

December 21, 2007

Bruce Pearson, Esq.
Styskal, Weise & Melchione, LLP
550 North Brand Boulevard, Suite 550
Glendale, CA 91203

Re: Preemption of Notice Provisions in California Rees-Levering Automobile Sales Finance Act.

Dear Mr. Pearson:

You have requested that we consider whether the Federal Credit Union Act (Act) and the lending regulation issued by the National Credit Union Administration (NCUA) preempt the notice provision in a California law directed at automobile sales finance lenders. CAL. CIV. Code §2983.2(a) (West 1993). Yes, we conclude the notice provision's penalty, which is the loss of the right to collect a deficiency judgment, directly affects the terms and conditions of lending and is preempted. We do not preempt the substantive rights under state law regarding default or the circumstances for curing default.

This California statute requires a creditor to provide a detailed, comprehensive notice to the borrower of intent to dispose of a repossessed motor vehicle. The notice must:

- advise the borrowers of their right to redeem the motor vehicle by paying the full amount of the indebtedness within fifteen days of the giving of the notice and provide an itemization of the contract balance and any costs of collection and an itemization of the amount of any credit for unearned finance charges or cancelled insurance;
- specifically state either that there is a conditional right to reinstate the contract until the expiration of fifteen days from the date of giving notice or that there is no right of reinstatement and provide a statement of reasons therefor;
- allow a ten-day extension of the redemption and any reinstatement periods upon written request;
- disclose where the vehicle will be returned upon redemption or reinstatement, designate the name and address of the person or office to whom payment is to be made;
- state the seller's or holder's intent to dispose of the vehicle after the expiration of the applicable periods of time;

- inform the persons being given notice of their right to an accounting regarding the disposition of the vehicle upon written request; and
- include a notice in specific statutory language in at least ten-point bold type regarding their potential liability for a deficiency, and inform the persons being given notice of their liability for the deficiency balance plus interest.

Cal. Civ. Code §2983.2(a) (West 1993). Failure on the part of the creditor to comply with these requirements destroys the creditor's ability to hold the borrower liable for any deficiency. *Id.*

NCUA's position regarding preemption of state law in certain areas of lending, as stated in its lending regulation, derives from the authority granted to the NCUA Board by the Federal Credit Union Act. 12 U.S.C. §§1751 *et seq.* Federal credit unions are federal instrumentalities, chartered and regulated under federal law. The NCUA, headed by a three-member Board appointed by the president, is an independent federal agency within the executive branch and is the cradle-to-grave regulator of federal credit unions. In addition to its role as the chartering authority and supervisor of federal credit unions, the NCUA, through the National Credit Union Share Insurance Fund, provides federal share insurance for all accounts in federal credit unions and, upon application, to state-chartered credit unions.

NCUA's lending regulation expressly preempts state laws affecting the terms of repayment for all loans.¹ The regulation states:

Section 701.21 is promulgated pursuant to the NCUA Board's exclusive authority as set forth in Section 107(5) of the Federal Credit Union Act (12 U.S.C. §1757(5)) to regulate the rates, terms of repayment and other conditions of Federal credit union loans

¹ A California appellate court recently reviewed the applicability of this provision of state law to federally chartered thrifts in California. Although the case was appealed to the state's supreme court and was settled before that court could rule on the issues, we find the appellate court's reasoning as to the impact of this law to be persuasive. The appellate court characterized the required statutory notice as a "credit related document" that added terms to the loan document for the event of default, limiting the creditor's right to enforce its security interest and obtain a deficiency judgment. *WFS Financial, Inc. v. Superior Court*, 140 Cal. App. 4th 637 (Cal. Ct. App., 2006), at 652. The court concluded the required notice provision imposed terms that affected the lender's ability to collect on delinquent loans and impermissibly regulated and affected the lending activities of federally chartered thrifts. *Id.* As such, the court found the California statute preempted by OTS rules, which expressly occupy the field of lending regulation for federally chartered thrifts. *Id.*

and lines of credit (including credit cards) to members. This exercise of the Board's authority preempts any state law purporting to limit or affect:

* * *

(ii) terms of repayment, including:

* * *

(B) the amount, uniformity, and frequency of payments, including the accrual of interest if payments are insufficient to pay all interest due.

12 C.F.R. §701.21(b)(1). The California law at issue affects the terms of repayment by placing additional burdens on lenders before they may recover deficiency balances owed by borrowers. NCUA's long-standing position is that state laws affecting terms of repayment are preempted. 49 Fed. Reg. 30683, 30684 (August 1, 1984).

Our lending rule contains an express disclaimer of any intent to preempt state laws imposing conditions related to "the circumstances in which a borrower may be declared in default and may cure default." 12 C.F.R. 701.21(b)(2)(iii)(C). Although default triggers the effect of a failure to comply with the notice obligations in the California statute—namely, eliminating the lender's right to a collect a deficiency judgment—this state statute does not, in fact, address the circumstances in which default may be declared. The requisite notice addresses a right of reinstatement, but goes significantly further than simply providing notice regarding the debtor's right to cure the default. Failure of the creditor to adhere to the notice provisions results in the creditor's inability to recover the full amount it lent to the consumer. Thus, the law directly affects a fundamental repayment term.² NCUA's regulation specifies that state laws having that effect are preempted. 12 C.F.R. §701.21(b)(1). We also note NCUA's regulation specifies that, even where aspects of a state law have applicability to federal credit unions, NCUA has exclusive authority to take enforcement actions against the credit union. 12 C.F.R. §701.21(b)(4). We view the California statute's effect of eliminating a right to collect deficiencies for failure to comply with the notice

² Several years ago, we considered the applicability to federal credit unions of a California statute imposing certain additional disclosure obligations on credit card issuers. We concluded that the statute was preempted as to federal credit unions. OGC Op. No. 02-0638 (June 26, 2002). In subsequent litigation involving the issue, a federal court ruled that that statute was preempted as to its application to federally chartered financial institutions. *American Bankers Association v. Lockyer*, 239 F. Supp. 2d 1000 (E.D. Cal. 2002).

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provisions as an enforcement tool and, for that further reason, conclude its application to FCUs is inappropriate.

Sincerely,

/S/

Sheila A. Albin
Associate General Counsel

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