

June 24, 1992

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Re: Preemption of Texas Law Governing Late Charges (Your June 1, 1992, Letter)

Dear Mr. Williams:

You asked whether federal law preempts a Texas statute prohibiting imposition of late charges by a federal credit union ("FCU") with respect to a "dealer indirect financing transaction." For the reasons set forth below, we do not believe that the Texas statute is preempted.

Background

Your firm represents several FCUs that wish to engage in a dealer indirect financing program. Under the program, an automobile dealer enters into a retail installment sales contract with a buyer (presumably, an FCU member) who has been preapproved by the FCU or qualifies for an FCU loan under a loan application faxed to the FCU by the dealer. The contract is immediately assigned to the FCU by the dealer. The FCU holds a perfected security interest in the vehicle.

Article 5069-7 of the Texas Consumer Credit Code governs vehicle installment sales, including "retail installment transactions." That term is defined by Article 5069-7.01(d) as: "any transaction as a result of which a retail buyer acquires a motor vehicle from a retail seller under a retail installment contract for a sum consisting of the cash price and other charges and in which the buyer agrees with the retail seller to pay part or all of such sum in one or more deferred installments." The term includes all such transactions even where (1) the seller sells or arranges to sell, transfer or assign the buyer's obligation; (2) the amount of the charges are determined by reference to information furnished by a financing institution; (3) the forms of instruments are furnished by a financing institution; and (4) the buyer's credit standing has been evaluated by a financing institution. A "retail installment contract" is defined in Article 5069-7.01(e) as "any contract evidencing a retail installment transaction." The arrangement you describe qualifies as a retail installment transaction, and therefore the loan contract is a retail installment contract that must comply with Article 5069-7 unless that statute is preempted in its application to FCUs.

Article 5069-7 does not specifically prohibit imposition of late charges in the situation you describe. However, the Office of the Consumer Credit Commissioner ("Commissioner") has issued a letter stating that late charges may not be assessed in "simple interest contracts" subject to Article 5069-7. We assume from your letter that the dealer indirect financing program utilizes simple interest contracts. That being the case, unless Article 5069-7 is preempted for FCUs, it would seem that no late charges may be assessed under the program.

You question whether Section 701.21(b)(1)(i)(B) of the NCUA Rules and Regulations ("Regulations"), which preempts state laws affecting late charges on FCU loans and lines of credit, operates to preempt the relevant provisions of the Code and the Commissioner's interpretation thereof. The following is a general analysis, together with your specific questions, and our answers to each.

Analysis

You correctly note that FCUs generally have the unrestricted right to impose late charges, pursuant to Section 107(10) of the Federal Credit Union Act ("Act"), Section 701.21(b)(1)(i)(B) of the Regulations, and Article XII, Section 8 of the Standard FCU Bylaws. Moreover, Section 701.21(b)(1)(i)(B) specifically states that any state laws purporting to limit or affect FCU late charges is preempted. Where an FCU originates a loan, any attempt by a state to limit an FCU in its exercise of the power to assess late charges conflicts with the Act and the Regulations, and any state law so limiting an FCU would be preempted.

However, this analysis does not apply to loans made by other lenders and assigned to an FCU. As used in Section 701.21(b), the term "FCU loans" refers to loans actually originated by the FCU. While an FCU may purchase certain loans (see, Section 107(13) of the Act and Section 701.23 of the Regulations), only those loans that the FCU itself makes are exempt from state laws under Section 701.21(b). Loans purchased by, or assigned to an FCU are subject to state law unless refinanced by the FCU. When an FCU refinances such a loan, it in fact originates a new loan, which is subject to both the limitations and the benefits imposed by the Act and the Regulations, including any applicable preemption of state law.

In light of the foregoing, our answers to your specific questions are as follows.

1. May a federal credit union engaging in dealer indirect financing transactions be subject to state law which purports to limit the imposition of late charges? If so, presumably the entirety of that state law would be operable and the pre-emption would be totally ineffective.

Answer. Yes, an FCU engaging in dealer indirect financing transactions is subject to state law limiting late charges. The FCU is not the originator of the loan, and hence the loan must comply with state law. Again, if the FCU were to refinance the loan, state law on finance charges would be pre-empted with regard to the new loan.

2. In light of the NCUA Board's exclusive authority to regulate rates, terms of repayment and other conditions of FCU loans and lines of credit, does NCUA expand the definition of "loans and lines of credit" to encompass retail installment contract purchase and assignment transactions where at the inception of the transaction all parties contemplate the credit union and its member will be the ultimate borrower and lender?

Answer. We have not given the phrase "loans and lines of credit" the broad interpretation you suggest. As was stated above, FCU loans are loans that the FCU itself actually originates. Despite the fact that at the time that the loan is made by the dealer all parties contemplate that it will be assigned to the FCU as the "ultimate lender," the loan you describe is still being originated by the dealer, and therefore it is not an FCU loan.

3. Would NCUA's position with regard to the foregoing differ depending upon the proximity of the assignment to the member's execution of the Retail Installment Contract?

Answer. No. The proximity of the assignment has no effect on the critical fact that the FCU is not the originator of the loan.

4. What is NCUA's position, if any, concerning the effectiveness and propriety of a choice of law provision stipulating that the Federal Credit Union Act and Regulations will control a transaction such as that outlined above?

Answer. We offer no opinion on the legality or propriety of such a provision. In our view, state contract law would control on this issue.

I hope that we have been of assistance.

Sincerely,

Hattie M. Ulan
Associate General Counsel

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1 Without having been referred to a definition of "financing institution," we assume that the term includes FCUs