible to a business or consumer customer that their system/network may have compromised include:

1. Inability to log into online banking (thieves could be blocking customer access so the customer won't see the theft until the criminals have control of the money);

[19] Generally, hackers will have done some type of monitoring/transaction testing of the corporate account before a monetary theft is made.

2. Dramatic loss of computer speed;
3. Changes in the way things appear on the screen;
4. Computer locks up so the user is unable to perform any functions;
5. Unexpected rebooting or restarting of the computer;
6. Unexpected request for a one time password (or token) in the middle of an online session;
7. Unusual pop-up messages, especially a message in the middle of a session that says the connection to the bank system is not working (system unavailable, down for maintenance, etc.);
8. New or unexpected toolbars and/or icons; and
9. Inability to shut down or restart the computer.

III. RESPOND

R1. Update incident response plans to include corporate account takeover.

An incident response plan should include actions for stopping a corporate account takeover and should be reviewed at least annually. Update the plan to include the following:

1. Designate a fraud response committee with a specific member as the central point of contact for cyber threats. Ensure that:
   a. All bank employees know that any phone calls from customers that might be about a corporate account takeover must be transferred to the designated employee as soon as possible;
   b. The designated employee knows to convene the fraud response committee to evaluate the situation and take appropriate action;
   c. The designated employee has been given authority to take immediate action and reverse or block suspected transactions;
   d. Multiple backup personnel are in place in the event that the designated employee is unavailable. (These thefts exploit reduced staffing of holiday and vacation periods.); and
   e. Account holders have provided a primary and secondary contact person along with after-hours phone numbers that the bank can call to confirm activity that appears suspicious;
2. Identify the recovery time frame and resources needed, including:
   a. Number of employees available and trained to attempt to recover the money;
   b. Resources/skills needed by the designated central point of contact at the bank; and
   c. Resources needed by the recovery team;
3. Address customer relations/communication during an incident. Include these steps:
   a. Identify the bank staff permitted to speak to the customer.
   b. Script the initial employee communication with the customer;
   c. Confirm account holder is aware that the bank is not automatically accepting liability; and
   d. Identify the bank staff permitted to speak to the media;
4. Include criteria for contacting computer forensic specialists to review appropriate equipment as well as contact information; and
5. Include and maintain contact information for regulatory agencies, the United States Secret Service and other law enforcement agencies. They should be contacted as early as possible but without diverting resources from the initial recovery effort.

R2. "Immediately" verify if a suspicious transaction is fraudulent.

Bank employees should know how to contact account holder immediately. The customer's primary and secondary contact information including after-hours phone numbers are critical, not email addresses.

R3. "Immediately" attempt to reverse all suspected fraudulent transactions.

A bank's ability to recovery funds is reduced over time, measured in minutes, not hours. Thefts often include both wire transfer and ACH transfers, and could include other forms of transfers in the future. Be prepared to address all types. Have software available for immediate use to edit ACH files either onsite or through your correspondent or online banking vendor.[20] Be aware that the Federal Reserve Bank (FRB) has different "processing times" for transactions and reversals. Reversals are sometimes not processed until hours or days after a transaction has already been sent and it is too late to recover the funds. No fraudulent transactions should be sent for processing along with a reversing entry under the presumption that the "reversal" will cancel the processing instruction.

R4. Send a "Fraudulent File Alert" through FedLine.

Sending a "Fraudulent File Alert" through the Federal Reserve Bank (FRB)'s FedLine system may help prevent receiving banks from delivering funds to their customer (who is receiving stolen funds). In 2011 there were three steps to file an alert:

1. Contact the FRB Operations Center;
2. Fax or email the information to the FRB; and
3. Follow up to confirm the alert had been transmitted by the FRB.

FRB contact information and a sample form for notifying the FRB are included in Appendix E.

R5. "Immediately" notify the receiving bank(s) of the fraudulent transactions and ask them to hold or return the funds.

Once cyber thieves have transferred the stolen money to another bank, the thieves will attempt to move the money out as rapidly as possible. A process/plan must be in place for notifying the bank(s) that has received the stolen money and requesting a hold on those funds. The following steps should be taken:

1. Locate phone numbers for bank ACH departments using the FRBs FedACH directory at http://www.fededirectory.frb.org/search_ACH.cfm;
2. Distribute the list of fraudulent transactions to a group of bank employees with calling assignments and instructions to call on the largest items first. Distribute the largest transactions among several employees to facilitate the quickest call-back on the largest transactions;
3. Remind bank employees making the phone calls that the employee at the receiving bank is crucial to recovery. If recovery effort is occurring after normal business hours or extends beyond normal business hours, ask the employee at the receiving bank for an after-hours phone number in case a call back is needed;
4. Document all calls with names, dates, and times;
5. Send a notice of fraudulent activity to the receiving bank(s). A sample form is available at www.ectf.dob.texas.gov. This sample form is **not** endorsed, recommended or required by the Texas Department of Banking or the United States Secret Service. It is provided because it may be useful as a starting point in drafting an appropriate notice of fraudulent activity, with the assistance of bank counsel.
6. If the receiving bank sees that a "Fraudulent File Alert" has arrived from the FRB, they may have greater confidence that not delivering the funds to their customer will not result in liability from their customer; and
7. If the receiving bank employee is reluctant to hold the funds, remind them that this is a theft and minutes are crucial in preventing the theft from being successful. Request to speak to a supervisor.

R6. Implement a contingency plan to recover or suspend any systems suspected of being compromised.

When a system is suspected of being compromised, it is important to close off the method being used to commit the crime.

[20] Some online banking systems create ACH files that include a large number of different customers. The ability to edit the file to remove fraudulent transactions so that the file can be sent for processing of the legitimate transactions of other customers is important. Often the fraudulent transactions occur near the cutoff time when there is not sufficient time to manually re-enter all of the legitimate transactions.

1. If it appears that user credentials of your customer have been compromised, consider immediately disabling your account holder's access to the online banking system.
2. If it appears that the bank's network was compromised, consider shutting down all online corporate banking activity (if that is feasible).

Depending on the size of the theft and potential losses, consider having forensic analysis performed on all suspected compromised systems as soon as possible to determine where, when and how the compromise occurred. Consider paying for the analysis of your account holder's system to help in the bank's discovery of how the crime was committed.[21]

R7. Contact law enforcement and regulatory agencies once the initial recovery efforts have concluded.

Law enforcement and regulatory agencies should be contacted once initial recovery efforts are complete. Have these agency contact numbers available in advance. In addition, a Suspicious Activity Report must be filed with the Financial Crimes Enforcement Network (FinCEN). Agencies to contact include:

1. United States Secret Service (or other federal law enforcement agency)[22];
2. State and local law enforcement; and
3. State and federal bank regulatory agencies.

R8. Implement procedures for customer relations and documentation of recovery efforts.

Since the account holder can be the victim of a large theft, proper handling of the incident is important for customer relations, financial liability, and potentially public relations. Procedures should be in place regarding contacting customers and documenting all discussions. It is important to keep in mind that when an electronic theft is initially discovered, the source of the compromise is sometimes unknown.

1. Designate one employee in the bank as the central point of contact for communicating with the account holder and have a prepared script of the actions the bank is taking to retrieve their funds.
2. Document account holder discussions (note names, date, and times), especially how and when the account holder believes the compromise began.
3. Reassure account holders that the bank is diligently working towards a full recovery of the funds; however, there is no guarantee that a full recovery will be achieved.

RELATED ISSUES

MONEY MULES

Identifying Potential Money Mule Activity[23]

While it is important to prevent and detect thefts from your own corporate customers' accounts, it is also important

[21] The bank's contingency plan needs to include the names of the firms to use for forensic analysis as well as primary and secondary contacts and after hours phone numbers. Perform a review of these vendors in advance. There isn't time to find or fully evaluate a company when a situation occurs. Trade associations and other technology related service-providers may be a good reference source.

[22] Contact your local United States Secret Service field office (http://www.secretservice.gov/field_offices.shtml) or the Secret Service's local Electronic Crimes Task Force (http://www.secretservice.gov/ectf.shtml). Contact information for the local FBI field office can be found at http://www.fbi.gov/contact-us/field/field-offices. You may also want to file a complaint with the Internet Crime Complaint Center (www.ic3.gov.).

[23] Evaluate policies for options to close accounts used to transfer stolen funds to thieves, commonly called "money mule" accounts. Educate bank employees on the characteristics of money mule accounts. Money Mules are often existing account holders that have been recruited through postings of legitimate sounding job offers on popular Internet job sites. However, the "employer" (cyber thief) asks the money mule to receive and then quickly transfer money to another bank; Money Mules are involved in money laundering; and Money Mules may claim to be unaware (and in some cases may actually be unaware) that they are facilitating a theft.

to monitor for thefts that might be passing through your bank through a money mule account.

Warning signs that a bank customer could potentially be a money mule include:

1. New accounts opened with small deposit followed shortly by larger transfers via ACH or wire;
2. J-1 Visa student accounts receiving (unusually) large transfers;
3. New/unusual sources of transferred funds;
4. An existing account with a sudden increase in the number and dollar amount of deposits by ACH credit or wire transfer; and
5. An account that receives a large deposit followed by an immediate withdrawal, or around 10% less than the original deposit.
6. Destination of the monetary transfer that is not typical for the customer

Internal Controls

Certain internal controls can be implemented should your bank be used to move stolen money through a money mule account. Consider the following controls:

1. Establish a central point of contact (and backup) for working with other banks that have account holders that have been victimized;
2. Determine how holds, returns and withdrawals/transfers will be allowed;
3. Determine what documentation will be required before holding or returning funds;
4. Evaluate the history of the account holder that is receiving the potentially stolen funds to determine if the incoming transactions are consistent with prior banking history; and
5. Identify any red flags indicating that the account is or has become a "money mule" account (see above).

APPENDIX A

Resources for Business Account Holders

1. The Better Business Bureau's website on Data Security Made Simpler: http://www.bbb.org/data-security;
2. The Small Business Administration's (SBA) website on Protecting and Securing Customer Information: http://community.sba.gov/community/blogs/community-blogs/business-law-advisor/how-small-businesses-can-protect-and-secure-customer-information;
3. The Federal Trade Commission's (FTC) interactive business guide for protecting data: http://www.ftc.gov/bcp/edu/multimedia/interactive/infosecurity/index.html;
4. The National Institute of Standards and Technology's (NIST) Fundamentals of Information Security for Small Businesses: http://csrc.nist.gov/publications/nistir/ir7621/nistir-7621.pdf;
5. The jointly issued "Fraud Advisory for Businesses: Corporate Account Takeover" from the U.S. Secret Service, FBI, IC3, and FS-ISAC available on the IC3 website (http://www.ic3.gov/media/2010/CorporateAccountTakeOver.pdf) or the FS-ISAC website (http://www.fsisac.com/files/public/db/p265.pdf); and
6. NACHA – The Electronic Payments Association's website has numerous articles regarding Corporate Account Takeover for both financial institutions and banking customers: http://www.nacha.org/c/Corporate_Account_Takeover_Resource_Center.cfm .

APPENDIX B

Examples of Deceptive Ways Criminals Contact Account Holders

1. The FDIC does **not** directly contact bank customers (especially related to ACH and Wire transactions, account suspension, or security alerts), nor does the FDIC request bank customers to install software upgrades. Such

messages should be treated as fraudulent and the account holder should permanently delete them and not click on any links.

2. Messages or inquiries from the Internal Revenue Service, Better Business Bureau, NACHA, and almost any other organization asking the customer to install software, provide account information or access credentials is probably fraudulent and should be verified before any files are opened, software is installed, or information is provided.

3. Phone calls and text messages requesting sensitive information are likely fraudulent. If in doubt, account holders should contact the organization at the phone number the customer obtained from a different source (such as the number they have on file, that is on their most recent statement, or that is from the organization's website). Account holders should not call phone numbers (even with local prefixes) that are listed in the suspicious email or text message.

APPENDIX C

Incident Response Plans

Since each business is unique, customers should write their own incident response plan. A general template would include:

1. The direct contact numbers of key bank employees (including after hour numbers);
2. Steps the account holder should consider to limit further unauthorized transactions, such as:
   a. Changing passwords;
   b. Disconnecting computers used for Internet banking; and
   c. Requesting a temporary hold on all other transactions until out-of-band confirmations can be made;
3. Information the account holder will provide to assist the bank in recovering their money;
4. Contacting their insurance carrier; and
5. Working with computer forensic specialists and law enforcement to review appropriate equipment.

APPENDIX D

Information Security Laws and Standards Affecting Business Owners

Although banks are not responsible for ensuring their account holders comply with information security laws, making business owners aware of consequences for non-compliance if the information is breached can reinforce the message that they need to maintain stronger security. Breaches of credit and debit card information from retail businesses are common. Loss of that information or sensitive personal information can create financial and reputational risks for the business.

When providing security awareness education to corporate customers, banks may want to also alert business owners of the need to safeguard their own customers' sensitive information. Texas statutes related to safeguarding customer information include:

1. Chapter 521 of the Texas Business and Commerce Code, which is known as Identity Theft Enforcement and Protection Act, provides that penalties of up to $50,000 may be imposed for violations. See §521.053 Notification Required Following Breach of Security of Computerized Data. http://www.statutes.legis.state.tx.us/Docs/BC/htm/BC.521.htm#521.053; and

2. Chapter 72 of the Texas Business and Commerce Code relates to disposal of business records. This statute addresses paper and electronic records/information, including information stored on photocopy machines and printers. http://www.statutes.legis.state.tx.us/Docs/BC/htm/BC.72.htm.

The Payment Card Industry Security Standards Council was launched in 2006 to manage security standards related to card processing. Any merchant that accepts credit or debit cards for payment is required to secure their data based on the standards developed by the council. The PCI Security Standards Council's website https://www.pcisecuritystandards.org/security_standards/index.php notes that noncompliance may lead to lawsuits, cancelled accounts, and monetary fines. The website provides information for small business compliance.

APPENDIX E

Procedures for Sending a Fraudulent ACH File Alert Request to the Federal Reserve Bank

The following information is valid as of September 2011. Banks should update their FRB contact information at least annually as part of updating their incident response plan.

1. **Contact FRB Operations and/or your representative with the Federal Reserve.**

   Contact information for FEDACH Central Operations Support can be located on the Federal Reserve Bank Services website @ www.frbservices.org/contactus/fedach_operations.html.

   Contact information for FRB Dallas Account Executives can be located on the Federal Reserve Bank Services website @ www.frbservices.org/contactus/sales_account_executives.html#dallas.

2. **Fax or email the following information to your Federal Reserve contact.**

   The following sample form is not endorsed, recommended or required by the Texas Department of Banking or the United States Secret Service. It is provided because it may be useful as a starting point in drafting an appropriate fraudulent ACH file alert, with the assistance of bank counsel and your Federal Reserve contact.

   SAMPLE MESSAGE

   A FRAUDULENT file was processed for ___________________ (*Bank Name & ABA*) in error on __________ (mm/dd/yy). The original file was processed on __________ (mm/dd/yy) with settlement of __________ (mm/dd/yy). The FRAUDULENT file was processed on __________ (mm/dd/yy) and will settle on _________ (mm/dd/yy). A reversal file was processed on ___________ (mm/dd/yy) and will settle on _________ (mm/dd/yy). For additional information, contact _________________ (*Bank Name*) at ______ (*Bank's phone number*).

   ______________ (*Bank Name & ABA*) hereby assumes all responsibility and liability for any processing errors, losses, damages, and liability in any way arising out of the transmission of the broadcast message. ______________ (*Bank Name & ABA*) also agrees to indemnify and hold harmless the Federal Reserve Bank, its agents and employees, from and against all claims, damages, lawsuits, and expenses, including reasonable attorneys' fees, in any way arising out of the transmission of the broadcast message.

3. **Follow up and confirm that the message has been transmitted.**

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SUPERVISORY MEMORANDUM – 1030

February 19, 2013

TO: All State-Chartered Trust Companies
All Bank and Trust Examining Personnel

FROM: Charles G. Cooper, Banking Commissioner

SUBJECT: Policy on Enforcement Actions for Trust Companies

OVERVIEW

The purpose of this Memorandum is to set forth the circumstances under which enforcement actions are used by the Department of Banking (Department) with regard to the trust companies under its regulation, and to specify the general methodology which is followed. An enforcement action is designed to address and correct specific problems identified within the financial and operational affairs of trust institutions, and is an essential element of effective regulation.

