

SUBJECT: Conforming revisions to the Finance Code

COMMITTEE: Financial Institutions — favorable, without amendment

VOTE: 6 ayes — Solomons, Flynn, Chavez, Anderson, McCall, Orr

0 nays

1 absent — Anchia

WITNESSES: For — None

Against — None

On — Randall James, Texas Department of Banking

BACKGROUND: In 1993, Texas authorized a limited liability company (LLC) charter for state banks, known as the Texas limited banking association (LBA). The charter was designed for pass-through federal income tax treatment similar to that received by a partnership. When the Texas Banking Code of 1943 was repealed and replaced with the Texas Banking Act in 1995, LBA provisions were spread throughout the banking statutes.

The Internal Revenue Service (IRS) denied pass-through treatment for LBAs in 1995. In 2003, the Federal Deposit Insurance Corporation (FDIC) adopted a rule granting deposit insurance to a state bank chartered as an LLC if the bank possessed the corporate characteristics of perpetual succession, centralized management, limited liability, and free transferability of interests. The IRS still would have to change its position regarding LBAs for state banks to receive pass-through treatment.

Management of LBAs is vested to participants in proportion to each participant's capital contribution. Participants and managers are not liable for a debt, obligation, or liability of an LBA with the exception of a full liability participant.

In 2003, the 78th Legislature adopted the Business Organizations Code incorporating laws formerly codified in the Texas Business Corporation

Act. The Finance Code still references the Texas Business Corporations Act as it applies to state banks and trust companies.

Finance Code, ch. 274 allows a bank holding company to allocate and redistribute trust assets possessed by a subsidiary institution to another subsidiary as a successor or substitute fiduciary. This authorization applies to state banks with their main offices or branches in Texas.

During the 2001 regular session, the 77th Legislature enacted HB 2155 by Averitt, which revised Finance Code, secs. 34.101 and 34.201, amending banking regulations to conform with federal legislation. During the 1999 regular session, the 76th Legislature enacted HB 2066 by Marchant, which updated the Finance Code regarding regulation of bank holding companies.

**DIGEST:** HB 1962 would make various revisions to the Finance Code. It would require that LBAs be managed by a board of managers elected by participants. The board of managers would operate in a manner substantially similar to the board of a banking association. A participant could transfer participation shares, including voting rights, without consent of the other participants. By-laws of an LBA could require automatic dissolution of an LBA based only upon the passage of time.

HB 1962 would repeal the LBA-related definitions of “full liability participant,” “managing participant,” and “participant-transferee” and would remove other occurrences of these terms from the Finance Code. The bill also would remove terms and references unique to the current structure of LBAs and would define corporate terms such as shareholder, share, and director to include necessary references to LBAs.

HB 1962 would apply the Business Organizations Code to banking associations, limited banking associations, trust associations, and limited trust associations organized on or after January 1, 2006, and would apply to all state banks, regardless of organization date, beginning January 1, 2010. The bill would eliminate references to the Texas Business Corporation Act and replace these references, as necessary, with references to the Business Organizations Code. If a state bank were organized before January 1, 2006, the bank would be governed by prior law unless it elected to be governed by the Business Organizations Code.

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HB 1962 would revise Finance Code, ch. 274 to allow national banks with their main offices or branches in Texas to allocate trust assets among subsidiaries.

The bill also would make conforming changes based on HB 2155 enacted by the 77th Legislature and HB 2066 enacted in the 76th Legislature.

The bill would take effect September 1, 2007.

**SUPPORTERS SAY:** HB 1962 would help banks establish LBAs to avoid double taxation. Because banks are organized as corporations, they pay federal income tax prior to distributing dividends. Shareholders then are taxed on the dividends. The bill would conform Texas banking statutes to meet FDIC requirements for a state bank chartered as an LBA to receive deposit insurance should the IRS change its position on the eligibility of LBAs to receive pass-throughs.

When the Finance Code first granted state bank holding companies the ability to allocate trust assets among subsidiaries, national holding companies were not in the financial market. Now that these types of entities do exist, HB 1962 would provide the growing number of national holding companies the same authority granted to state banks to move trust assets among subsidiaries.

Finally, the bill would make several necessary changes to conform bank statutes to enacted legislation, including changes to conform bank regulation to the Business Organizations Code.

**OPPONENTS SAY:** No apparent opposition.

**NOTES:** The companion bill, SB 1546 by Frasier, has been referred to the Senate Business and Commerce Committee.