# Testimony Of Catherine A. Ghiglieri, Banking Commissioner State Of Texas Before The House Interim Financial Institutions Committee Interstate Branching

*Date: September 17, 1998*

## INTRODUCTION

Thank you for the opportunity to address this committee regarding the advent of interstate branching in Texas and the legislative changes that are necessary to implement this development.

## BACKGROUND

As Commissioner, I strove to uphold the legislation passed in 1995 to opt-out of interstate branching, now located at Section 31.0095 of the Texas Finance Code. I filed three different lawsuits against the Comptroller of the Currency (OCC) and the two banks that sought to operate on an interstate basis. For nearly three years the litigation continued until the Supreme Court of the United States refused to hear our appeal. After this disappointment, the OCC ruled that the Texas opt-out provision was ineffective to prevent cross-border mergers and branching. In essence, federal law requires an opt-out statute to apply equally to all banks. Because state saving banks are defined as "banks" under federal law, currently existing, interstate branching powers of Texas state savings banks cause the opt-out statute to be federally preempted. The United States District Court for the Northern District of Texas then allowed NationsBank of Texas to merge into NationsBank of North Carolina.

As a result of the loss in these court challenges, the opt-out law would apply to state chartered institutions but would not apply to national banks. This situation placed our state banks in a position of competitive inequality. Consequently, I authorized the same interstate branching rights for state institutions on May 13, 1998. Attached as Exhibit A is the opinion of our general counsel outlining the technical, legal basis for this determination, along with a copy of the notice sent to the Texas Legislature and the Texas Congressional delegation, attached as Exhibit B.

As a result of the court decisions and our opinion, we have already received three interstate merger applications, all from Alabama bank holding companies, Compass, Regions, and Colonial, to merge their Texas operations into their Alabama lead banks.

We believe interstate branching will have a minimal impact on our Department. A worst case scenario would occur if all banks owned by out-of-state holding companies were to be converted to branches of the out-of-state lead banks. We believe that this worst case would require us to reduce our staff by only five to six employees. While that may not seem likely, what we have experienced that several of the pending applications actually bring assets into the state system. For example, Regions is buying seven national banks in Texas and making them branches of its state bank in Alabama. We have entered into a fee-sharing agreement with the Alabama State

Banking Department that would compensate us for our work on the Texas branches of Alabama banks. So in the case of Regions branching out of Texas, our revenue is going to go up with no impact to the staffing levels.

While the mergers out of the state will not affect staffing and Banking Department revenue to a material extent, it will affect franchise tax revenue. NationsBank currently pays no franchise taxes to Texas and the other banks that merge out of state will escape franchise taxes as well. This loss of revenue highlights the need to adapt our laws to match an interstate branching environment.

In 1995, a bill was filed to change the method of computing franchise taxes for banks. This bill passed muster with the Comptroller of Public Accounts and the bank trade associations. Approximately 20 states have adopted the same franchise tax formula as was proposed in the 1995 bill, and no states have contacted the Multistate Tax Commissioners to complain about any problems with this formula. However, because franchise tax bills may be unpopular with some businesses, we will recommend the bill be presented separately from the general interstate amendments.

My fellow regulators from other states and I have entered into a nationwide agreement providing for a single point of contact for state banks operating on an interstate basis. Because national banks have a single regulator, this effort to maintain a single point of contact for state banks has important competitive aspects.We will continue to pursue other means of reducing the regulatory burden for state banks in an interstate branching environment. For example, a uniform interstate charter application has been developed. This application is shorter than the form currently used by the Department and may be extended to in-state merger applications as well.

**INTERSTATE BRANCHING TASK FORCE**

Following the announcement authorizing interstate branching for state-chartered banks, we convened an Interstate Branching Task Force. The Task Force has met three times to review and discuss possible amendments to state law. The Task Force consists of banking lawyers, representatives of trade associations and consumer groups, staff of the Banking Department, the Comptroller of Public Account's office and other state agencies, and legislative staff members. (The members of the Task Force and the subcommittees are attached as Exhibit C .) The focus of the group is to make recommendations for changes required for the proper administration and supervision of interstate branching. In addition, the Task Force has reviewed laws from across the country to assess the powers of banks in other states. It is the goal of the Task Force to design a system to advance a Texas charter as the charter of choice, and thereby enhance the economic development of this state.