PUBLIC DISCLOSURE OF ENFORCEMENT ACTIONS

Other than final Prohibition or Removal Orders, Department enforcement actions, whether informal or formal, are confidential. The Banking Commissioner has discretion to publicize final Cease and Desist Orders, final Administrative Penalty Orders, Supervision Orders, and Conservatorship Orders if the Commissioner concludes that the release would enhance effective enforcement of the order.

DEFINITIONS

"Management" includes trust company officers as well as trust company directors.

"Regulatory responses" are actions taken by the Department in response to particular conditions at a trust company. They include informal communications as well as enforcement actions.

POLICY FOR IMPLEMENTING ENFORCEMENT ACTIONS

Regulatory responses are initiated whenever the Department becomes aware of situations or issues that weaken the safety and soundness of an institution, or that arise from noncompliance with policies, procedures, regulations, or laws. To assure uniformity of action and to ensure that supervisory efforts are directed to trust companies exhibiting elevated risk profiles or other major deficiencies, the general policy of the Department is to initiate enforcement actions on trust companies with composite CAMEL ratings of "3," "4," or "5," and on trust companies with composite modified Uniform Interagency Trust Rating System (UITRS) ratings of "3," "4," or "5." (See the definition of trust company CAMEL ratings and UTRIS ratings in Supervisory Memorandum – 1002.) Trust companies rated "1" or "2" generally do not warrant an enforcement action, although the Department may initiate an action depending on the specific circumstances of the institution. In particular, trust companies have Information Technology examinations and Bank Secrecy Act examinations that may reveal the need for an enforcement action even though the trust company has a composite rating of "1" or "2."

Enforcement actions often set forth the practices, conditions, and violations giving rise to the particular problems or weaknesses identified. The actions also outline specific corrective measures, often including appropriate time frames and goals for achievement. Specific types of enforcement actions available to the Department are outlined below in the section "Types of Enforcement Actions."

The Department's enforcement actions are not part of a hierarchy; they are not designed to build on one another. On a case by case basis, the Department thoroughly analyzes the situation at the trust company and designs the action it believes to be the most effective in curing the trust company's adverse conditions.

TRUST COMPANY RATINGS

1-Rated Trust Companies

A composite "1" rating implies that a trust company is sound in all respects and that any weaknesses or deficiencies are so insignificant or immaterial that they pose no supervisory concern. Regulatory responses are generally limited to informal requests for future plans and/or a written response from the trust company regarding the examiner's findings as indicated in the report of examination.

2-Rated Trust Companies

Trust companies having a composite rating of "2" are fundamentally sound. Identified weaknesses or deficiencies are generally of a moderate nature and correction is attainable in the normal course of business. Regulatory responses are the same as for 1-rated trust companies; however, a Board Resolution may be initiated depending on specific circumstances encountered. In instances of repeated or willful law violations and/or continuing unsound trust company practices, the issuance of a stronger enforcement action may be warranted.

3-Rated Trust Companies

A composite "3" rating implies that a trust company has weaknesses which, if not corrected, could worsen into a more severe situation. Regulatory responses will most likely be enforcement actions which require remedial action.

4 and 5-Rated Trust Companies

Trust companies with composite ratings of "4" or "5," by definition, have problems of sufficient severity to warrant a strong regulatory response. An enforcement action such as a Cease and Desist Order is issued when there is evidence of unsafe and unsound practices or conditions. Exceptions to this policy are considered only when the condition of the trust company clearly reflects significant improvement resulting from an effective correction program or where individual circumstances militate against the appropriateness or feasibility of strong enforcement actions.

TYPES OF ENFORCEMENT ACTIONS

Enforcement actions are either formal or informal. With the exception of Determination Letters, informal enforcement actions are voluntary commitments made by trust company management designed to correct identified deficiencies and ensure compliance. Formal enforcement actions are generally more severe and result in an order issued by the Commissioner. Trust companies have a statutory right of appeal from formal enforcement actions to which they have not agreed.

A. Informal Enforcement Actions

Board Resolutions: A Board Resolution is a statement adopted by the board of directors of a trust company that specifies corrective actions the board of directors will take. It is issued either on management's own volition or at the request of the Department. Board Resolutions are accepted from trust companies that exhibit only modest regulatory concerns.

Memorandum of Understanding: A Memorandum of Understanding is an agreement between a trust company and the Commissioner that sets forth specific corrective actions to be undertaken by the board of directors of a trust company. This action is normally pursued with trust companies where management does not pose a significant regulatory concern, and where the Department believes management has the ability and the willingness to correct noted deficiencies. A Memorandum of Understanding is an agreement within the meaning of Texas Finance Code Sections 181.002(a)(22)(B) and 185.002. Therefore, violation of a Memorandum of Understanding is grounds for issuance of a Cease and Desist Order, and, if other conditions are met, a Supervision or Conservatorship Order. A Memorandum of Understanding may occasionally have a different title.

Determination Letter: A Determination Letter is a warning issued pursuant to Section 185.001 of the Texas Finance Code that the practices or condition of a trust company need immediate attention to avoid the issuance of an enforcement order under the Texas Finance Code. A Determination Letter includes a listing of the requirements to abate the Commissioner's determination. A Determination Letter is normally used in a trust company where problems are of a serious nature, but the Commissioner believes that a more formal enforcement action may not be necessary to achieve correction.

B. Formal Enforcement Actions

Cease and Desist Order: A Cease and Desist Order is issued pursuant to Section 185.002 of the Texas Finance Code, demanding that an officer, employee, director, or manager of a trust company, or the trust company itself discontinue violations and/or unsafe and unsound practices, and take certain affirmative action as may be necessary to correct the conditions resulting from such violations or practices. A Cease and Desist Order is deemed necessary and appropriate for serious violations and unsafe practices. Management of a trust company subject to such an order would normally have demonstrated a disregard for safe and sound trust company practices and/or the lack of willingness or ability to correct deficiencies on their own. If a trust company agrees to enter into such an order, the order is called a Consent Order. The Commissioner may publish a final Cease and Desist Order or Consent Order pursuant to Section 185.012.

Order of Removal or Prohibition: A Removal or Prohibition Order is issued pursuant to Section 185.003 of the Texas Finance Code if the Commissioner finds that a present or former officer, director, manager, managing participant, or employee, controlling shareholder or participant, or other person participating in the affairs of a state trust company has committed or participated in violations of law or agreements, and/or unsafe and unsound trust company practices, or made false entries, which caused certain effects, and which were done in other than an inadvertent or unintentional manner. Such orders have the effect of removing a person from office or employment or prohibiting a person from office, employment, or any further participation in the affairs of a state trust company or any other entity chartered, registered, permitted, or licensed by the Commissioner. The Commissioner must publish all final Removal and Prohibition Orders.

Order of Supervision: Pursuant to Section 185.101 of the Texas Finance Code, upon determining that a trust company is in hazardous condition as defined by Texas Finance Code Section 181.002(a)(22), the Commissioner may issue an Order of Supervision without prior notice to appoint an individual as a supervisor of the trust company. Supervision is generally used in situations where the Commissioner has little confidence in the ability or willingness of the management of the trust company to follow safe and sound trust company practices. The authority of a supervisor, (enumerated under Section 185.106), includes acting as the Commissioner's on-site observer and agent to assure, through veto authority and/or moral suasion, that the trust company is operated properly and in accordance with law and the enforcement action.

Order of Conservatorship: A Conservatorship Order may be issued by the Commissioner pursuant to Section 185.102 of the Texas Finance Code when it is determined that a trust company is in hazardous condition and immediate and irreparable harm is threatened to the trust company, its depositors, creditors, clients, shareholders or participants, or the public. Under Section 185.107, the board of directors may not direct or participate in the affairs of the trust company during conservatorship. An appointed conservator immediately takes charge of the trust company, its property, books and records, and affairs on behalf of and at the direction and control of the Commissioner.

Administrative Penalties: If a trust company or person commits applicable violations of law or a Commissioner’s order (see Section 185.009), the Commissioner may seek to assess monetary fines or penalties. The trust company or person is notified that a hearing will be held to determine whether administrative penalties will be assessed. Unless the violation is of a Commissioner’s order, the trust company or person will be given an opportunity to correct the action and reduce or avoid the penalty.

Section 185.010(b) sets out factors the Commissioner must consider when setting the penalty and Section 185.010(c) sets out minimum and maximum penalty amounts.

PROCEDURE FOR IMPLEMENTING ENFORCEMENT ACTIONS

Board Resolutions, Memorandums of Understanding, and Determination Letters are normally handled through written correspondence with the board of directors of a trust company. Nevertheless, they may require a special meeting of the board of directors. Other enforcement actions usually require a special meeting of the directorate of the trust company and generally such meetings are conducted by senior Department officials, including a member of the legal staff, at the Austin headquarters office.

Follow-up by examining personnel on enforcement actions is conducted in accordance with the Department's examination priorities unless variance from policy is deemed necessary. A trust company that is placed under Supervision or Conservatorship will have the appointed supervisor or conservator assist in monitoring compliance with enforcement orders.

SUPERVISORY MEMORANDUM – 1032

November 8, 2013

TO: All State-Chartered Trust Companies
All Bank and Trust Examining Personnel

FROM: Charles G. Cooper, Banking Commissioner

SUBJECT: Policy on Other Real Estate Owned[1]

OVERVIEW

This policy statement interprets the state statutes and rules governing other real estate and defines the Department's classification policy for OREO for state-chartered trust companies.

Section 184.003 of the Texas Finance Code authorizes a state trust company to hold real estate other than its trust company premises in limited circumstances. Title 7, Section 19.51 of the Texas Administrative Code (7 TAC §19.51) defines other real estate; describes the limited circumstances under which it can be lawfully acquired by a trust company; outlines the appraisal/evaluation requirements; establishes a procedure whereby additional expenditures may be made; defines a maximum holding period for each parcel; and outlines the minimum criteria for disposition efforts by a trust company.

ACCOUNTING FOR OREO

Initial Booking

Under 7 TAC §19.51, OREO must be accounted for in accordance with regulatory accounting principles,[2] defined in the Texas Finance Code as generally accepted accounting principles (GAAP) as modified by rules adopted under the Code or an applicable federal statute or regulation.

Each parcel of OREO should be recorded at the fair value less costs to sell the property, which becomes the "cost" of the foreclosed real estate. If the fair value (less the estimated costs to sell) exceeds the recorded amount of the loan, the excess should be reported as a recovery of a previous charge-off on the loan or in current earnings, as applicable.[3] If the recorded value of the loan exceeds the fair value of the foreclosed property minus estimated selling costs upon initial booking, the deficiency is a loss which should be charged to the Allowance for Loan and Lease Losses.

The recorded value is the outstanding principal balance of the loan *plus* any booked accrued and unpaid interest (not to exceed 90 days) *plus* any unamortized premium and loan acquisition costs, *less* previous write-downs, finance charges, and any unamortized discount. Title insurance and other direct costs associated with acquiring clear title to the property are allowed as a recorded value. Direct costs incurred by the trust company in a foreclosure, such as legal fees, should be expensed when they are incurred.

Accounting for Other Liens

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[1] This policy revises and supersedes the policy dated May 10, 2013 which clarified the definition of recorded value. Current revisions address the change in the holding period for former future expansion property and the treatment of OREO related to a merger, acquisition, or charter conversion.

[2] In general, the accounting and reporting standards for foreclosed real estate are set forth in Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) Topic 310-40, *Troubled Debt Restructurings by Creditors*, and ASC Topic 360-10-35, *Impairment or Disposal of Long-Lived Assets*

In accordance with FASB ASC Topic 360 (formerly FASB 144, Accounting for the Impairment of Disposal of Long-Lived Assets) the amount of any senior debt (principal and accrued interest) to which the other real estate is subject (even if not formally assumed by the trust company) should be reported as a liability at the time of foreclosure. The carrying amount of the asset would, therefore, be increased by such amount; however, the resulting carrying amount cannot exceed the market value, net of estimated sales costs, of the property. Any subsequent payments of principal should reduce the liability. Interest that accrues after foreclosure should be recognized as interest expense and added to the liability account balance if left unpaid.

Subsequent Costs

Ongoing expenses *not* associated with acquiring clear title to the property (i.e., taxes, hazard insurance, utilities, etc.) should be expensed as incurred. Costs incurred to protect a trust company's investment in OREO which is improved or under construction, and necessary to place a property in a saleable condition, may be capitalized in accordance with GAAP. Additional investments which alter the current status or intended use of the property or made for the purpose of speculating in real estate are not allowed under the law.

APPRAISALS AND EVALUATIONS

As provided in 7 TAC §19.51(e), when OREO is acquired, a state trust company must substantiate the market value by obtaining a qualifying valuation (either an appraisal or an evaluation, depending upon which one applies), within 60 days from the date of the property's acquisition by the trust company. For purposes of this section, the term "qualifying valuation" will be used to mean either an "appraisal" or "evaluation."

If the trust company has already obtained a qualifying valuation within the year prior to foreclosure, as provided in 7 TAC §19.51(e) (2), then a new valuation is not yet required. Except for the initial 60 day grace period after acquisition, OREO properties must be supported at all times by a qualifying valuation prepared within the last year. Therefore, if a valuation was obtained six months prior to the foreclosure date, then an updated valuation is not required until six months after the foreclosure date.

An evaluation may be substituted for an appraisal if the recorded book value of OREO is less than $250,000.

An evaluation shall be made on all OREO at least once a year. An appraisal shall be made at least once every three years on OREO with a recorded book value in excess of $250,000.

If any subsequent qualifying valuation indicates a reduction in the value of a property below the current book value, FASB ASC 360 (formerly FASB 144) requires the trust company to recognize the deficiency as a valuation allowance against the asset, which is created through a charge to expense. For reporting purposes, the reserve account should be netted against the book value of the OREO and is not considered as part of the trust company's capital structure. The valuation allowance should thereafter be increased or decreased (but not below zero) through charges or credits to expense for changes in the asset's value or estimated selling costs. In no event, however, should the carrying value of the property be increased to an amount greater than the original book value at the time of acquisition or transfer to the other real estate category.

Maintenance of a general reserve for losses on the sale of OREO and write-downs below appraised value are not consistent with generally accepted accounting principles. Write-downs below appraised value should be supported by reasonable documentation.

HOLDING PERIOD FOR OREO

Holding Period Limit

Texas statutes require that a state-chartered trust company dispose of OREO within five years from the date the real property:

- is originally acquired or transferred to that asset category;
- ceases to be used as a trust company facility; or

- ceases to be considered future expansion property as a trust company facility as provided in §184.002 (b) of the Texas Finance Code[4].

When a state chartered trust company acquires OREO as the result of a merger with or an acquisition of another institution, the holding period of the newly acquired OREO commences on the date of merger or acquisition. If an entity converts to a state-chartered trust company, the OREO property held by the entity at the time of conversion will be considered acquired or transferred to OREO as of the conversion date.

The banking commissioner may grant an extension of time for disposing of an OREO property if, in the commissioner's opinion, the trust company has made a good faith effort to dispose of the property, or if the commissioner determines that disposal of the property within the initial five-year period would be detrimental to the trust company. Should the extension request be denied, failure to dispose of the property may result in citing a violation of 7 TAC §19.51 at the next examination. Examining personnel will review the trust company's efforts to dispose of each property and evaluate compliance with the regulation. Continued noncompliance and/or absence of good faith efforts to dispose of the property may result in the issuance of an enforcement action to effect correction.

Criteria for Holding Period Extensions

All requests for extensions of holding periods must be in writing and should provide, at a minimum, the information outlined below. The form to assist in the request for an extension is in the Appendix.

Extensions for future expansion will be handled on a case-by-case basis. Primary factors that are considered by the Department in evaluating compliance with the law and in deciding whether to approve requests for extensions of holding periods include the following:

- Carrying value of the property in relation to current market value, asking price, and purchase offers received;
- Length of time the property has been held and reason(s) why it has not been sold;
- Income and expenses associated with ownership and maintenance of the property for: (i) all prior years; (ii) the current year; and, (iii) an estimate of next two years; and
- Potential or known contingent liabilities (e.g., environmental concerns, litigation, etc.) relative to the holding of the property.

Extensions for holding property, other than future expansion, are not normally granted if the extended time exceeds ten years from the original date of acquisition (or the date a former trust company facility was reclassified as OREO).

