NATIONAL CREDIT UNION ADMINISTRATION

WASHINGTON, D.C. 20456

February 14, 1992

Doniel Kitt, Esq.
Administrative Attorney
State of Connecticut
Department of Banking
44 Capitol Avenue
Hartford, CT 06106

RE: Proposed Connecticut Statute
(Your Letter of January 22, 1992)

Dear Mr. Kitt:

You requested an opinion regarding whether a proposed Connecticut statute would be preempted by NCUA regulations. It is our belief that it would be.

BACKGROUND

The proposed Connecticut Statute (attached) differs from the priority schedule for involuntary liquidations set forth in the NCUA Rules and Regulations in three respects. See 12 C.F.R. §709.5. First, it includes as the first order of priority a category not extant in the NCUA regulations, namely "all fees and assessments due the Commissioner." It might seem that these sorts of expenses would usually fall into the first order of priority for unsecured claims as "administrative costs and expenses of liquidation" under normal NCUA liquidation procedure. See 12 C.F.R. §709.5(b)(1). Secondly, it includes as the fifth order of priority another category not extant in the NCUA regulations, namely "costs and expenses incurred by creditors in successfully opposing the release of the central credit union from certain debts as allowed by the commissioner." This category was formerly recognized by the NCUA, but was deleted in the recently amended Part 709 due to the infrequency of its use by creditors. Thirdly, it includes a statement of general applicability to all categories of priority not extant in the NCUA regulations, namely "in application of the preceding sentence, any provision for subordination contained within any debt instrument issued by the central credit union shall be given effect." NCUA states in its regulation a statement of similar, but more general, import: "Priorities are to be

Full Vol. IV, A, I

based on the circumstances that exist on the date of liquidation." 12 C.F.R. §709.5(c).

ANALYSIS

In the preamble to the final involuntary liquidation rule, the NCUA states:

> One commenter noted that the regulation establishes a payout priority in an attempt to preempt state law when the Board acts as liquidating agent for state-chartered credit unions. State law will be followed to the extent that it does not conflict or interfere with the Board's statutory authority. Whether a particular state's statute providing for a payout priority different from that established in this regulation is preempted will depend upon the substantive effect of that statute. Generally, the Board believes this is a non-issue because the major claimant against a credit union's assets is the NCUSIF based on its insurance payout and, in reality, it will receive its funds after all other claimants. 56 Fed.Reg. 56921 (November 7, 1991).

The NCUA's policy regarding preemptions is derived partly from Executive Order No. 12612, Federalism. In pertinent part, this Order states:

> §4(a) To the extent permitted by law, Executive departments and agencies shall construe, in regulations and otherwise, a Federal statute to preempt State law only when the statute contains an express preemption provision or there is some other firm and palpable evidence compelling the conclusion that the Congress intended preemption of State law, or when the exercise of State authority directly conflicts with the exercise of Federal authority under the Federal statute. . . . (c) Any regulatory preemption of State law shall be restricted to the minimum level necessary to achieve the objectives of the statute pursuant to which the regulations are promulgated. (d) As soon as an Executive department or agency foresees the possibility of a conflict between State law and Federally protected interests within its area of

> regulatory responsibility, the department or agency shall consult, to the extent practicable, with appropriate officials and organizations representing the States in an effort to avoid such a conflict. 52 Fed.Reg. 41685 (October 26, 1987).

Given NCUA and federal policy regarding preemption, it is clear that preemption is an action not taken lightly. The court test for determining whether a promulgated federal regulation preempts state law is discussed in Fidelity Federal S & L Assn. v. de la Cuesta, 458 U.S. 141 (1982). In this case, the Supreme Court held that the Home Owners' Loan Act empowered the Federal Home Loan Bank Board ("FHLBB") to issue regulations authorizing due-on-sale clauses in the loan contracts of federally-chartered thrifts, and that the FHLBB regulation challenged preempted conflicting state limitations on the due-on-sale practices of federally-chartered thrifts.