**Subcommittees**

Public Depositories - The issue regarding whether a bank that does not have its main office in Texas can, under state law, hold public deposits became apparent immediately upon the merger of NationsBank out of the state. Numerous school districts and local government officials called the Department with questions regarding their public deposits. Federal banking law and the Commerce Clause preempt state laws prohibiting an out-of-state national bank with branches in this state from holding public deposits under the same conditions as state banks. The Public

Depositories subcommittee has reviewed over 90 state laws regarding public deposits and discussed these issues with the Texas Education Agency, various school districts, county treasurers and other officials charged with the safekeeping of public monies. In addition, the subcommittee has researched federal law and the laws of other states that address public deposits. The laws regarding public deposits are inconsistent; state funds may be deposited with a bank doing business in the state, school districts may deposit funds in a bank domiciled in the state, and other laws require that deposits may be placed in a bank located in the state. Consequently, even though federal law preempts protectionist state law, local officials still feel restricted by this statutory language.

The subcommittee first recommended a global amendment, which would define the term "eligible bank" for purposes of accepting public deposits. However, after discussions with representatives of local government officials, the subcommittee will recommend specific changes to each affected provision, in addition to a global amendment. Clarifying the law in this manner will aid those officials who must make appropriate investment decisions and who would not, as a practical matter, utilize the Finance Code to look for subtleties in definition. Because of the number of laws to be affected, I anticipate that these amendments will be presented to the Committee as a separate bill.

Unclaimed Property - The Unclaimed Property subcommittee reviewed whether there was a gap in the Texas unclaimed property statutes when a bank holding unclaimed property only has a branch in Texas. Such a gap could result in the loss of monies or property such as safety deposit boxes, cashier's checks, and checking accounts that are currently escheated to the state.

Upon review of the laws, the subcommittee determined that the definition of "depository" is broad enough to cover both in-state and out-of-state institutions. However, because of statutory differences between states, conflicting claims against abandoned property may arise. Some years ago, the Supreme Court resolved state ownership of property by determining primary and secondary claims. A state has a primary claim if it is the state of the property owner's last known address. If there is no known address, the state in which the business remitting the funds is incorporated has a secondary claim. This test does not change in the context of interstate branching.

The most important factor that affects a state claim to unclaimed property is the statutory abandonment period. Texas has a five-year abandonment period; some states have only a three-year period. Generally, the state with the shorter time frame prevails, even if it has a secondary claim. The subcommittee will review other state laws to determine whether any amendments to time frames or definitions should be recommended to assure that the unclaimed property of Texas depositors is reported to this state.

Consumer Lending - The Consumer Lending subcommittee reviewed the laws that would be applicable to branches of out-of-state banks operating in this state. One of the main concerns to banks is the usury statute and whether local banks would suffer a competitive disadvantage regarding the applicable interest rate that could be charged. Under certain circumstances, out-of-state banks may export higher interest rates to Texas customers. But because of the significant controversy that exists between consumer advocates and the banks on this issue, no

recommendation will be included regarding changes in usury law affecting consumer lending, but is one that deserves further study by the Legislature.

Notice and Reporting Requirements - The Notice and Reporting Requirements subcommittee considered what information should be required from an out-of-state bank. Under the Reigle-Neal Interstate Banking and Branching Act passed by the federal government in 1994, states have wide latitude to adopt non-discriminatory reporting requirements. The subcommittee will recommend that the proposed legislation include the notice and reporting requirements suggested by the Conference of State Bank Supervisors in their model legislation. These provisions require banks to file copies of applications for interstate merger transactions and copies of financial reports filed with other states or federal agencies with the Banking Commissioner, if they are not otherwise accessible to the Commissioner.

Separately, we reached an agreement with NationsBank to submit reports to the Department. NationsBank will submit a report containing deposit information by branch and state-wide loan and deposit totals attributable to the State of Texas, arranged by category. NationsBank will also provide copies of Home Mortgage Disclosure Act and small business lending reports, and information on nonbank credit products.

In addition, NationsBank committed to support legislation requiring annual loan and deposit reporting, on a county-by-county basis, by all banks operating in Texas, provided such legislation does not discriminate against out-of-state banks.

Fiduciary Practices - The Fiduciary subcommittee was charged with the review of the Trust Company Act adopted last session and whether any changes should be made to allow trust companies to operate on an interstate basis. The Trust Company Act contains a self-executing parity provision with state banks, so changes to the Finance Code will also benefit trust companies. However, this provision authorizes parity in the exercise of fiduciary powers of a bank domiciled in this state. While any amendments to the Trust Company Act this session are complicated by the fact that the Trust Company Act will be codified into the Finance Code, these changes must be made to avoid any disadvantages to the Texas trust company charter. The recommended changes will include specific authorization for out-of-state offices and supervisory authority to regulate trust companies headquartered in other states.