DISPOSAL OF OREO

Minimum Documentation Requirements

Under 7 TAC §19.51(h), trust companies are expected to maintain documentation showing compliance with the regulation and good faith efforts to dispose of each parcel of OREO. Required minimum documentation includes:

- Specific action plans for disposal of each parcel of OREO showing review and approval by the trust company's board of directors or a designated committee thereof. Such action plans and reviews should be recorded in the official records of the board or committee meetings;

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[4] Although Finance Code §184.002(c) and §184.003(c) provide conflicting disposal periods for ORE formerly held as future expansion property, §184.002(c) takes precedence over §184.003(c) because it is more recently amended, as provided in the Code Construction Act (Gov't Code §311.025(a)).

- Listing agreements executed with real estate agents/brokers detailing the asking price and terms of sale. If a property is not listed, adequate documentation showing the trust company's own marketing efforts must be maintained;
- Documented reasonableness of the asking price relative to the appraised market value of the property;
- Records of all verbal and/or written inquiries and offers received for each property;
- Decisions made and actions taken by the board, or designated committee, on all verbal or written offers received; and
- Files of all advertising media employed, e.g., signs, publications, and broadcast media.

Exchange, Acceptance or Additional Purchases

With the prior written approval of the banking commissioner, a trust company may exchange or acquire real estate or personal property in order to avoid or minimize loss potential on OREO. Alternate or additional real estate so acquired should be accounted for on the trust company's books as OREO, and the initial holding period for such properties will be measured from the date legal title to the original OREO was first acquired by the trust company. Disposal of personal property should be within 90 days of acquisition.

Criteria for Exchanging or Acquiring Additional OREO

The commissioner's decision to approve or deny requests for the exchange or acquisition of real estate will be made after considering all relevant factors of the transaction, particularly the following:

- Has the trust company demonstrated good faith efforts to dispose of the original OREO?
- Has the trust company reduced its loss exposure as evidenced by current market value appraisals of the properties involved?
- Does the trust company have specific plans to market the newly acquired property?
- What is the amount of cash to be received by the trust company in connection with a transaction where the trust company is accepting an alternate parcel of real estate as partial consideration in the sale of existing OREO?
- Will the nature of the original OREO be changed?
- What is the trust company's aggregate investment in the existing OREO plus the property to be acquired in relation to equity capital?

Transfer of OREO to Subsidiary or Affiliate

Title 7, Section 19.51(i) of the TAC addresses the various options for disposition of OREO. Among those options are transfers to a majority-owned subsidiary or sale to an affiliate.

Section 19.51(i) (4) provides that a trust company may dispose of real estate by transferring the real estate for market value to an affiliate. This is subject to Section 183.109 of the Texas Finance Code and applicable federal law, including 12 U.S.C. §§371c, 371c-1, and 1828(j) (relating to transactions with affiliates) if the trust company is a subsidiary of a bank holding company.

CLASSIFICATION STANDARDS

The Department evaluates OREO in the same manner as any other trust company-owned asset, utilizing the same criteria for assessing quality and propriety. As warranted, adverse criticism is assigned in a manner consistent with the uniform classification standards used by state and federal bank regulatory agencies.

Income producing properties may be excluded from classification provided the annual net cash flow from the property yields a market rate of return on the entire book amount. "Net cash flow" is defined by GAAP as gross cash receipts less the cost of insurance, taxes, management fees, and other operating costs. For purposes of the classification treatment outlined below, the market rate of return must equal or exceed the average yield on real estate loans as reflected in the trust company's most recent reports of condition and income plus 100 basis points. If book value is materially less than the market value of the property due to previous unsubstantiated write downs, for classification purposes the rate of return is calculated using the market value of the asset.

Suggested classification treatments are shown below and assume that the examiner has no material reservations with the validity of the appraisal or its assumptions. In the case of income producing properties, the assumption is also made that there are no significant reservations about the quality and continued viability of the future cash flow stream of the property. However, if an examiner has reasonable cause to question the appraisal, its assumptions, or the future cash flow stream, more severe classifications than those shown may be assigned.

Income Producing Properties

- **Pass** - Consider income and expenses generated by the property and any other factors affecting the probability of loss exposure.
- **Substandard** - Consider income and expenses generated by the property and any other factors affecting the probability of loss exposure.
- **Doubtful** - N.A. (this classification is generally not appropriate).
- **Loss** - Excess of book value over current appraised value.

Non-income Producing Properties

- **Substandard** - Current appraised value.
- **Doubtful** - N.A. (this classification is generally not appropriate).

Loss - Excess of book value over current appraised value.

Appendix
Application to Extend Holding Period on Other Real Estate Owned (OREO) (October 2013)

BANK / TRUST COMPANY NAME:	DATE:
CITY:	CHARTER NO.:
OREO NAME:	
DESCRIPTION OF PROPERTY AND IMPROVEMENTS:	

DATE ACQUIRED: ______	ORIGINAL BOOK VALUE: ______
ACQUIRED THROUGH MERGER, ACQUISITION, OR CONVERSION? YES NO	LESS: WRITE DOWNS
PERCENT OWNED: %	
OTHER OWNERS	SALES ______
NAMES / %	RESERVES ______
NAMES ______ / %	CURRENT BOOK VALUE

SUPERIOR LIEN:		
NAME:		AMOUNT:
TYPE:	TERMS:	
CONTINGENT LIABILITIES:		
AMOUNT:	DESCRIPTION:	
AMOUNT:	DESCRIPTION:	

INCOME DATA: *(EXCLUDE AMOUNTS CHARGED-OFF OR EXPENSED FOR SPECIFIC RESERVES)*

	DATES	INCOME	EXPENSES	NET
2 YEAR PROJECTION				
1 YEAR PROJECTION				
YEAR TO DATE				
LAST 12 MONTHS				
TOTAL OF PRIOR YEARS				

DESCRIBE TYPE OF ANY INCOME RECEIVED:

DESCRIBE LEASES OR CONTRACTS:

APPRAISAL HISTORY: *(LIST THE THREE MOST RECENT APPRAISALS)*

NAME OF APPRAISER	DATE	VALUE

MARKETING INFORMATION: *(INCLUDE THE LAST THREE LISTING AGENTS AND ASKING PRICES)*

AGENT(S)	LISTING PERIOD	ASKING PRICE

DESCRIBE OTHER INTERNAL OR EXTERNAL MARKETING EFFORTS:
(INCLUDE DATES AND TYPES OF MEDIA ADVERTISING)

INQUIRIES AND OFFERS:

WHO	DATE	AMOUNT	REASON REJECTED

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SUPERVISORY MEMORANDUM – 1033

September 30, 2015

TO: Chief Executive Officers of State-Chartered Trust Companies and all Bank and Trust Examination Personnel

FROM: Charles G. Cooper, Banking Commissioner

SUBJECT: Level II Full Scope Examinations for Trust Companies[1]

PURPOSE

The purpose of this Supervisory Memorandum is to provide written guidelines under which a Level II Full Scope Examination (Level II) utilizing risk focused examination procedures may be conducted and considered acceptable to meet the Texas Department of Banking (Department) examination requirements of the Texas Finance Code §181.104 and Supervisory Memorandum 1004 - Examination Frequency for Trust Companies. Under a Level II program, qualifying institutions that are determined to present a low risk profile based on specific criteria may receive an examination focusing on the highest risk areas in lieu of the more comprehensive Level I Full Scope Examination (Level I). The Department has determined that this program can be implemented without materially jeopardizing the agency's mission to ensure that Texas state-chartered trust companies are operating in a safe and sound manner and in compliance with applicable banking statutes and supervisory guidelines.

OVERVIEW

The Department's on-site examinations in combination with off-site monitoring ensure that the inherent risks in the banking system and individual trust companies are assessed and monitored. These supervisory methods have also allowed the Department to identify institutions that present a low risk profile. These trust companies have historically received composite CAMEL[2] and MOECA[3] ratings of 1 or 2 and exhibit management practices that are risk adverse and which consistently adhere to safe and sound practices and procedures. The Department has reviewed and considered other factors such as the longevity and quality of leadership, current business plan and regulatory history in determining characteristics conducive to a trust company receiving a Level II examination. A Level II examination will be documented in a Report of Examination to the trust company. CAMEL and MOECA ratings will be issued.

ELIGIBILITY

Trust Companies that meet the below criteria are eligible to receive a Level II examination as determined by the Chief Trust Examiner.

1) The institution has received a composite CAMEL and MOECA ratings of either 1 or 2 at the last two examinations and is not subject to an administrative or enforcement action of any type;
2) There has been no change in the ownership or executive officers, or a significant change in board composition within the last 12 months;
3) There has been no change in the types of fiduciary accounts administered by the trust company since the last two examinations;
4) The institution is not a de novo trust company and has been operating for at least five years;

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1 Current revisions to this policy update the contact information for the Chief Trust Examiner.
2 The Trust Company Rating System includes the evaluation and rating of Capital adequacy, Asset Quality, Management, Earnings and Liquidity (CAMEL).
3The Uniform Interagency Trust Rating System includes the evaluation and rating of the Management; Operations, Internal Controls and Audits; Earnings; Compliance, and Asset Management (MOECA)

5) The institution is not under any type of special monitoring or has become a concern to the Department through its off-site monitoring program, a substantial change in its business plan, or other factors as determined by the Commissioner; and

6) The institution received a Level I examination within the preceding 24 months.

WHAT TO EXPECT

Institutions selected for a Level II examination will be informed by the Examiner-in-Charge (EIC) before the examination begins and will receive a reduced list of required examination documents. The length of the on-site portion of the examination should be reduced as well as the number of Department personnel participating in the examination. The examination will follow the Department's pattern of regular communication including a management exit meeting to review the findings in detail and a Board meeting to review the overall conclusions of the examination. A written examination report will be issued.

EXAMINATION SCOPE

The Level I examination is the Department's most comprehensive examination program conducted. The Level I examination follows the Department's standard risk-focused procedures. Under the Level II program, examiners focus on the highest risk areas of the trust company, while excluding certain operational assignments determined to be of lower risk due to the nature of the trust company's activities. Examiners will continue to review all critical aspects of the trust company's operations to the extent needed to assign appropriate CAMEL and MOECA ratings. The Bank Secrecy Act /Anti-Money Laundering (BSA/AML) compliance review will continue to be thorough and comprehensive.

If at any point during a Level II examination, the Department's review findings indicate increased risk, less than satisfactory compliance or additional exposure, the scope of the examination will be expanded to thoroughly assess the areas of concern.

CONTACT INFORMATION

Questions regarding this guidance may be directed to either Kurt Purdom, Director of Bank & Trust Supervision, at (512) 475-1333 or Mark Walker, Chief Trust Examiner, at (979) 213-0968.

SUPERVISORY MEMORANDUM – 1034

January 25, 2013

TO: All State-Chartered Banks
All Bank and Trust Examining Personnel

FROM: Charles G. Cooper, Banking Commissioner

SUBJECT: Level II Full Scope Examinations – Information Technology

PURPOSE

The purpose of this Supervisory Memorandum is to provide written guidelines under which a Level II Full Scope Examination (Level II) utilizing risk focused Information Technology (IT) examination procedures may be conducted and considered acceptable to meet the Texas Department of Banking (Department) examination requirements of Texas Finance Code §31.105 and Supervisory Memorandum 1020 – Information Technology Examination Frequency and Ratings. Under a Level II program, qualifying institutions that are determined to present a low IT risk profile based on specific criteria, may receive an examination focusing on the highest risk areas in lieu of the more comprehensive, Level I Full Scope Examination (Level I). The Department has determined that this program can be implemented without materially jeopardizing the agency's mission to ensure that Texas state-chartered banks are operating in a safe and sound manner and in compliance with applicable banking statutes and supervisory guidelines.

OVERVIEW

A financial institution's exposure to risk through its IT operations is aligned with the complexity and nature of its operations. A complete assessment of the risk profile of an institution requires that all major areas of operation be evaluated. Therefore, an IT review should generally be conducted before or concurrent with each safety and soundness (S&S) examination of both banks and trust companies.

The Department believes that IT examinations of financial institutions with low technology risk can be performed using examination procedures focusing on the highest risk areas. Therefore, the Department is implementing the Level II examination program for examiners to utilize. This Administrative Memorandum provides guidance and outlines the processes for the Level II reviews.

ELIGIBILITY

Institutions that meet the below criteria are eligible to receive a Level II examination as determined by the Chief IT Security Examiner.

1) The institution has received an IT rating of either 1 or 2 at the last two examinations and is not subject to an administrative or enforcement action of any type;
2) The institution does not exceed $500 million in total assets as of its last call report; and
3) The institution received a Level I examination within the preceding 24 months.

EXAMINATION PROCESS

Review of policies, procedures and other documentation as well as report processing may be performed off site. At least one day on-site will be required to follow the Department's pattern of regular communication including a management exit meeting. On site activity will include reviewing the findings in detail with management and discussing the overall conclusions of the examination. A written examination report will be issued as usual.

EXAMINATION SCOPE

The Level I examination is the Department's most comprehensive examination program conducted. The Level I examination follows the Department's standard risk-focused procedures. Under the Level II program, examiners follow the standard risk-focused procedures but will focus on the highest risk areas of the bank while excluding certain assignments determined to be of lower risk to the safety and soundness of the institution. Examiners will continue to review all critical aspects of the banks operations to the extent needed to assign a composite rating.

The following procedures will be performed during a Level II Review:

1) #10 - Planning and Control which includes a review of the Information Technology Officer's Questionnaire (ITOQ) and an analysis prepared by an IT Specialist as well as the completion/approval of the Level II Eligibility Form;

2) #11- IT–Risk Management Program (RMP) Work Program which includes a review of the ITOQ and the completion of the following sections of the IT RMP:

   - Part 1 (Risk Assessment);
   - Part 3 (Audit);
   - Part 4 (Disaster Recovery); and
   - Part 6 (Interagency Guidelines Establishing Information Security Standards).

   Part 2 (Operations) and Part 5 (Vendor Management and Service Provider Oversight) of the IT RMP will be completed at the discretion of the EIC or if responses in the ITOQ warrant further review;

3) #5 - Wire Transfer/ACH;

4) #14 - ID Theft Red Flags,

5) #15 - Remote Deposit Capture (RDC);

6) #16 - Unlawful Internet Gambling (UIGEA); and

7) #17 - Corporate Account Takeover

The ID Theft Red Flags and the UIGEA procedures may be waived at a Level II examination if they were performed at a previous examination and no problems or issues were identified. The RDC procedure may be waived if the institution does not provide this service.

If at any point during a Level II examination, the Department's review findings indicate increased risk, less than satisfactory compliance or additional exposure, the scope of the examination will be expanded to thoroughly assess the areas of concern.

Questions regarding this guidance may be directed to the Director of Bank & Trust Supervision, at (512) 475-1333 or the Chief IT Security Examiner at (817) 640-4050.

SUPERVISORY MEMORANDUM – 1039

May 11, 2015

TO: All State-Chartered Banks
All Bank and Trust Examining Personnel

FROM: Charles G. Cooper, Banking Commissioner

SUBJECT: Bargain Purchases and Assisted Acquisitions

PURPOSE

The Texas Department of Banking generally agrees with the federal *Interagency Supervisory Guidance on Bargain Purchases and FDIC- and NCUA-Assisted Acquisitions*, issued June 7, 2010[1] (Federal Guidance). Since its issuance, the Department has been applying the Federal Guidance in approval of state bank acquisitions but with certain differences. This Supervisory Memorandum clarifies the differences between the Department's treatment of bargain purchases and that described in the Federal Guidance.

SUPERVISORY CONSIDERATIONS

The Federal Guidance addresses supervisory considerations related to business combinations that result in bargain purchase gains and the impact such gains have on the acquisition approval process. The Federal Guidance indicates that an acquiring bank's primary federal regulator shall have the authority to approve applications for acquisitions and business combinations and apply conditions of approval regarding capital preservation, dividend limitations, auditing requirements, independent valuations, and lending limit requirements. Such guidance does not diminish the Department's separate authority under state law to establish conditions for approval of, and to approve, state bank acquisitions and business combinations.

Neither this Supervisory Memorandum nor the Federal Guidance add to or modify existing regulatory reporting requirements issued by the Department, the federal bank regulatory agencies, other regulatory agencies, or current accounting requirements under generally accepted accounting principles (GAAP). Institutions and examiners should refer to the relevant GAAP literature and regulatory reporting instructions for appropriate accounting and reporting guidance.