> When the administrator promulgates regulations intended to preempt state law, the court's inquiry is similarly limited: "If [h]is choice represents a reasonable accommodation of conflicting policies that were committed to the agency's care by the statute, we should not disturb it unless it appears from the statute or its legislative history that the accommodation is not one that Congress would have sanctioned." (citations omitted).... Thus, the Court of Appeal's narrow focus on Congress' intent to supersede state law was misdirected. Rather, the questions upon which resolution of this case rests are whether the [FHLBB] meant to preempt California's due-on-sale law, and, if so, whether that action is within the scope of the [FHLBB's] delegated authority. 458 U.S. at 155.

The preamble to the involuntary liquidation regulation clearly indicates that the NCUA Board considered the preemptive effect of the regulation when it was promulgated. The Board notes that whether a state statute with a different priority will be preempted depends upon the substantive effect of the state statute. The substantive effect of the proposed Connecticut statute is difficult to assess at this point, but (depending upon its interpretation) may vary from the NCUA priority schedule significantly and might conceivably affect the amounts received by various categories of creditors. For this reason, it seems that it has a substantive effect upon the liquidation and would be preempted. Thus, the first prong of the Fidelity Federal test is met. If, however, the State of Connecticut could reconcile the proposed state statutory order of priority with the NCUA involuntary liquidation regulatory order of priority, preemption would be less likely to result.

Looking to the Federal Credit Union ("FCU") Act for the NCUA Board's authority to promulgate the involuntary liquidation rule, plentiful authority abounds. "The Board may prescribe regulations regarding the allowance or disallowance of claims by the liquidating agent and providing for administrative determination of claims and review of such determination." 12 U.S.C. §1787(b)(4). This is coupled with broad authority to act as liquidating agent (12 U.S.C. §1787(b)(2)), determine claims (12 U.S.C. §1787(b)(3)) and disallow claims (12 U.S.C. §1787(b)(5)(D)). The supremacy of federal law in this area is bolstered by the deletion of the following sentence from the FCU Act in 1989: "The rights of members and other creditors of any State-chartered credit union shall be determined in accordance with the applicable provisions of State law." 12 U.S.C. §1787(d) (repealed in 1989). Thus, the second prong of the Fidelity Federal test is met.

Since both prongs of the test are satisfied, if the statute were enacted it would probably be preempted by the NCUA's involuntary liquidation regulation. If you have further questions, please call Martin Conrey, Staff Attorney, at 202-682-9630.

Sincerely,

Hattie M. Ulan

Hattie M. Ulan
Associate General Counsel

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(d) The holders of claims in any class set forth in this section shall not receive any distribution until the holders of claims in all classes having a higher priority under this section are paid in full. If the avails of the property of any such capital stock bank, mutual savings bank or savings and loan association are insufficient to pay in full all of the claims in a particular class, the avails shall be distributed to each claimant within such class on a pro rata basis.

Sec. 3. Subsection (h) of section 36-196d of the general statutes is repealed and the following is substituted in lieu thereof:

In the event of liquidation of the central credit union, the assets of the central credit union or the proceeds from any disposition of the assets shall be applied and distributed in the following sequence: (1) ALL FEES AND ASSESSMENTS DUE THE COMMISSIONER; [(1) Secured] (2) SECURED creditors up to the value of their collateral; [(2)] (3) costs and expenses of liquidation; [(3)] (4) wages due the employees of the central credit union; [(4)] (5) costs and expenses incurred by creditors in successfully opposing the release of the central credit union from certain debts as allowed by the commissioner; [(5)] (6) taxes owed to the United States or any other governmental unit; [(6)] (7) debts owed to the United States; [(7)] (8) general creditors and secured creditors to the extent their claims exceed the value of their collateral; and [(8)] (9) members, to the extent of uninsured share accounts, and the organization that insured the share accounts of the central credit union. IN APPLICATION OF THE PRECEDING SENTENCE, ANY PROVISION FOR SUBORDINATION CONTAINED WITHIN ANY DEBT INSTRUMENT ISSUED BY THE CENTRAL CREDIT UNION SHALL BE GIVEN EFFECT.

Sec. 4. Subsection (a) of section 36-224e of the general statutes is repealed and the following is substituted in lieu thereof:

Each applicant for a license to be a lender or to be both a lender and broker, at the time of making such application, shall pay to the commissioner a