Another issue is whether to repeal Section 105A of the Probate Code. Section 105A prohibits the solicitation of fiduciary business in Texas by out-of-state banks and trust companies. This provision has been partially preempted by the OCC and by the federal regulator of federal savings banks, the Office of Thrift Supervision. From my experience, I can also say that Section 105A is extremely difficult to enforce. Prohibiting solicitation of trust business across geographic boundaries in the era of the Internet is virtually impossible. We have spoken with a probate judge about repealing this provision. He recommends instead that we eliminate the preempted provisions and retain the balance of the statute. He believes that certain procedural mechanisms in Section 105A applicable to out-of-state fiduciaries should remain to enable judges to easily locate these provisions in the Probate Code.

Supervision of trust companies on an interstate basis provides problems unique from banks. First, there is no "backup" federal regulator. Some states have little to no experience in the regulation of trust companies. Additionally, this is a rapidly growing area of assets and our past experience indicates that it is an area ripe for fraud. Multi-state cooperation in the supervision of trust companies is essential and we must maintain the ability to intervene immediately in the operation of an out-of-state trust company. My fellow state regulators and I are continuing to evaluate the attributes of an effective, multi-state regulatory system for trust companies.

Powers - The Powers subcommittee extensively reviewed the authority granted to national banks, savings institutions and other state institutions. As a result of this research, the subcommittee will recommend that in order to reach the goal of making the Texas charter the charter of choice, the legislation should include a "super wildcard" provision. This wildcard provision would allow a Texas bank, upon notice to the Banking Commissioner, to exercise any power authorized to another financial institution in the United States that is permitted under applicable federal law. The Banking Commissioner could veto the activity if the activity would jeopardize the safety and soundness of the bank. The provision would be innovative and flexible to promote the long-term economic development of financial institutions in the state, while providing important safeguards.

Civil Practice and Remedies - The Civil Practice and Remedies subcommittee researched issues relating to practical problems that arise when claims against customers are served or delivered to an institution with an out-of-state main office and the difficulties that claimants may face in knowing which office to serve. Current law allows service of a claim at any office at which there is a vice-president. For banks, this is any branch office. A claim includes a writ of attachment, writ of garnishment, notice of freeze, notice of levy, notice of child support lien, notice of seizure, notice of receivership and other instruments asserting a claim against a customer's account. In order to avoid confusion, the subcommittee will recommend that a bank register with the Secretary of State and that service of a claim must be made at the office of the registered agent. Banks located only within Texas are also interested in the option of designating an office for service of process.

Staff of the Banking Department will meet with staff of the Secretary of State's office to coordinate any recommended changes in this area.

Market Issues - Market issues comprise the most controversial matters discussed by the Task Force. Here is the area of greatest change and, consequently, the greatest unknown. The subcommittee has discussed the conditions under which an out-of-state institution may engage in the banking business in this state, and, correspondingly, the ability of our banks to operate in other states. Restrictive market entry has two purposes: to protect the market share of in-state banks and to enhance their franchise value. Currently, the law allows interstate branching only through acquisition of an institution at least five years old. Following the acquisition, the resulting bank may not hold greater than 20% of the deposits in the state.

The Task Force has reviewed the following issues:

- permitting de novo branching

- permitting acquisition of a branch only
- reducing the minimum age requirement
- changing the deposit cap
- permitting agents for unaffiliated institutions

There was no consensus among Task Force members regarding a change in the deposit cap or the minimum age requirement. The subcommittee will not recommend any changes in these two areas. The Task Force does believe that allowing banks to act as agents for unaffiliated institutions will allow community banks to provide increased customer service, especially in communities near the borders of Louisiana, Arkansas, Oklahoma, and New Mexico, without the attendant cost of acquiring an institution across state lines.

De novo branching and acquisition of a branch only are permitted in a minority of other states. Currently, we will authorize interstate de novo branches into the states that permit de novo branching without reciprocity. However, this only allows our banks to branch into four other states on a de novo basis, and none contiguous to Texas. National banks can still avoid restrictive entry into Texas because the 30-mile loophole provision that figured so prominently in the NationsBank case may still be utilized to open a new main office here while keeping branches in the former headquarters' state. From a market perspective, many institutions will not enter a new market without purchasing the assets of an existing bank. The impact of permitting de novo branching may therefore be minimal except in border areas where a de novo branch might be physically located near the bank's main office and within its existing geographic market.

Because a change to permit de novo branching or acquisition of a branch only is an immense change from the decision to opt out of interstate branching, some hesitation exists to opening the doors that wide to out-of-state banks. The Task Force is now considering a compromise position, which would permit de novo branching, but only on a reciprocal basis. The Board of Directors of the Independent Bankers Association of Texas will consider this issue in their September 28th meeting. If the compromise is approved, the Task Force will forward this recommendation.

**CONCLUSION**

The Task Force subcommittees are completing their work and we have begun the process of drafting the bills. Our goal is to recommend consensus bills that have support from all participants and forward a comprehensive package to prepare our state for a position of leadership in an interstate branching environment. As we move through this process, we will continue to solicit input from all affected parties.