CONDITIONS IN APPROVAL OF ACQUISITIONS

The Department generally will apply the Federal Guidance in considering state bank applications for Banking Commissioner approval to acquire other financial institutions, substantially all of the assets of other financial institutions, or other business combinations, except as identified below. This Supervisory Memorandum uses the same defined terms as used by the Federal Guidance unless otherwise noted.

The Commissioner ***will*** impose the following conditions in approval of any acquisition by a state bank involving bargain purchase gains. Prior to the end of the conditional period and validation of the bargain purchase gain as set forth in the Federal Guidance, an acquiring state bank will be required to exclude such bargain purchase gain from calculation of its capital for purposes of its:

(1) dividend-paying capacity;

(2) legal lending limit under:

   a. Chapter 34, Subchapter C, of the Texas Finance Code (TFC); and

   b. the legal lending limit rules in Chapter 12, Title 7 of the Texas Administrative Code (TAC); and

[1] See the FDIC's Financial Institution Letter 30-2010 or the Federal Reserve Board's SR 10-12, which were issued June 7, 2010.

(3) all investment limits established in TFC Chapter 34, Subchapters A and B, and the investment limit rules in 7 TAC Chapter 12, including the limits on:

   a. investments in bank facilities and other real estate;

   b. securities investments; and

   c. investments in bank subsidiaries.

The Commissioner therefore ***will*** impose the dividend limitations and legal lending limit conditions that the Federal Guidance states federal bank regulatory agencies may impose in their approvals of acquisitions by state banks.

An acquiring state bank must seek approval from the Commissioner, in its acquisition application, if it wishes to include some or all of the bargain purchase gain in calculation of its capital prior to the end of the conditional period for purposes of its dividend-paying capacity, its legal lending limit or its investment limits. The Commissioner will consider the following factors in determining whether to approve such request:

(1) The quality and extent of the acquiring bank's due diligence review of the assets to be acquired from the other financial institution, including:

   a. The percentage of the loan portfolio reviewed; and

   b. Whether the acquiring bank employed a qualified third party to assist in its due diligence review;

(2) The competence and expertise of the acquiring bank;

(3) The relationship of the total value of assets to be acquired to the original capital of the acquiring bank; and

(4) Any other factors that the Commissioner determines to be relevant.

In addition, in its acquisition application, an acquiring state bank must address certain post-acquisition legal lending limit issues as follows:

(1) Provide assurances to the Department that the bank has specifically considered and identified the impact of the assets to be acquired on its legal lending limit following the acquisition.

(2) If the bank to be acquired, or whose assets are to be acquired, is chartered by another state or is a national bank, then, when determining the impact referred to in the previous sentence, consider the differences in any legal lending limit law applicable to the acquired institution, or the loans to be acquired. For example, the acquiring bank should consider whether another state's law, or the law applicable to a national bank, differs from the Texas legal lending limit law governing attribution of loans of related persons or entities to a particular borrower and aggregation of such loans to that same borrower.

(3) Determine, to the extent possible, whether the institution to be acquired has, or any of its loans have, borrowers in common with the acquiring bank, and identify such borrowers and their loans, which, if aggregated, might exceed the legal lending limit for the bank following the acquisition.

Within 90 days after consummation of an acquisition, the acquiring bank must provide a report to the Board of Directors identifying all loans purchased in the acquisition that are non-conforming under 7 TAC §12.10(a)(3).

REGULATORY REPORTING

Although the Department will not consider the purchase money gain in calculating various investment limits, management remains responsible for filing regulatory reports in accordance with the requirements in effect as of the filing date. Updates to the Financial Account Standards Board (FASB) Accounting Standards Codification topics discussed in the Federal Guidance as well as updates to instructions for preparing Consolidated Reports of Condition and Income (Call Reports) should be followed.

Questions about this Supervisory Memorandum may be directed to the Director of Bank and Trust Supervision at 512-475-1300.

OUTSTANDING REGULATORY GUIDANCE

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Regulatory Guidance - 3001

August 7, 2001

To: Chief Executive Officers of Texas Chartered Banks

From: Randall S. James, Banking Commissioner

RE: Regulatory Guidance on Senate Bill 626 – Amendments to Code of Criminal Procedure, Chapter 59

Overview:

Code of Criminal Procedure Chapter 59, the civil asset forfeiture statute, authorizes and establishes a procedure for state law enforcement to seize and forfeit property related to criminal offenses. The scope of Chapter 59 is broad, and offenses that give rise to seizure and forfeiture generally include any felony offense. Property that is subject to seizure and forfeiture is statutorily referred to as "contraband", and includes any: (i) property used in the commission of or to facilitate the crime; (ii) the proceeds of the crime; and (iii) property derived from or purchased with the proceeds of the crime. Not infrequently, a bank or other regulated financial institution holds property that may be subject to seizure and forfeiture by the State.

During the 77th Regular Session, the Texas Legislature amended Chapter 59**. Senate Bill 626, which becomes effective September 1, 2001, expands the protection afforded innocent lienholders and significantly changes the procedures that apply to the seizure of contraband held at regulated financial institutions**. To put these changes and their significance in context, we believe it is helpful to briefly discuss some of the more problematic aspects of the prior law before explaining the recent amendments.

Texas Law from 1989 to Present:

Before the enactment of Senate Bill 626, Chapter 59 required a lienholder with a bona fide security interest in contraband other than real property to prove two things in order to protect that interest from forfeiture: one, that the security interest was acquired prior to or during the commission of the offense; and two, that at the time the security interest was acquired and perfected, the lienholder did not know or have reason to know of the criminal offense or that it was likely to occur. A bank that acquired and perfected a security interest in contraband after the time the crime was committed lost that security interest no matter how "innocent" or ignorant of the crime the bank may have been.

The failure to protect an innocent lienholder that acquired and perfected a security interest after the commission of the crime was not the only problem that Chapter 59 created for banks. Chapter 59 also authorized the State to withdraw seized contraband from a bank immediately upon service of the seizure warrant. Such action, depending upon the amount of the seizure in relation to the bank's capital and assets, could jeopardize the bank's liquidity and potentially precipitate a de facto insolvency and bank closing. Additionally, Chapter 59 included no provision for the sharing of information with, or giving notice to, state and federal banking regulators regarding contemplated asset seizures that could adversely affect these banking institutions.

Texas Law Effective September 1, 2001:

The revised law addresses these problems by: 1) recognizing the rights of the innocent lienholder who acquires and perfects its security interest after the commission of the offense but before the seizure of the property; 2) establishing specific procedures for the seizure of accounts and assets at regulated financial institutions; and 3) authorizing, and in some instances requiring, law enforcement's disclosure of information to the Texas Banking Department in those instances when a bank employee is suspected to be involved in the crime.

Protection of Security Interests of Bona Fide Lienholders

The revised law continues to recognize the rights of the bona fide lienholder that acquires and perfects its security interest, in what is later determined to be contraband, before or during the commission of a criminal act that gives rise to forfeiture. It does not change what the lienholder must establish in order to keep its interest from being forfeited. Section 59.02(c) still requires the lienholder to establish that, at or before the time of acquiring and perfecting the interest, the lienholder did not know or should not reasonably have known of the act or omission giving rise to the forfeiture, or that it was likely to occur.

Unlike the prior law, however, the revised statute permits the lienholder who acquires and perfects its security interest **after** the commission of the offense, but before the seizure of the property, to protect that interest. **To prevent the after-acquired security interest from being subject to forfeiture, the lienholder must establish that: 1) it was an interest holder for value at the time the interest in the property was acquired; and 2) it was "without reasonable cause to believe that the property was contraband and did not purposefully avoid learning that the property was contraband."** The new law also specifically provides that the rights of lienholders in seized property remain in effect while the forfeiture proceedings are pending as if the property had remained in the lienholder's possession.

Procedures for Seizure of Accounts and Assets at Regulated Financial Institutions

The revised law establishes specific procedures to govern the seizure of contraband held at a regulated financial institution when the contraband consists of depository accounts or assets in which the institution has a security interest. A bank served with a seizure warrant has two options:

A. Pay the account or tender the assets at the time the warrant is served; or

B. Transfer the account or assets to a segregated, interest-bearing account in the name of the attorney representing the state as trustee, where the account funds or assets must remain until disposed of by final order of the court in the forfeiture proceeding.

   If the bank chooses option (B), the bank must:

   1. freeze and segregate the account or assets immediately upon service of the seizure warrant; and,

   2. provide the peace officer with evidence, certified by a bank officer, of the terms and amount of the account or a detailed inventory of the assets.

Except as authorized by the statute, no transaction involving the account or assets, other than the deposit or reinvestment of interest, dividends or similar payments, can occur without court approval.

If the bank fails to release or transfer the account or assets as required by the statute, and, as a result, cannot comply with the court's final forfeiture order, if that is the court's decision, certain sanctions apply. The court can order the bank and its culpable officers, agents and employees to pay actual damages, attorneys' fees and court costs. Additionally, the court may find the bank and those culpable persons in contempt.

The new law establishes a safe harbor from liability for a bank that complies with its provisions.

Disclosure and Notice Provisions

The revised law authorizes the attorney representing state law enforcement to disclose information to the Banking Commissioner, including confidential information, relating to an actual or contemplated seizure involving a depository account in a financial institution or assets held by a financial institution as security for an obligation owed to the institution.

The state law enforcement attorney must notify the Banking Commissioner before taking any action under Chapter 59 that implicates a potentially culpable bank officer or director. The Commissioner is to then notify appropriate state and federal regulators.

The information disclosed to the Banking Commissioner, and other state and federal financial institution regulators, is confidential, and a regulator who knowingly discloses the information, except as authorized by the statute, is subject to penalties.

Banker Guidance:

What does this mean? What must a bank do to protect itself against the risk that accounts held at the bank, or, more importantly, assets in which the bank has a security interest, will be seized and forfeited to the State?

1. Banks should heighten their awareness of their loan customers, especially new relationships and those borrowers that deal in cash and cash equivalent assets. Bankers should fully understand the nature of a borrower's business, and perform and document background and reference checks for further assurance about the integrity of a borrowing relationship. (*A key component of the law's revision places emphasis on the banker to know his customers. Should the bank find itself in a seizure and forfeiture situation, the extent of that knowledge, and due diligence that is evidenced, will be critical*.)

2. When necessary, bankers should adequately document the origin of loan collateral to the fullest extent possible. Supporting documentation could include a bill of sale, purchase money invoice, or a closing settlement statement for real property. Certificates of deposit, equitable securities, and bonds held by third party institutions can present special challenges in determining the nature of their genesis. Prior years' tax returns should receive close review to determine possible asset holdings, sales, and investment capabilities. Additionally, bank statements may need review to ascertain the extent of cash transactions.

3. Understand the use of loan proceeds. Purchase money loans should be well documented with invoices and when possible, bank checks made payable to the selling party and the borrower. Borrower accounts that receive deposited loan proceeds should be periodically reviewed in order that the intended use of the proceeds can be collaborated with their disposition.

4. The Board and management should formulate policies and procedures in the event that the bank is served a notice of seizure. At a minimum the policy should address the following:

   A. Who is responsible for coordinating and interfacing with law enforcement officials (*includes branch locations*);

   B. How will different assets be segregated and who will be responsible for monitoring the segregated accounts (*should the bank chose to retain, and not immediately turn funds over to law enforcement, the amount of funds held by the bank and verified by the bank at the time of inquiry, should be the same amount the bank has provided credit to the customer, i.e., collected funds*); and,

   C. How and when will the board be notified.

Questions or comments about revised Chapter 59, Texas Criminal Code, should be directed to Deputy Commissioner Gayle Griffin or General Counsel Everette Jobe at 512-475-1300.

Attachments: Senate Bill 626
Analysis of Senate Bill 626

S.B. No. 626

AN ACT

relating to liens on certain property related to certain criminal offenses and the effect of forfeiture of that property; providing penalties.

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF TEXAS:

SECTION 1. Article 59.01, Code of Criminal Procedure, is amended by adding Subdivisions (9), (10), and (11) to read as follows:

(9) "Depository account" means the obligation of a regulated financial institution to pay the account owner under a written agreement, including a checking account, savings account, money market account, time deposit, NOW account, or certificate of deposit.

(10) "Primary state or federal financial institution regulator" means the state or federal regulatory agency that chartered and comprehensively regulates a regulated financial institution.

(11) "Regulated financial institution" means a depository institution chartered by a state or federal government, the deposits of which are insured by the Federal Deposit Insurance Corporation or the National Credit Union Administration.

SECTION 2. Subsections (c) through (g), Article 59.02, Code of Criminal Procedure, are amended to read as follows:

(c) An owner or interest holder's interest in property may not be forfeited under this chapter if the owner or interest holder proves by a preponderance of the evidence that the owner or interest holder[~~:~~

[~~(1)~~] acquired and perfected the interest:

(1) before or during the act or omission giving rise to forfeiture or, if the property is real property, he acquired an ownership interest, security interest, or lien interest before a lis pendens notice was filed under Article 59.04(g) of this code[~~;~~] and

[~~(2)~~] did not know or should not reasonably have known of the act or omission giving rise to the forfeiture or that it was likely to occur at or before the time of acquiring and perfecting the interest or, if the property is real property, at or before the time of acquiring the ownership interest, security interest, or lien interest; or

(2) after the act or omission giving rise to the forfeiture, but before the seizure of the property, and only if the owner or interest holder:

(A) was, at the time that the interest in the property was acquired, an owner or interest holder for value; and

(B) was without reasonable cause to believe that the property was contraband and did not purposefully avoid learning that the property was contraband.

(d) Notwithstanding any other law, if property is seized from the possession of an owner or interest holder who asserts an ownership interest, security interest, or lien interest in the property under applicable law, the owner or interest holder's rights remain in effect during the pendency of proceedings under this chapter as if possession of the property had remained with the owner or interest holder.

(e) On motion by any party or on the motion of the court, after notice in the manner provided by Article 59.04 of this code to all known owners and interest holders of property subject to forfeiture under this chapter, and after a hearing on the matter, the court may make appropriate orders to preserve and maintain the value of the property until a final disposition of the property is made under this chapter, including the sale of the property if that is the only method by which the value of the property may be preserved until final disposition.

(f) [~~(e)~~] Any property that is contraband and has been seized by the institutional division of the Texas Department of Criminal Justice shall be forfeited to the institutional division under the same rules and conditions as for other forfeitures.

(g) [~~(f)~~] An individual, firm, corporation, or other entity insured under a policy of title insurance may not assert a claim or cause of action on or because of the policy if the claim or cause of action is based on forfeiture under this chapter and, at or before the time of acquiring the ownership of real property, security interest in real property, or lien interest against real property, the insured knew or reasonably should have known of the act or omission giving rise to the forfeiture or that the act or omission was likely to occur.

(h) [~~(g)~~] The forfeiture provisions of this chapter apply to contraband as defined by Article 59.01(2)(B)(v) [~~(iv)~~] of this code only in a municipality with a population of 250,000 or more.

SECTION 3. Subsection (a), Article 59.03, Code of Criminal Procedure, is amended to read as follows:

(a) Property subject to forfeiture under this chapter, other than property described by Article 59.12, may be seized by any peace officer under authority of a search warrant.

SECTION 4. Subsection (b), Article 59.04, Code of Criminal Procedure, is amended to read as follows:

(b) A forfeiture proceeding commences under this chapter when the attorney representing the state files a notice of the seizure and intended forfeiture in the name of the state with the clerk of the district court in the county in which the seizure is made. The attorney representing the state must attach to the notice the peace officer's sworn statement under Article 59.03 of this code or, if the property has been seized under Article 59.12(b), the statement of the terms and amount of the depository account or inventory of assets provided by the regulated financial institution to the peace officer executing the warrant in the manner described by Article 59.12(b). Except as provided by Subsection (c) of this article, the attorney representing the state shall cause certified copies of the notice to be served on the following persons in the same manner as provided for the service of process by citation in civil cases:

(1) the owner of the property; and

(2) any interest holder in the property.

SECTION 5. Chapter 59, Code of Criminal Procedure, is amended by adding Articles 59.12, 59.13, and 59.14 to read as follows:

Art. 59.12. SEIZURE OF ACCOUNTS AND ASSETS AT REGULATED FINANCIAL INSTITUTION. (a) This article applies to property consisting of a depository account or assets in a regulated financial institution.

(b) A regulated financial institution, at the time a seizure warrant issued under Chapter 18 is served on the institution, may either:

(1) pay an account or tender assets held as security for an obligation owed to the institution at the time of the service of the seizure warrant; or

(2) transfer the depository account or assets to a segregated interest-bearing account in the name of the attorney representing the state as trustee, to remain in the account until the time has expired for an appeal from a decision of the court relating to the forfeiture of accounts or assets under Article 59.05.

(c) Immediately on service of the seizure warrant, the regulated financial institution shall take action as necessary to segregate the account or assets and shall provide evidence, certified by an officer of the institution, of the terms and amount of the account or a detailed inventory of the assets to the peace officer serving the warrant. Except as otherwise provided by this article, a transaction involving an account or assets, other than the deposit or reinvestment of interest, dividends, or other normally recurring payments on the account or assets that do not involve distribution of proceeds to the owner, is not authorized unless approved by the court that issued the seizure warrant or, if a forfeiture action has been instituted, the court in which that action is pending.

(d) Any accrual to the value of the account or assets during the pendency of the forfeiture proceedings is subject to the procedures for the disbursement of interest under Article 59.08.

(e) If the regulated financial institution fails to release the depository account or assets to a peace officer pursuant to a seizure warrant or transfer the account or assets as required by Subsection (b), and as a result cannot comply with the court's forfeiture order, the court:

(1) shall order the regulated financial institution and its culpable officers, agents, or employees to pay actual damages, attorney's fees, and court costs incurred as a result of the institution's failure to comply; and

(2) may find the regulated financial institution and its culpable officers, agents, or employees in contempt.

(f) A regulated financial institution that complies with this article is not liable in damages because of the compliance.

(g) This article does not:

(1) impair the right of the state to obtain possession of physical evidence or to seize a depository account or other assets for purposes other than forfeiture under this chapter; or

(2) waive criminal or civil remedies available under other law.

Art. 59.13. DISCLOSURE OF INFORMATION RELATING TO ACCOUNTS AND ASSETS AT REGULATED FINANCIAL INSTITUTION. (a) The attorney representing the state may disclose information to the primary state or federal financial institution regulator, including grand jury information or otherwise confidential information, relating to any action contemplated or brought under this chapter that involves property consisting of a depository account in a regulated financial institution or assets held by a regulated financial institution as security for an obligation owed to a regulated financial institution. An attorney representing the state who discloses information as permitted by this subsection is not subject to contempt under Article 20.02 for that disclosure.

(b) A primary state or federal financial institution regulator shall keep confidential any information provided by the attorney representing the state under Subsection (a). The sharing of information under Subsection (a) by a representative of the state is not considered a waiver by the state of any privilege or claim of confidentiality.

(c) A regulator described by Subsection (b) commits an offense if the regulator knowingly discloses information in violation of this article. An offense under this subsection is punishable by confinement in jail for a period not to exceed 30 days, a fine not to exceed $500, or both such confinement and fine.

Art. 59.14. NOTICE TO PRIMARY STATE AND FEDERAL FINANCIAL INSTITUTION REGULATORS. (a) Before taking any action under this chapter that implicates a potentially culpable officer or director of a regulated financial institution, the attorney representing the state shall notify the banking commissioner, who shall notify the appropriate state or federal financial institution regulator.

(b) A state or federal financial institution regulator shall keep confidential any information provided by the attorney representing the state under Subsection (a).

(c) A regulator described by Subsection (b) commits an offense if the regulator knowingly discloses information in violation of this article. An offense under this subsection is punishable by confinement in jail for a period not to exceed 30 days, a fine not to exceed $500, or both such confinement and fine.

(d) The provision of notice under Subsection (a) is not considered a waiver by the state of any privilege or claim of confidentiality.

SECTION 6. The change in law made by this Act applies only to a seizure that occurs on or after the effective date of this Act. A seizure that occurs before the effective date of this Act is covered by the law in effect when the seizure occurred, and the former law is continued in effect for that purpose.

SECTION 7. This Act takes effect September 1, 2001.

______________________________ ______________________________

President of the Senate Speaker of the House

____

Secretary of the Senate

I hereby certify that S.B. No. 626 passed the House, with amendment, on May 10, 2001, by a non-record vote.

____

Chief Clerk of the House

Approved:

____

Date

____

Governor

SRC-JBJ S.B. 626 77(R)BILL ANALYSIS

Senate Research CenterS.B. 626
By: Duncan
Jurisprudence
6/21/2001
Enrolled

DIGEST AND PURPOSE

Under Texas law, the holder of a bona fide security interest in property other than real property may lose that lien or security to forfeiture even though the lienholder is innocent, not knowing or having reason to suspect that the property constitutes contraband. S.B. 626 addresses several problems that may arise in the seizure of accounts held at banks and assets that have been pledged to secure loans made by banks.

RULEMAKING AUTHORITY

This bill does not expressly grant any additional rulemaking authority to a state officer, institution, or agency.

SECTION BY SECTION ANALYSIS

SECTION 1. Amends Article 59.01, Code of Criminal Procedure, by adding Subdivisions (9)-(11), to define "depository account," "primary state or federal financial institution regulator," and "regulated financial institution."

SECTION 2. Amends Articles 59.02(c)-(g), Code of Criminal Procedure, to prohibit an owner or interest holder's interest in property from being forfeited under this chapter if the owner or interest holder proves by a preponderance of the evidence that certain specific conditions were met, including that the owner or interest holder, after the act or omission giving rise to the forfeiture, but before the seizure of the property, and only if the owner or interest holder was, at the time that the interest in the property was acquired, an owner or interest holder for value, and was without reasonable cause to believe that the property was contraband and did not purposefully avoid learning that the property was contraband. Provides that if property is seized from the possession of an owner or interest holder who asserts an ownership interest, security interest, or lien interest in the property under applicable law, notwithstanding any other law, the owner or interest holder's rights remain in effect during the pendency of proceedings under this chapter as if possession of the property had remained with the owner or interest holder. Provides that the forfeiture provisions of this chapter apply to contraband as defined by Article 59.01(2) (B) (v), rather than (iv), of this code only in municipality with a population of 250,000 or more.

SECTION 3. Amends Article 59.03, Code of Criminal Procedure, by amending Subsection (a) and adding Subsection (d), to authorize property subject to forfeiture under this chapter, other than property described by Article 59.12, to be seized by any peace officer under authority of a search warrant.

SECTION 4. Amends Article 59.04(b), Code of Criminal Procedure, to require the attorney representing the state to attach to the notice the peace officer's sworn statement under Article 59.03 of this code or, if the property has been seized under Article 59.12(b), the statement of the terms and amount of the depository account or inventory of assets provided by the regulated financial institution to the peace officer executing the warrant in the manner described by Article 59.12(b).

SECTION 5. Amends Chapter 59, Code of Criminal Procedure, by adding Articles 59.12-59.14, as follows:

Art. 59.12. SEIZURE OF ACCOUNTS AND ASSETS AT REGULATED FINANCIAL INSTITUTION. (a) Provides that this article applies to property consisting of a depository account or assets in a regulated financial institution.

(b) Authorizes a regulated financial institution, at the time a seizure warrant issued under Chapter 18 is served on the institution, to take either of two enumerated actions.

(c) Requires the regulated financial institution, immediately on service of the seizure warrant, to take action as necessary to segregate the account or assets and to provide evidence, certified by an officer of the institution, of the terms and amount of the account or a detailed inventory of assets to the peace officer serving the warrant. Provides that a transaction involving an account or assets, other than the deposit or reinvestment of interest and except as otherwise provided by this article, or other normally recurring payments on the account or assets that do not involve distribution of proceeds to the owner is not authorized unless approved by the court that issued the seizure warrant or, if a forfeiture action has been instituted, the court in which that action is pending.

(d) Provides that any accrual to the value of the account or assets during the pendency of the forfeiture proceedings is subject to the procedures for the disbursement of interest under Article 59.08.

(e) Requires the court, if the regulated financial institution fails to release the depository account or assets to a peace officer pursuant to a seizure warrant or transfer the account or assets as required by Subsection(b), and as a result cannot comply with the court's forfeiture order, to order the regulated financial institution and its culpable officers, agents, or employees to pay actual damages, attorney's fees, and court costs incurred as a result of the institution's failure to comply, and authorizes the court to find the regulated financial institution and its culpable officers, agents, or employees in contempt.

(f) Provides that a regulated financial institution that complies with this article is not liable in damages because of the compliance.

(g) Provides that this article does not impair the right of the state to obtain possession of physical evidence or to seize a depository account or other assets for purposes other than forfeiture under this chapter, or waive criminal remedies available under other law.

Art. 59.13. DISCLOSURE OF INFORMATION RELATING TO ACCOUNTS AND ASSETS AT

REGULATED FINANCIAL INSTITUTION. (a) Authorizes the attorney representing the state to disclose information to the primary state or federal financial institution regulator, including grand jury information or otherwise confidential information, relating to any action contemplated or brought under this chapter that involves property consisting of a depository account in a regulated financial institution or assets held by a regulated financial institution as security for an obligation owed to a regulated financial institution. Provides that an attorney representing the state who discloses information as permitted by this subsection is not subject to contempt under Article 20.02 for that disclosure.

(b) Requires a primary state or federal financial institution regulator to keep confidential any information provided by the attorney representing the state under Subsection (a). Provides that the sharing of information under Subsection (a) by a representative of the state is not considered a waiver by the state of any privilege or claim of confidentiality.

(c) Provides that a regulator described by Subsection (b) commits an offense if the regulator knowingly discloses information in violation of this article. Provides that an offense under this subsection is punishable by confinement in jail for a period not to exceed 30 days, a fine not to exceed $500, or both such confinement and fine.

Art. 59.14. NOTICE TO PRIMARY STATE AND FEDERAL FINANCIAL INSTITUTION REGULATORS. (a) Requires the attorney representing the state, before taking any action under this chapter that implicates a potentially culpable officer or director of a regulated financial institution, to notify the banking commissioner, who is required to then notify the appropriate state or federal financial institution regulator.

(b) Requires a state or federal financial institution regulator to keep confidential any information provided by the attorney representing the state under Subsection (a).

(c) Provides that a regulator described by Subsection (b) commits an offense if the regulator knowingly discloses information in violation of this article. Provides that an offense under this subsection is punishable by confinement in jail for a period not to exceed 30 days, a fine not to exceed $500, or both such confinement and fine.

(d) Provides that the provision of notice under Subsection (a) is not considered a waiver of any privilege or claim of confidentiality.

SECTION 6. Makes application of this Act prospective.

SECTION 7. Effective date: September 1, 2001.

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Regulatory Guidance - 3003

December 20, 2001

To: Chief Executive Officers of Texas Chartered Banks and Trust Companies

From: Randall S. James, Banking Commissioner

RE: Brokered Certificates of Deposit

Background:

Recent supervisory actions by the Securities and Exchange Commission (SEC) against Robert L. Bentley, Entrust Group, and Bentley Financial Services, Inc. (collectively, Bentley), serve as a warning about fraudulent investment activities. On October 23, 2001, the SEC filed suit against Bentley for suspected securities fraud. Bentley, located in Paoli, Pennsylvania, allegedly committed fraud in the sale of securities to financial institutions, including banks, thrifts, and credit unions, and to individual investors. Specifically, the SEC alleges that Bentley was representing to investors that they (Bentley) were selling federally-insured certificates of deposit (CDs) when, in fact, they were selling uninsured securities issued by Bentley. The SEC also alleges that Bentley had to attract new investors in order to repay previous investors. The Philadelphia District Court issued a Temporary Restraining Order against Bentley that freezes Bentley's accounts and appoints a receiver to exercise control over Bentley's assets.

The FDIC has advised that institutions holding any funds, securities or other assets in the name of or for the benefit of Bentley should take steps necessary to comply with the terms of the Temporary Restraining Order. Further, all financial institutions that have invested funds through Bentley are advised to confer with counsel about appropriate courses of action, including contacting the court-appointed Receiver about the institution's investments. The Receiver may be reached at 215-772-725. (FDIC-PR-76-2001)

Risk Assessment:

The purpose of this regulatory guidance is to reemphasize the importance of closely scrutinizing all aspects of a financial transaction, including those perceived to contain little or no risk. In the case of Bentley, investors may have failed to follow fundamental safety and soundness principals. Discussed below are principal areas of concern regarding brokered CD activity.

Who is the broker dealer?

Fluctuations in the equity markets over the last year have prompted many investors to search for lower-risk investments; however, declining interest rates have complicated efforts to maintain satisfactory yields. CDs have traditionally filled this demand, offering safety and a rate of return higher than other types of deposit accounts. While insured depository institutions directly offer CDs, many brokerage firms and independent salespeople also offer these types of deposits. These individuals and entities, known as "**deposit brokers**", can sometimes negotiate a higher rate of interest by promising to bring a certain amount of deposits to the institution. The deposit broker then offers these "**brokered CDs**" to their customers.

Many investors do not realize that there are **no federal or state licensing requirements** for deposit brokers. Anyone from a person working alone at home to someone affiliated with a major financial services firm can be a deposit broker. This situation places a greater burden upon the potential investor to fully investigate the credentials and qualifications of the deposit broker and the credibility of the transaction.

The burden of investigation and due diligence before committing bank funds to any investment remains with the bank's Board of Directors. Banks that rely on third parties for the purchase, settlement, or holding of any type investment should perform routine screening checks into the qualifications and backgrounds of these individuals or entities. One of the initial actions taken before acquiring brokered CDs should involve determining whether the deposit broker is, or is required to be, registered with the Securities and Exchange Commission and/or the State Securities Board. Registration and certain background information can be obtained from the National Association of Securities Dealers (NASD). Brokers registered with the SEC will be listed in the NASD Central Registration Depository (CRD) and will have a unique number. The CRD can be accessed via the Internet at www.nasdr.com "about your broker", or at NASD Regulation's Public Disclosure toll-free Hotline at (800) 289-9999. Additional information may also be available from the State Securities Board at (512) 305-8300 or www.ssb.state.tx.us, the Secretary of State at (512) 463-5701 or www.sos.state.tx.us, or the local chapter of the Better Business Bureau.

How will the investment be held and who is the issuer?

The Board needs to approve the type and nature of ownership for brokered CDs, which can be held individually by the institution or by a group of unrelated investors. As a general rule, banks should only use an unregistered firm or individual as a finder if the bank purchases the CD directly from the issuing depository institution. This means that bank funds are sent directly to the issuing institution and the issuing institution's records indicate the bank as owner of the investment.

If several investors own a portion of a master CD, the deposit broker will probably not list each person's name in the title. The purchasing institution should insist that account records of the issuing bank reflect that the broker is merely acting as an agent for the institution and the other owners (*Example – "XYZ Brokerage as Custodian for Customers"*). This will ensure that the bank's portion of the CD qualifies for full FDIC coverage.

In other instances, brokered CD purchases present a different concern and may involve one or more jumbo CDs which are federally insured, but are resold as "**fractionalized**" investments using the pool of CDs as collateral. Investors may be misled into believing that they are buying the CDs themselves when in fact they are simply making an investment with the broker. In this case, the broker may be selling investments which require him or her to have a securities broker dealer license. Often, this fact is not disclosed. **NOTE***:* ***Investments in brokered CDs as described above, in which the broker dealer is the recorded owner of the CD and the investment is actually with the broker dealer, will be subject to the bank's legal loan limit.***

The responsibility for verifying the specific nature of ownership resides with the investor. Each of the types previously described will affect the amount of deposit insurance coverage and the investor's rights and remedies if legal proceedings are required for collection. Additionally, the Board should require an unaffiliated third party "safekeeper" be used to record legal ownership rights when investments entail master CDs or fractionalized interests.

Note: Bankers are reminded that bank investments held by a brokerage fund are **not** eligible for assistance by the Securities Investor Protection Corporation regarding claims that may result from a failure of the brokerage firm.

What are the characteristics of the investment?

The investment itself (brokered CD) may carry unique characteristics. Brokered CDs could be "**zero coupon**" instruments, reflect a long-term maturity, contain a "call" provision benefiting the issuer, and/or may be quoted in simple interest rates. Unscrupulous brokers attempt to cover these undesirable features by omitting certain information, using small print, or even offering to repurchase the investment to indicate liquidity. Listed below are some of the basic characteristics of a brokered CD that should be determined through documented confirmation or verification with the issuer:

Maturity Date – Investors should confirm the maturity date and require verification in writing. Many brokered CDs reflect maturity dates of five, ten, or even twenty years.

Call Feature(s) – Callable CDs give the issuing bank the right to terminate or "call" or redeem the CD after a set period of time. The call is established for the benefit of the issuer and mitigates the issuer's exposure to interest rate risk.

Withdrawal Penalties – Deposit brokers often tout the fact that their CDs have no penalty for early withdrawal. While technically true, these claims can be misleading. If the investment is shared with other investors, the broker will have to find a buyer for investors wishing to sell their portion before maturity. If interest rates have risen, the broker may be able to sell the investment only at a discount, impacting the value received.

Interest Rate – The investor should require a disclosure statement that specifies the interest rate and whether it is fixed or variable. Interest rates should be thoroughly analyzed and understood. Decisions between investment options are difficult to analyze if yields are not comparable. *Bond equivalent yield* is the industry convention for comparing yields and should be adopted by your institution. When evaluating zero coupon CDs, avoid yield quotes based on simple interest yields because they will be misleading and appear artificially attractive.

Other Recommendations:

The Board should approve comprehensive policies and procedures regarding the use of brokered CDs. Investment decisions based solely on the representations of broker dealers or any third party can be dangerous. Management should be required to verify pertinent information about potential investments in brokered CDs and execute verification procedures during the process. On an ongoing basis, the bank's internal or external audit programs should include a positive direct verification of these investments.

The Board should also establish limits on the volume and types of investments that will be negotiated with each deposit broker. Such parameters are especially important when the investment is other than direct individual ownership and/or the brokered CD contains unique characteristics.

The use of brokered CDs can be beneficial if these types of investments are fully understood and managed within a well defined plan that conforms to the institutions asset/liability goals and objectives. During the examination process, Department examiners will review management's policies, procedures, and practices regarding brokered CDs. Any questions about this regulatory guidance should be directed to Robert (Bob) Bacon at (512) 475-1300 or bob.bacon@banking.state.tx.us.

Regulatory Guidance - 3004

December 20, 2001

To: Chief Executive Officers of Texas Chartered Banks

From: Randall S. James, Banking Commissioner

RE: Securities Investor Protection Corporation (SIPC) Coverage for Banks

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Background:

In October 2001, the Securities Investor Protection Corporation (SIPC), received approval by the U.S. Bankruptcy Court in Minneapolis to consummate a transfer of 175,000 investor accounts at the financially troubled MJK Clearing, Inc. (MJK), a subsidiary of Minneapolis-based Stockwalk Group, Inc., to SWS Securities, Inc., a Dallas-based financial services company. MJK was found to be out of compliance with federal rules requiring the maintenance of minimum capital levels. The capital shortfall occurred due to the failure of another brokerage firm to deliver significant capital owed to MJK. The Securities and Exchange and Commission (SEC) is investigating the events that led to the failure of MJK, which is the largest liquidation case ever handled by the SIPC.

The Department became aware that Texas-chartered banks along with institutions from other states had investments that were held by MJK. Primarily, the investments of the Texas banks were fractionalized interests in certificates of deposit held as book entry and styled "Master Certificate as Agent for Customers". The ensuing settlement may result in about 95% of the original investment being returned to the banks.

The purpose of this Regulatory Guidance is to notify banks about the necessity of understanding the limitations of SIPC assistance and to caution against undue investment concentrations being held by a brokerage firm.

Risk Assessment:

State bankers are reminded that the SIPC does not offer to investors the same blanket protection that the FDIC provides to bank depositors. Generally, the SIPC only helps investors whose money, stocks and other securities are stolen by a broker or put at risk when a brokerage fails. However, special rules apply to banks. The Securities Investor Protection Act of 1970, §78fff-3(a)(5) of 15 U.S.C., **specifically prohibits** SIPC funds from being used to pay claims of any failed brokerage firm customer who is a broker or dealer or **bank** acting for itself rather than for its own customer or customers. **Therefore, bank investments held by a brokerage firm are not eligible for assistance by the SIPC regarding claims that may result from a failure of the brokerage firm.**

In addition, other investments that are ineligible for SIPC protection are commodity futures contracts and currency, as well as investment contracts (such as limited partnerships) that are not registered with the SEC under the Securities Act of 1933.

In the case of the bank customers described above, the SIPC satisfied the net equity claims of the banks to the extent allowed under a ratable sharing basis between all the customers of the broker.

Recommendations:

State bankers should become aware of the limitation of SIPC assistance afforded their institutions, and if necessary, amend their policies and procedures to prevent any undue concentrations of investments being held with a security broker or dealer registered under §78o(b) of 15 U.S.C.. Because of the absence of protection afforded banks through the SIPC, sufficient due diligence including careful screening and continuous monitoring should be used in selecting and using the services of a financial services broker.

According to the SIPC, banks are entitled to receive any securities transacted through a broker if the investment meets the definition of "customer name securities". This term means "*securities which are held for the account of a customer on the filing date by or on behalf of the debtor (broker) and which on the filing date were registered in the name of the customer, or were in the process of being so registered pursuant to instructions from the debtor (broker), but does not include securities registered in the name of the customer which, by endorsement or otherwise, were in negotiable form*", §78lll(3) of 15 U.S.C.

Banks are encouraged to contact the agencies listed below to aid in evaluating the services of a financial broker.

U.S. Securities and Exchange Commission................ .... www.sec.gov

NASD Regulation, Inc...... .... www.nasdr.com

National Fraud Information Center .... www.fraud.org

Investor Protection Trust .. .. www.investorportection.org

Alliance for Investor Education...... .... www.nasaa.rog

Securities Industry Association .... www.sia.com

During the ordinary course of examinations, examiners will review the nature and extent that banks are using security brokers to hold investments. The Board should adequately document their decisions in this regard including parameters used to evaluate security brokers used by their institution along with limits for any investments held in a capacity other than customer named securities.

Questions about this regulatory guidance can be directed toward Robert (Bob) Bacon, Director of Strategic Support at 512-475-1300 or bob.bacon@banking.state.tx.us.

Regulatory Guidance - 3005

Revised April 10, 2013

To: Chief Executive Officers of:
Texas State Banks;
Foreign Bank Branches and Agencies;
Texas Trust Companies;
Money Services Businesses (Money Transmitters and Currency Exchangers) and their Authorized Delegates

From: Charles G. Cooper, Banking Commissioner

RE: Consumer Complaint Notices – 7 TAC §11.37 and §33.51

OVERVIEW:

Regulatory Guidance 3005 explains the requirements of 7 TAC §11.37 that state-chartered banks and trust companies and foreign bank agencies provide consumers with information about how to file a complaint with the Department, and 7 TAC §33.51, concerning the complaint notice requirements that apply to Money Services Act (MSA) license holders and their authorized delegates. The Finance Commission adopted revisions to 7 TAC §33.51 in March 2013 to accommodate changes in federal regulations with regard to consumer complaint notices. This Regulatory Guidance has been revised to include the adopted revisions to 7 TAC §33.51. The rules, 7 TAC §11.37 and §33.51, can be found in Exhibit A and Exhibit B, respectively.

STATE-CHARTERED BANKS AND TRUST COMPANIES AND FOREIGN BANK BRANCHES AND AGENCIES:

7 TAC §11.37 applies to state-chartered banks and trust companies and the Texas state branches and agencies of foreign banks. The section requires these supervised entities to provide a notice to consumers on how to file a complaint concerning the entity with the Department.

Requirements and Recommendations – Section 11.37 first sets out the substance and form of the language that must be included in the notice, and then specifies how the notice must be provided. The wording of the notice is identical regardless of how it is provided and is shown in Exhibit C1.

(1) ***Providing Notice*** **–** Supervised entities must provide the notice in the language in which the transaction is conducted. If the supervised entity is required to provide a "privacy notice" to consumers under a specific state or federal law, the entity must include the consumer complaint notice when it sends out the required privacy notice. If the entity is not required to provide a privacy notice, then it must provide the consumer complaint notice at the time the consumer first obtains a product or service from the entity.

(2) ***Posting Notice* –** In addition to providing the consumer complaint notice as specified in Paragraph (1), the supervised entity must conspicuously post the required notice in each area or location where the entity conducts business on a face-to-face basis. If business is conducted in two or more languages at one or more locations, each area should post notices in all applicable languages. The posted notice(s) should be readable by a person with 20/20 vision from a reasonable distance. Posting notice on a bulletin board or in a place designated for other notifications, such as the Community Reinvestment Act notice, is acceptable.

(3) ***Providing Website Notice*** - If the supervised entity offers goods and services over the internet, the entity's website must also contain or provide access to the required consumer complaint notice. Acceptable measures include posting the notice on a separate page of the website with a conspicuous link from those web pages offering goods and services to the notice page.

STATE-CHARTERED BANKS AND TRUST COMPANIES AND FOREIGN BANK BRANCHES AND AGENCIES ACTING AS AUTHORIZED DELEGATE FOR MSA LICENSE HOLDERS:

7 TAC §33.51(f) applies to a state-chartered bank or trust company and a Texas state branch or agency of a foreign bank that conducts money transmission as the authorized delegate of a MSA license holder.

Requirements and Recommendations - Under §33.51(f), a MSA license holder must require its authorized delegate to provide the required notice by one or more of the methods specified in §33.51(e)(3)(A), (B), and (C). A license holder must specify the method or methods to be used and provide the authorized delegate with the means by which to give the notice. A license holder that fails to do so, and/or an authorized delegate that fails to provide the notice as directed by the license holder, is subject to enforcement action. Enforcement actions may include suspension or termination of the authorized delegate designation.

The methods specified in §33.51(e)(3)(A), (B), and (C) are:

(1) ***Including Notice on Payment Instrument or Access Device or Receipt (§33.51(e)(3)(A))*** - The required notice, in at least 8 point type, may be included on each payment instrument or other access device or receipt the authorized delegate uses in connection with the license holder's money transmission business, provided that:

a. the payment instrument or other access device constitutes the only means of accessing the money the authorized delegate receives for transmission; or

b. the authorized delegate issues a receipt for every money transmission transaction conducted.

(2) ***Posting Notice (§33.51(e)(3)(B))*** - If the authorized delegate personally receives all the funds for money transmission, the required notice may be posted where the authorized delegate conducts these activities with customers on a face-to-face basis.

(3) ***Providing Separate Notice (§33.51(e)(3)(C))*** - The required notice may be provided separately, provided that:

a. not later than the time the transaction is conducted, the authorized delegate delivers the notice in a form that the customer can retain; or

b. if the license holder uses an access device such as a stored value card and mails the device to the customer, the notice is included in the mailing; and

c. if the same access device may be used continuously, such as a reloadable stored value card, the license holder also delivers the required notice to the customer at least once every twelve months; the notice may be included with a privacy statement or with another statement, or by another means, so long as the customer actually receives the notice within each twelve month period.

As a general matter, many MSA license holders specify posting under 7 TAC §33.51(e)(3)(B) as the method by which an authorized delegate that is a state-chartered bank or trust company or authorized foreign bank branch or agency must provide notice. If posting is the specified method, the bank, trust company or branch or agency may (1) post two separate notices, as reflected in Exhibits C1 and C3; or (2) with the consent of the license holder, post a combined notice as reflected in Exhibit C2. If the C3 or combined C2 notice is posted, the Department will consider the requirements of §33.51(f) to have been met by the license holder and the authorized delegate, even if the license holder has not itself provided the notice to the authorized delegate. The Department will also consider the C3 or combined C2 notice to satisfy §151.403(a)(6) of the MSA, which requires an authorized delegate to prominently display a notice that indicates the person is an authorized delegate of the MSA license holder. (Under §33.51(f), if an authorized delegate personally receives all funds paid by customers and the license holder requires the authorized delegate to post notice (see Paragraph (2) above), one posted notice may be used to satisfy the requirement of 7 TAC §33.51(f) and §151.403(a)(6) of the MSA).

NOTE: 7 TAC §11.37 requires that the notice be given to "consumers" of state-chartered banks and trust companies and foreign bank Texas branches and agencies. Section 11.37 defines "consumer" as an individual who obtains or has obtained a product or service that is to be used primarily for personal, family or household purposes. 7 TAC §33.51 requires that the notice be given to "customers", which term is defined as a person to whom a license holder provides or has provided money transmission services or conducted a money transmission transaction. Therefore, the combined notice reflected in the authorized delegate portion of Exhibit C2 references both "customer" and "consumer".

Again, 7 TAC §33.51 applies only if a state-chartered bank or trust company or foreign bank branch or agency is acting as the authorized delegate of a MSA license holder. Additionally, unless the license holder so directs, the §33.51 notice does not need to be included in a privacy notice that the state-chartered bank or trust company or foreign bank branch or agency is required to send under a specific state or federal law, or included on the website of the bank, trust company, or foreign bank branch or agency.

OTHER FINANCIAL INSTITUTIONS NOT CHARTERED OR LICENSED BY THE DEPARTMENT:

Several types of financial institutions that are not chartered or licensed by the Department may act as an authorized delegate for one or more MSA license holders. These entities may include, for example, national banks; federal savings banks; state savings banks; thrifts; and credit unions. The 7 TAC §33.51 notice requirement is imposed upon these entities if they conduct money transmission as the authorized delegate of a license holder. Each license holder is responsible for ensuring that the required notice is provided. Therefore, in order for the license holder to comply with this rule, the license holder must specify and provide the means for its authorized delegates that are not regulated by the Department to provide the required notice.

MSA LICENSE HOLDERS:

7 TAC §33.51 applies to persons licensed under the MSA. As explained below, the authorized delegate of a MSA license holder must also provide the required notice and the license holder must specify the method and provide the means by which the authorized delegate must give the notice.

Requirements and Recommendations - Section 33.51 requires a MSA license holder to provide a complaint notice that substantially conforms to the format and wording of the notice as reflected in Exhibit C4, and specifies how the notice must be provided. The same format and wording should be used regardless of how the notice is provided. Alternatively, if the federal Remittance Transfer Rule of Regulation E applies to a MSA license holder, the license holder may provide a complaint notice that conforms to the federal requirements in place of the notice reflected in Exhibit C4. The notice must be provided in the language in which the transaction is conducted.

(1) ***Providing Notice with "Privacy Notice"*** **–** If a MSA license holder must provide a privacy notice to Texas consumers under a specific state or federal law, the license holder must include the §33.51 notice with each privacy notice.

(2) Providing Website Notice - If a MSA license holder maintains a website by which a Texas customer may remit money for transmission or obtain information about the license holder or the customer's transaction, the §33.51 notice must be included on the website. The notice must be prominently displayed on the initial page the customer uses to initiate the remittance or access the information, or on a page available no more than one link from the initial page. The link must clearly describe the information available by clicking the link, e.g., "Texas customers click here for information about filing complaints about our money transmission or currency exchange product or service."

NOTE: If a license holder's business is entirely internet-based, so that account relationships and transactions are initiated solely by means of the internet, the additional disclosures described in Paragraph (3) below are not required.

(3) Providing Additional Notice - In addition to including the §33.51 notice in a required privacy notice and on the website, as applicable, a MSA license holder must tell customers how to file a complaint by one or more of the following methods:

a. *Including Notice on Payment Instrument or Access Device or Receipt (§33.51(e)(3)(A)* - The notice, in at least 8 point type, may be included on each payment instrument or other access device or receipt used in connection with the license holder's money transmission or currency exchange business, provided that:

i. the payment instrument or other access device constitutes the only means of accessing the money received for transmission; or

ii. the license holder issues a receipt for every money transmission or currency exchange transaction conducted.

b. *Posting Notice (§33.51(e)(3)(B))* - If the license holder personally receives all the funds paid by customers, the notice may be posted where the license holder conducts money transmission or currency exchange activities with customers on a face-to-face basis.

c. *Providing Separate Notice (§33.51(e)(3)(C)*) - The notice may be provided separately, provided that:

i. not later than the time the transaction is conducted, the license holder delivers the notice in a form that the customer can retain; or

ii. if the license holder uses an access device such as a stored value card and mails the device to the customer, the notice is included in the mailing; and

iii. if the same access device may be used continuously, such as a reloadable stored value card, the license holder also delivers the notice to the customer at least once every twelve months; the notice may be included with a privacy statement or with another statement, or by another means, so long as the customer actually receives the notice within each twelve month period.

Under 7 TAC §33.51(f), a MSA license holder that conducts business through an authorized delegate must require the delegate to provide the notice reflected in Exhibit C4 by one or more of the methods specified in §33.51(e)(3)(A), (B), and (C). The license holder must specify the method or methods to be used and provide the authorized delegate with the means by which to give the notice selected. The specified methods are set out in Paragraph (3) above, ***Providing Additional Notice.*** An authorized delegate that fails to provide the required notice as directed by the license holder is subject to enforcement action, including suspension or termination of the authorized delegate designation.

Additionally, §151.403(a)(6) of the MSA requires an authorized delegate to prominently display a notice that indicates that the person is an authorized delegate of the MSA license holder. If an authorized delegate personally receives all funds paid by customers and the license holder requires the authorized delegate to post notice (see Paragraph 3(b) above, ***Providing Additional Notice***, *Posting Notice*), one posted notice as reflected in Exhibit C3 may be used to satisfy the requirement of 7 TAC §33.51(f) and §151.403(a)(6) of the MSA.

You can direct your questions about this regulatory guidance or 7 TAC §11.37 or §33.51 to the Director of Strategic Support at 512-475-1300.

Exhibit A

Section §11.37 applies to state-chartered bank and trust companies and the Texas state branches and agencies of foreign banks. As used in this section, the terms "I" and "You" refer to a bank, foreign bank branch or agency, or trust company that is chartered, licensed, or registered by the Texas Department of Banking.

7 TAC §11.37. How Do I Provide Information to Consumers on How to File a Complaint?

(a) Definitions

(1) "Consumer" means an individual who obtains or has obtained a product or service from you that is to be used primarily for personal, family, or household purposes.

(2) "Privacy notice" means any notice which you give regarding a consumer's right to privacy as required by a specific state or federal law.

(3) "Required notice" means a notice in a form set forth or provided for in subsection (b) (1) of this section.

(4) "You" means a bank, foreign bank, bank holding company, or trust company that is chartered, licensed, or registered by the Texas Department of Banking under the Finance Code.

(b) How do I provide notice of how to file complaints?

(1) You must use the following notice in order to let your consumers know how to file complaints:

> The (your name) is (chartered, licensed, or registered) under the laws of the State of Texas and by state law is subject to regulatory oversight by the Texas Department of Banking. Any consumer wishing to file a complaint against the (your name) should contact the Texas Department of Banking through one of the means indicated below:
>
> In Person or U.S. Mail: 2601 North Lamar Boulevard, Suite 300, Austin, Texas 78705-4294
>
> Telephone No.: 877/276-5554
>
> Fax No.: 512/475-1313
>
> E-mail: consumer.complaints@dob.texas.gov
>
> Website: www.dob.texas.gov

(2) You must provide the required notice in the language in which a transaction is conducted.

(3) You must include the required notice with each privacy notice that you send out.

(4) Regardless of whether you are required by any state or federal law to give privacy notices, you must take appropriate steps to let your consumers know how to file complaints by giving them the required notice in compliance with paragraph (1) of this subsection.

(5) You must use the following measures to give the required notice:

(A) In each area where you conduct business on a face-to-face basis, you must conspicuously post the required notice. A notice is deemed to be conspicuously posted if a consumer with 20/20 vision can read it from the place where he or she would typically conduct business or if it is included on a bulletin board**,** in plain view, on which all required notices to the general public (such as equal housing posters, licenses, Community Reinvestment Act notices, etc.) are posted.

(B) For consumers who are not given privacy notices, you must give the required notice when the consumer first obtains a product or service from you.

(C) Those portions of your website that offer consumer goods and services must contain access to the required notice.

Source: *The provisions of this §11.37 adopted to be effective January 3, 2002, 26 TexReg 10850; amended to be effective November 4, 2010, 35 TexReg 9695.*

Exhibit B

Section §33.51 applies to persons licensed under the MSA and their authorized delegates. As a general matter, the terms "I" and "You" as used within this section refer to license holders and authorized delegates. However, the term "You", as used in the required notice, refers to the customer.

7 TAC §33.51. How Do I Provide Information to My Customers about How to File a Complaint?

(a) Does this section apply to me? This section applies if you hold a money transmission or currency exchange license issued by the department under Finance Code, Chapter 151.

(b) Definitions. Words used in this section that are defined in Finance Code, Chapter 151, have the same meaning as defined in the Finance Code. The following words and terms, when used in this section, shall have the following meanings unless the text clearly indicates otherwise.

(1) Conspicuously posted -- Displayed so that a customer with 20/20 vision can read it from the place where he or she would typically conduct business with you or, alternatively, on a bulletin board, in plain view, on which you post notices to the general public (such as equal housing posters, licenses, Community Reinvestment Act notices, etc.).

(2) Customer -- Any person to whom, either directly or through an authorized delegate, you provide or have provided money transmission or currency exchange products or services or for whom you conduct or have conducted a money transmission or currency exchange transaction.

(3) Privacy notice -- Any notice regarding a person's right to privacy that you are required to give under a specific state or federal law.

(4) Required notice -- The notice described in subsection (d) of this section.

(c) Must I provide notice to customers about how to file complaints? Yes. You must tell each of your Texas customers how to file a complaint concerning the money transmission or currency exchange business you conduct under Finance Code, Chapter 151, in accordance with this section.

(d) What must the notice say?

(1) You must use:

(A) a notice that conforms to the complaint notice requirements of the Remittance Transfer Rule of Regulation E (12 C.F.R. Part 1005, Subpart B), such as described by 12 C.F.R. §1005.31(b)(2)(vi), if the Remittance Transfer Rule applies to you; or

(B) a notice that substantially conforms to the language and form of the following notice: If you have a complaint, first contact the consumer assistance division of (Name of License Holder) at (License Holder consumer assistance telephone number), if you still have an unresolved complaint regarding the company's money transmission or currency exchange activity, please direct your complaint to: Texas Department of Banking, 2601 North Lamar Boulevard, Austin, Texas 78705, 1-877-276-5554 (toll free), www.dob.texas.gov.

(2) You must provide the required notice in the language in which the transaction is conducted.

(e) How and where must I provide the required notice?

(1) If a state or federal law requires you to send a privacy notice to your customers, you must include the required notice with each privacy notice.

(2) If you maintain a website by which a customer may remit money for transmission or obtain information about you or the customer's transaction or an existing account, you must include the required notice on your website. The notice must be prominently displayed on the initial page the customer uses to initiate the remittance or access the information, or on a page available no more than one link from the initial page. The link must clearly describe the information available by clicking the link, e.g., "Texas customers click here for information about filing complaints about our money transmission or currency exchange product or service."

(3) In addition to including the required notice in a privacy notice in accordance with paragraph (1) of this subsection and on your website in accordance with paragraph (2) of this subsection, you must tell customers how to file complaints by one or more of the following methods:

(A) You may include the required notice in at least 8 point type, on each payment instrument or other access device or receipt used in connection with your money transmission or currency exchange business, provided that:

(i) the payment instrument or other access device constitutes the only means of accessing the money received for transmission; or

(ii) you issue a receipt for every money transmission or currency exchange transaction you conduct.

(B) If you personally receive all the funds paid by your customers, you may conspicuously post the required notice where you conduct money transmission or currency exchange activities with customers on a face to face basis.

(C) You may provide each customer with the required notice separately, provided that:

(i) not later than the time the transaction is conducted, you deliver the required notice in a form that your customer can retain; or

(ii) if you use an access device, such as a stored value card, in your money services business and mail the device to your customer, you include the required notice in the mailing; and

(iii) if the same access device may be used continuously, such as a reloadable stored value card, you also deliver the required notice to your customer at least once every twelve months. You may include the required notice with a privacy statement, with or on another statement, or by another means so long as the customer actually receives the notice within each twelve-month period.

(4) If your business is entirely internet based, so that account relationships and transactions are initiated solely by means of the internet, the additional disclosures described in paragraph (3) of this subsection are not required.

(f) How do I provide the required notice if I conduct business through authorized delegates?

(1) If you conduct business through one or more authorized delegates, each authorized delegate must provide the required notice by one or more of the methods described in subsection (e)(3) of this section. You must specify the method or methods to be used by your authorized delegate and provide your authorized delegate with the means by which to give the notice you select.

(2) If your authorized delegate personally receives all funds paid by your customers and you require your authorized delegate to post the required notice described in subsection (e)(3)(B) of this section, you may use one posted notice to provide the required notice and the authorized delegate designation required under Finance Code, §151.403(a)(6).

(g) Am I subject to an enforcement action if I do not provide the required notice? Yes. You are subject to enforcement sanctions under Finance Code, Chapter 151, Subchapter H, if you:

(1) fail to provide the required notice in accordance with this section; or

(2) fail to specify the method and provide the means by which your authorized delegate must give the required notice in accordance with subsection (f)(1) of this section.

(h) Is my authorized delegate subject to an enforcement action if the delegate does not provide the required notice? Yes, if you have complied with subsection (f)(1) of this section. If you have specified the method and provided the means by which your authorized delegate must give the required notice, your authorized delegate is subject to enforcement sanctions if the delegate fails to provide the required notice as directed.

Source: *The provisions of this §33.51 adopted to be effective May 18, 2006, 31 TexReg 3869; amended to be effective July 8, 2010, 35 TexReg 5805; amended to be effective November 4, 2010, 35 TexReg 9698; amended to be effective March 7, 2013, 38 TexReg 1357.*

Exhibit C1

Notice for State-Chartered Banks and Trust Companies and Texas State Branches and Agencies of Foreign Banks (7 TAC §11.37)

NOTICE

The (your name) is (chartered, licensed, or registered) under the laws of the State of Texas and by state law is subject to regulatory oversight by the Texas Department of Banking. Any consumer wishing to file a complaint against the (your name) should contact the Texas Department of Banking through one of the means indicated below:

In Person or U.S. Mail……...	Texas Department of Banking 2601 North Lamar Boulevard Suite 300 Austin, TX 78705-4294
Telephone Number…………..	1-877/276-5554 (toll free)
Fax Number……………….......	512/475-1313
E-mail Address…..……….......	consumer.complaints@dob.texas.gov
Website Address..…………...	www.dob.texas.gov.

Exhibit C2

Combined Notice for State-Chartered Banks and Trust Companies and Texas State Branches and Agencies of Foreign Banks Acting as Authorized Delegate of License Holder under the Money Services Act, Chapter 151 of the Texas Finance Code (7 TAC §11.37 and §33.51 and §151.403(a)(6) of the MSA)

[**NOTE:** *7 TAC §11.37 requires that the Notice include the Department's suite number, full zip code, fax number, and consumer complaint email address, information that is not specifically required under 7 TAC §33.51. To comply with both sections, the combined notice must provide this additional information as indicated in the Combined Notice below.*]

COMBINED NOTICE

The (your name) is (chartered, licensed or registered) under the laws of the State of Texas and by state law is subject to regulatory oversight by the Texas Department of Banking. Any consumer wishing to file a complaint against the (your name) should contact the Texas Department of Banking.

The (your name) also engages in the money transmission and/or currency exchange business as an authorized delegate of (name of license holder) under Chapter 151 of the Texas Finance Code. If you have a complaint, first contact the consumer assistance division of (**Name of License Holder**) at (**License Holder consumer assistance telephone number**), if you still have an unresolved complaint regarding the company's money transmission or currency exchange activity, please direct your complaint the Texas Department of Banking.

Consumers/customers may file complaints with the Texas Department of Banking by contacting the Department through one of the means indicated below:

In Person or U.S. Mail………..	Texas Department of Banking 2601 North Lamar Boulevard Suite 300 Austin, TX 78705-4294
Telephone Number…………..	1-877/276-5554 (toll free)
Fax Number…………………......	512/475-1313
E-mail Address…..…….........	consumer.complaints@dob.texas.gov
Website Address..…………...	www.dob.texas.gov.

Exhibit C3

Notice for Authorized Delegate of License Holder under the Money Services Act, Chapter 151 of the Texas Finance Code (7 TAC §33.51(f) and §151.403(a)(6) of the MSA)

[**NOTE:** *7 TAC §11.37 requires that the Notice provided by state-chartered banks and trust companies and foreign banks that maintain Texas branches and agencies include the Department's suite number, full zip code, fax number, and consumer complaint email address. 7 TAC §33.51 does not specifically require a MSA license holder to include this information, which is shown below in brackets. However, we suggest that MSA license holders provide the additional, bracketed information in the §33.51 Notice below.]*

NOTICE

The (your name) engages in the money transmission and/or currency exchange business as an authorized delegate of (name of license holder) under Chapter 151 of the Texas Finance Code. If you have a complaint, first contact the consumer assistance division of **(Name of License Holder**) at (**License Holder consumer assistance telephone number**), if you still have an unresolved complaint regarding the company's money transmission or currency exchange activity, please direct your complaint to the Texas Department of Banking:

In Person or U.S. Mail……...	Texas Department of Banking 2601 North Lamar Boulevard [Suite 300] Austin, TX 78705[-4294]
Telephone Number………..	1-877/276-5554 (toll free)
Fax Number…………….....	[512/475-1313]
E-mail Address…..…….....	[consumer.complaints@dob.texas.gov]
Website Address.………...	www.dob.texas.gov.

Exhibit C4
Notice for License Holder under the Money Services Act, Chapter 151 of the Texas Finance Code
(7 TAC §33.51)

[**NOTE:** *7 TAC §11.37 requires that the Notice provided by state-chartered banks and trust companies and foreign banks that maintain Texas state branches and agencies include the Department's suite number, full zip code, fax number, and consumer complaint email address. 7 TAC §33.51 does not specifically require a MSA license holder to include this information, which is shown below in brackets. However, we suggest that MSA license holders provide the additional, bracketed information in the §33.51 Notice below.]*

NOTICE

If you have a complaint, first contact the consumer assistance division of (**Name of License Holder**) at (**License Holder consumer assistance telephone number**), if you still have an unresolved complaint regarding the company's money transmission or currency exchange activity, please direct your complaint to the Texas Department of Banking:

In Person or U.S. Mail…….	Texas Department of Banking 2601 North Lamar Boulevard [Suite 300] Austin, TX 78705[-4294]
Telephone Number………..	1-877/276-5554 (toll free)
Fax Number…………….....	[512/475-1313]
E-mail Address…..…….....	[consumer.complaints@dob.texas.gov]
Website Address.…………..	www.dob.texas.gov

Regulatory Guidance - 3007

January 23, 2007

To: Chief Executive Officers of Trust Companies

From: Randall S. James, Banking Commissioner

RE: Gramm-Leach-Bliley Act of 1999 (GLBA)

Background:

The Financial Modernization Act of 1999, also known as the Gramm-Leach-Bliley Act of 1999 or GLBA, includes provisions to protect consumers' personal financial information held by financial institutions. GLBA gives authority to eight federal agencies and the states to administer and enforce the Financial Privacy Rule and the Safeguards Rule. The Financial Privacy Rule governs the collection and disclosure of customers' personal financial information by financial institutions. The Safeguards Rule requires all financial institutions to design, implement and maintain safeguards to protect customer information.

Financial institutions include not only banks, but also trust companies. GLBA directs banking agencies to review their regulations and guidelines to ensure that financial institutions have policies, procedures and controls in place to prevent the unauthorized disclosure of customer financial information and to deter and detect fraudulent access to such information.

The Federal Financial Institutions Examination Council (FFIEC) and the Federal Trade Commission (FTC) issued guidelines that will assist trust companies in understanding and implementing what is required for GLBA compliance. FFIEC guidelines can be found at:

http://www.ffiec.gov/ffiecinfobase/resources/info_sec/fdi-fil-22-2001-security_standards_customer_information.pdf.

Our examiners will use FFIEC guidelines to evaluate your compliance. These guidelines are widely used, so trust companies have a large number of compliance tools and guides available from vendors and Internet resources.

This guidance is provided to assist Texas-chartered trust companies in complying with GLBA.

Guidelines

The Board of Directors and management should approach GLBA compliance with a logical process including a thorough ***risk assessment***, and a ***comprehensive information security program.*** A comprehensive written information security program will include administrative, technical, and physical safeguards appropriate for the size and complexity of the institution and the nature and scope of its activities. The information security program will be designed to ensure the security and confidentiality of customer information, protect against any anticipated threats or hazards to the information, and protect against unauthorized access to or use of such information.

The Board of Directors, or an appropriate committee of the Board, shall approve the institution's written information security program, and oversee its development, implementation, and maintenance, including assigning specific responsibility for its implementation.

Risk Assessment Program:

The risk assessment program should focus on securing information, both electronic and paper based. It must:

- Identify services and systems utilized (hardware and software);
- Identify the reasonably foreseeable threats associated with each system and service;
- Determine the likelihood of each threat (High, Medium, Low, or 1-5, or other measure);
- Assess the potential damage of each threat (High, Medium, Low, or 1-5, etc.);
- Develop policies and procedures to address identified risks; and,
- Assess the adequacy of policies, procedures, and other arrangements to control risks.

Comprehensive Information Security Program:

After completing a risk assessment, the institution must develop an information security program that should address:

- Board of Directors' oversight and assignment of responsibility;
- Program adjustments in light of strategic or technology changes;
- Periodic policy and procedural review, monitoring, and adjustment;
- Annual review of access controls and restrictions to systems and workstations;
- Regular internal and external security assessments to verify network security posture;
- Remote access procedures and controls;
- Virus protection standards;
- Encryption standards for electronically transmitted or stored data;
- Backup and recovery procedures;
- Annual training and education of staff regarding the information security program;
- Vendor oversight that monitors and requires service providers handling customer data to contractually agree to implement security measures that meet GLBA guidelines;
- Program adjustments in light of any relevant changes from monitoring and evaluation; and,
- Annual reports to the board that describe the overall status of the information security program and the institution's compliance with GLBA guidelines.

Conclusion

The Board of Directors is responsible for the information security program and should ensure that your institution is complying will all applicable GLBA requirements. The Department is ready to assist you in this regard by responding to your questions. Feel free to contact Regional Director Larry Walker at (817) 640-4050 or Larry.Walker@dob.texas.gov , who will coordinate a response to your questions.

Regulatory Guidance - 3008

April 20, 2011

To: Chief Executive Officers of State-Chartered Banks

From: Charles G. Cooper, Banking Commissioner

RE: Residential Mortgage Loan Fraud

Background:

Mortgage loan fraud has been rising significantly in recent years. According to the Financial Crimes Enforcement Network (FinCEN), the number of Suspicious Activity Reports (SARs) filed by depository institutions indicating suspected mortgage loan fraud increased by 1,411% between 1997 and 2005. Texas ranked fourth in the number of mortgage loan fraud related SARs filed in 2005. The Texas Legislature recognized the need for legislation to help combat the growing mortgage fraud problem and during the 80th Legislative Session passed the Residential Mortgage Fraud Act, House Bill 716 (HB716).

Overview:

HB716 amends Section 343.105 of the Finance Code and requires a lender, mortgage banker, or licensed mortgage broker to provide each applicant for a home loan a written notice at closing indicating that intentionally or knowingly making a materially false or misleading written statement to obtain property or credit is a violation of Section 32.32, Texas Penal Code. The bill also outlined the criminal penalties for making false or misleading written statements. In addition to changes to the Finance Code, HB716 added two sections to the Government Code, §402.031 and §402.032, regarding the reporting of fraudulent activities, and the establishment of the Residential Mortgage Fraud Task force to better enable law enforcement and state agencies to take a proactive stance towards tracking and prosecuting mortgage fraud and the perpetrators of mortgage fraud. The bill became effective September 1, 2007.

Section 343.105 of the Finance Code, titled "**Notice of Penalties for Making False or Misleading Written Statement**", provides the suggested language for the required notice and stipulates that the applicant shall verify the information and execute the notice. All residential mortgage loans closed on or after September 1, 2007 shall have an executed notice by each applicant. A copy of this section of the statute and a sample of the notice are found in Exhibits A and B, respectively.

Sections 402.031 and 402.032 of the Government Code address the reporting of fraudulent activities and the residential mortgage fraud task force, respectively. Section 402.031 states that fraudulent activities should be reported to an authorized governmental agency which includes the attorney general; a local, state or federal law enforcement agency; a U.S., county, or district prosecuting attorney; or one of the agencies represented on the Residential Mortgage Fraud Task Force. If a person reasonably suspects that fraudulent activity has been or is about to be committed, the person is required to report this information to one of these authorized agencies. If a person reports the information to the attorney general, the attorney general shall notify each agency with representation on the Residential Mortgage Fraud Task

Force. If a financial institution or person voluntarily reports fraudulent activity, neither the reporting party nor the notified agency can disclose to anyone involved in the fraudulent activity that the act has been reported. Any party voluntarily reporting possible fraudulent activity will not be liable to any person under any state or federal law or regulation for the report. This will not eliminate or diminish any common law or statutory privilege or immunity.

Section 402.032 of the Government Code creates the Residential Mortgage Fraud Task Force (Task Force). The Task Force, under the direction of the Attorney General, is a partnership between state, federal, and local law enforcement agencies formed to better enable law enforcement and state agencies to track and prosecute mortgage fraud and its perpetrators. The Task Force will focus its efforts on (1) sharing information and resources; and (2) successfully enforcing administrative and criminal actions against perpetrators of mortgage fraud. The Task Force consists of the following persons or their appointees: the Texas Attorney General, the Consumer Credit Commissioner, Banking Commissioner, Credit Union Commissioner, Commissioner of Insurance, Savings and Mortgage Lending Commissioner, the presiding officer of the Texas Real Estate Commission; and the presiding officer of the Texas Appraiser Licensing and Certification Board. Task Force members may share confidential or restricted information for the purpose of investigating mortgage fraud and its perpetrators. For purposes of the Task Force, only residential mortgage fraud will be addressed, which includes permanently financed 1-4 family real estate loans.

This Regulatory Guidance was originally issued in January 2008. The current revisions are technical in nature and were made to update the web site address references for the Texas Department of Banking.

Guidelines

The required "**Notice of Penalties for Making False or Misleading Written Statement**" is a separate document which should be provided to each applicant of a one to four family home loan at the time of closing. It is recommended that if a revision or renewal is made to an existing home loan which requires an underwriting decision, then the Notice of Penalties for Making False or Misleading Written Statement should be executed. The wording of such notice is found in §343.105 of the Finance Code. See Exhibit A. A sample notice is provided in Exhibit B.

If a financial institution suspects mortgage fraud, the financial institution shall first submit a Suspicious Activity Report to FinCEN as required by 31 CFR Part 103, and then contact one of the authorized governmental agencies serving on the Residential Mortgage Fraud Task Force. To contact the Department of suspected mortgage fraud, the financial institution should utilize the fraud report form found under Consumer Assistance on the Department's website, www.dob.texas.gov, and mail or fax it to:

Texas Department of Banking
Attention: Consumer Assistance Activities
2601 North Lamar Boulevard
Austin, TX 78705
Fax 512/475-1313

You can direct your questions about this regulatory guidance or §343.105 of the Finance Code to the Director of Strategic Support at 512-475-1300.

EXHIBIT A

§343.105. NOTICE OF PENALTIES FOR MAKING FALSE OR MISLEADING WRITTEN STATEMENT.

(a) A lender, mortgage banker, or licensed mortgage broker shall provide to each applicant for a home loan a written notice at closing.

(b) The notice must:
(1) be provided on a separate document;
(2) be in at least 14-point type; and
(3) have the following or substantially similar language:

"Warning: home loan, are true and correct as of the date of loan closing." Intentionally or knowingly making a materially false or misleading written statement to obtain property or credit, including a mortgage loan, is a violation of Section 32.32, Texas Penal Code, and, depending on the amount of the loan or value of the property, is punishable by imprisonment for a term of 2 years to 99 years and a fine not to exceed $10,000.

"I/we, the undersigned home loan applicant(s), represent that I/we have received, read, and understand this notice of penalties for making a materially false or misleading written statement to obtain a home loan.

"I/we represent that all statements and representations contained in my/our written home loan application, including statements or representations regarding my/our identity, employment, annual income, and intent to occupy the residential real property secured by the home loan, are true and correct as of the date of loan closing."

(c) On receipt of the notice, the loan applicant shall verify the information and execute the notice.

(d) The failure of a lender, mortgage banker, or licensed mortgage broker to provide a notice complying with this section to each applicant for a home loan does not affect the validity or enforceability of the home loan by any holder of the loan.

Added by Acts 2007, 80th Leg., R.S., Ch. 285, § 1, eff. September 1, 2007.

EXHIBIT B

NOTICE OF PENALTIES FOR MAKING FALSE OR MISLEADING STATEMENT

WARNING:
Intentionally or knowingly making a materially false or misleading statement to obtain property or credit, including a mortgage loan, is a violation of Section 32.32, of the Texas Penal Code, and, depending on the amount of the loan or value of the property, is punishable by imprisonment for a term of 2 years to 99 years and a fine not to exceed $10,000.00.

I/we, the undersigned home loan applicant(s), represent that I/we have received, read, and understand this notice of penalties for making a materially false or misleading written statement to obtain a home loan.

I/we represent that all statements and representations contained in my/our written home loan application, including statements or representations regarding my/our **identity, employment, annual income, and intent to occupy the residential real property** secured by the home loan, are true and correct as of the date of loan closing.

____ ___________
Applicant Date

____ ___________
Co-Applicant(s) Date

STATE OF TEXAS

COUNTY OF ______________________

Before me, the undersigned notary, on the ___________ day of ___________, 200__ personally appeared ____, and ______________________________________, a person(s) whose identity is known to me. After I administered an oath to him/her/them, he/she/they said he/she/they read the above notice and that the fact stated therein are within his/her/their personal knowledge and are true and correct.

____
Notary Public in and for the State of Texas

Regulatory Guidance – 3009

August 5, 2009

To: Chief Executive Officers of Texas State-Chartered Banks

From: Charles G. Cooper, Banking Commissioner

RE: Loan Participation Risks

Overview:

This guidance is issued to raise awareness among Texas state-chartered banks regarding potential risk to banks with loan participation agreements if the lead bank fails. Loan participants may suffer a loss in situations where the lead bank fails and the loan customer's deposits (including pledged deposits) are offset against their outstanding loan(s). Instead of participating pro-rata in the setoff amount, the participating bank will be issued a Receiver's Certificate in the amount of the setoff from the Federal Deposit Insurance Corporation (FDIC) as receiver of the lead bank.

Background:

Generally, a bank that purchases a loan participation is entitled to receive its pro-rata share of any payments made by the borrower, as provided in the loan participation agreement. In addition, in the event the borrower defaults and loan collateral is foreclosed upon, foreclosure proceeds will also be paid to the loan participant in accordance with the participation agreement. When a bank fails, the FDIC will either sell the borrower's loan at closing or retain it in the receivership estate. In either case, the borrower is still obligated to pay the debt. If the borrower has deposits in the failed bank, the borrower has the right to set off any of his/her deposits against any indebtedness owed to the failed bank, or the FDIC, as receiver, may initiate such action, particularly if a borrower's loan is in default.

A string of court cases in the 1980's have established that such an offset is not a payment; it is a bookkeeping transaction or "a mere shifting of credits." Only the balance of a loan after a setoff is deducted is considered part of the assets of a failed bank. Because the setoff does not augment the receivership estate, there are no proceeds to be passed on to the loan participant. As a result, a loan participant may suffer a loss if the borrower or receiver exercises a right of set off against the failed lead bank. Demand deposits and certificates of deposit pledged as collateral on a loan will also be considered a setoff when applied to the loan balance in a failed bank situation. The loan participant is therefore left with a general unsecured claim against the receivership for the amount of the setoff. After the setoff, the loan participant continues to receive its pro-rata share of any payments made by the borrower or any proceeds of foreclosed loan collateral.

A participated loan balance may also be reduced, post-failure, by the borrower using deposit insurance funds. When a bank fails, the insured portion of a deposit is paid by the FDIC to the depositor and these deposit insurance funds are therefore not part of the failed bank's estate. The borrower's use of the proceeds of deposit insurance to make a payment on a loan is treated differently than a setoff because these funds are considered "new money" contributed by a third party (the FDIC). The depositor is free to decide how to use the deposit insurance funds. If the borrower chooses to use these funds to make a payment on the participated loan, the payment would be allocated among the receiver and the participant bank according to the participation agreement. Typically, a depositor will only setoff the uninsured amount of its deposit, and will accept deposit insurance on the insured amount from the FDIC as deposit insurer.

Potential Risk Scenarios:

The effect of a setoff on a loan participation interest is illustrated in the following examples.

Bank A loans Borrower $1,000,000 and Bank B has a 50% participation interest in the loan. Borrower has $300,000 on deposit with Bank A, of which $250,000 is FDIC insured. Bank A fails. Borrower elects to exercise his/her right to set off the entire $300,000 deposit against the $1,000,000 debt. The Borrower's debt to Bank A would then be reduced to $700,000. Bank B's 50% participation in the outstanding balance of this loan is now $350,000. However, instead of this being a cash reduction, the FDIC would provide Bank B a Receiver's Certificate in the amount of $150,000, which is 50% of the setoff. This represents Bank B's general unsecured claim against the receivership. One month later, Borrower makes a $100,000 payment on the loan from Bank A. Bank B receives its pro rata share of the payment ($50,000). Bank B is left with a general unsecured claim of $150,000 and a remaining participation interest of $300,000.

In the scenario above, Borrower set off both the insured and the uninsured deposits against the loan. Borrower could have elected to receive the deposit insurance proceeds instead of setting off the entire deposit against the debt. If Borrower had received $250,000 in deposit insurance from the FDIC, the remaining $50,000 uninsured deposit would be set off against the loan. Bank B would have a $25,000 general unsecured claim against the receivership and would receive its 50% participation interest ($475,000) in the $950,000 balance of the loan that is subsequently paid by the Borrower. If the borrower chose to receive the $250,000 in deposit insurance and then pay this amount on the loan balance, Bank B would receive its 50% participation interest as a cash payment ($125,000).

Recommendation:

Bank management is reminded of the importance of monitoring participation interests and reducing concentrations of loans purchased from any one financial institution, regardless of loan type. Banks are strongly encouraged to perform sufficient monitoring and analysis to ensure that the lead bank is not a high risk institution. Participating banks should request borrower deposit information to determine the extent of any uninsured deposits and potential setoffs.

Loan participation agreements vary and state-chartered banks should consult with their legal counsel in analyzing their loan participation risks.

You can direct your questions about this regulatory guidance to Kurt Purdom, Director of Bank and Trust Supervision Division, at 512-475-1300.

Regulatory Guidance - 3010

September 13, 2010

To: Chief Executive Officers of State-Chartered Banks

From: Charles G. Cooper, Banking Commissioner

RE: Effect of Financial Accounting Standard No.166 on Legal Lending Limits

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New accounting rules that impact the way banks account for loan participations became effective January 1, 2010. The Financial Accounting Standards Board (FASB) issued Statement No. 166, *Accounting for Transfers of Financial Assets* (FAS 166), which revises FASB Statement No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*. FAS 166 addresses when transfers of financial assets may be accounted for as a sale. Part of this revision involved establishing characteristics of a "participating interest." Loan participations that do not possess the characteristics set out in FAS 166 cannot be treated as a sale and would therefore remain on the balance sheet of the transferor.

Because of its affect on which assets remain on a bank's balance sheet, this accounting change will impact a bank's regulatory capital ratios and allowance for loan and lease losses. Those effects have been addressed by the Federal regulatory agencies.

This change in accounting standards is unrelated to the requirements for the determination of legal lending limit for a Texas state-chartered bank. Therefore, despite this change in accounting treatment, the Department's treatment of loan participations for legal lending limit purposes has not changed.

Title 7 Texas Administrative Code §12.3 establishes how loans or extensions of credit will be treated in the determination of the legal lending limit for a Texas state-chartered bank. Section 12.3(b)(3) provides that a portion of a loan sold as a participation on a non-recourse basis will not be considered a loan for legal lending limit calculations so long as the participation results in a pro rata sharing of credit risk proportionate to respective interests of the originating and participating lenders. The rule additionally provides that this is true even if payments on the loan are not shared on a pro-rata basis.

Pursuant to 7 TAC §12.3, Texas chartered banks that have participation agreements structured to divide payments on a basis other than pro-rata (such as the commonly used last in – first out (LIFO), or first in – first out (FIFO) basis) can still have these participated accounts netted from the total loan balance for legal lending limit purposes provided the participation agreement includes a provision that the participation will convert to a pro-rata distribution in the event of default or a comparable event.

Therefore, loan participations that meet the requirements of 7 TAC §12.3, will be deducted for legal lending limit calculations, regardless of the accounting treatment of the loan provided under FAS 166. Should you have questions, please contact the Legal Division at 512-475-1300.

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