FINAL BILL ANALYSIS

BILL #: CS/HB 1121

FINAL HOUSE FLOOR ACTION:
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SPONSOR: Rep. Ingram

GOVERNOR'S ACTION: Approved

COMPANION BILLS: CS/SB 1332

SUMMARY ANALYSIS

CS/HB 1121 passed the House on April 29, 2011, and subsequently passed the Senate on May 3, 2011. The bill was approved by the Governor on June 21, 2011, chapter 2011-194, Laws of Florida, and becomes effective July 1, 2011.

The bill authorizes the Office of Financial Regulation (OFR) to appoint provisional directors if a bank or credit union lacks the minimum number of directors to meet statutory requirements, and appoint provisional executive officers if there is an insufficient number of qualified executive officers to operate the financial institution in a safe and sound manner.

The bill removes the requirement that the OFR conduct its own evaluation of each state-chartered bank at least once during each 36-month period, thereby reducing potential duplication of activities by federal regulators. It allows the OFR to enter into agreements with other appropriate state and federal regulatory agencies to facilitate the efficient utilization and coordination of resources in the examinations.

The bill also expands the actions that the OFR can take under an emergency order regarding a failing financial institution. These include: authorizing the direct or indirect acquisition of control of the failing institution; appointing provisional directors, executive officers, or other employees; and authorizing any other capital or liquidity restoration plan or action deemed prudent.

The bill authorizes the OFR to grant prior approval of a bank charter which would remain inactive until the investor(s) acquire a troubled institution. By granting preliminary approval of a "shelf charter", the pool of potential buyers for troubled institutions is expanded, potentially resulting in new equity capital available to bid on troubled institutions.

The bill provides for compliance with the federal Wall Street Reform and Consumer Protection Act which implements changes that affect the oversight and supervision of financial institutions. In doing so, it:

- Removes references to, or requirement for, reliance on credit ratings as regards a financial institution's investment of funds. It replaces those provisions with a requirement that financial institutions establish written policies and procedures to evaluate the risks and benefits associated with authorized investments.
- Requires state-chartered credit unions and banks to take into account potential liabilities and obligations resulting from derivatives transactions, repurchase agreements, securities lending and borrowing transactions, credit default swaps, and similar contracts when considering loans or lines of credit.
- Provides for de novo branching by an out-of-state bank and allows for establishment of additional branches by an out-of-state financial institution as though it was chartered in Florida.

The bill authorizes the OFR to approve special stock offering plans to assist undercapitalized banks in raising capital. Plans could include such things as stock splits, revaluations of par value, and creation of new classes of stock. In addition, the bill clarifies the definition and functions of a "banker's bank" to create uniformity with federal regulations.

The bill should have a positive fiscal impact on the private sector. The fiscal impact on state government is indeterminate but may have an insignificant positive fiscal impact on OFR.

I. SUBSTANTIVE INFORMATION

A. EFFECT OF CHANGES:

Background:

Chapters 655 through 667, Florida Statutes comprise the financial institution codes (Codes).[1] These provide general regulatory powers to be exercised by the Financial Services Commission[2] and the Office of Financial Regulation (OFR). The OFR is responsible for administering Florida's financial institution codes. The specific chapters are:

- Chapter 655, relating to financial institutions generally
- Chapter 657, relating to credit unions
- Chapter 658, relating to banks and trust companies
- Chapter 660, relating to trust business
- Chapter 663, relating to international banking corporations
- Chapter 665, relating to associations
- Chapter 667, relating to savings banks

While OFR has authority to regulate entities conducting banking or trust business in Florida, there are certain exceptions. These include:

- Banks chartered and regulated by other states.
- National banks, which are regulated by the Office of the Comptroller of the Currency.
- Federal thrifts, which are regulated by the Office of Thrift Supervision.
- Federal credit unions, which are regulated by the National Credit Union Administration.
- Institutions chartered and regulated by foreign countries, unless those institutions seek to "engage in the business of banking" or "engage in trust business" in Florida.

Currently, credit unions and banks are required to have a minimum of five directors on their board of directors.[3, 4] However, the Codes do not address the circumstance in which a state financial institution has an insufficient number of directors to meet those requirements. In a similar manner, the Codes are silent regarding the operation of a financial institution when there is no executive officer, or the institution lacks a qualified executive officer. This can leave the financial institution without the ability to take important actions to protect the institution and its depositors.

The OFR is required to conduct an examination of the condition of each state-chartered financial institution during each 18-month period, as computed beginning July 1, 1981. The law provides that it may accept an examination made by the Federal Reserve Bank, FDIC or the National Credit Union Association, as appropriate, or make a joint or concurrent examination.

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[1] s. 655.005(j), F.S.

[2] The Financial Services Commission is composed of the Governor, the Attorney General, the Chief Financial Officer, and the Commissioner of Agriculture.

[3] s. 657.021(1), F.S.

[4] s. 658.33(1), F.S.

However, there is also a requirement that the OFR conduct its own evaluation of each state-chartered bank at least once during each 36-month period from July 3, 1992 onwards.[5]

The OFR, based upon reports or receipt of other evidence indicating a financial institution is insolvent or is threatened with imminent insolvency, may enter an emergency order to prevent the probable failure of a financial institution.[6] This can only be done with the concurrence of the appropriate federal regulatory agency in the case of any financial institution the deposits of which are insured by the Federal Deposit Insurance Corporation or the National Credit Union Administration. The emergency order may authorize:

- The merger with an appropriate state financial entity.
- An appropriate state financial entity to acquire assets and assume liabilities, including all rights, powers, and responsibilities as fiduciary in an instance in which the failing financial institution is actively engaged in the exercise of trust powers.
- The conversion into a state financial entity.
- The chartering of a new state financial entity to acquire assets and assume liabilities, and to assume rights, powers, and responsibilities as fiduciary in a case in which such failing financial entity is engaged in the exercise of trust powers.

The OFR may pre-approve individuals who may become directors and executive officers of a failing financial institution. A nonrefundable, nontransferable filing fee of $7,500 must accompany the application.[7] The law does not provide for pre-approval of a new institutional charter.

The Wall Street Reform and Consumer Protection Act[8] (Act) enacted on July 21, 2010 implements changes that affect the oversight and supervision of financial institutions. Many of the provisions apply to financial institutions with over $10 billion in assets. There are currently no state-chartered financial institutions which meet that threshold. There are some sections of the Act that do impact the OFR and require modification of Florida law. These involve:

- The use of credit rating service grades for the determination of permissible investments.
- Interstate branching, conversions, mergers, and acquisitions.
- Risk management criteria for derivatives, to include potential liabilities and obligations.

The law relating to the investment powers and limitations for credit unions contains provisions that require the use of credit rating services grades for determining permissible investments.[9] There are similar provisions which relate to banks and trust companies.[10]

Currently, the law prohibits a bank or bank holding company headquartered in another state from establishing its initial presence in Florida by any means other than a merger or acquisition of an existing Florida bank that is more than three years old.[11] An out-of-state bank that does not operate a branch in this state is prohibited from establishing a de novo branch in this state.[12]

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[5] s. 655.045(1)(a), F.S.
[6] s. 655.4185(1), F.S.
[7] s. 658.20(3), F.S.
[8] H.R. 4173, Public Law 111-203
[9] s. 657.042, F.S.
[10] s. 658.67, F.S.
[11] s. 658.2953(7)(c), F.S,
[12] s. 658.2953(5), F.S.

The law prohibits ownership and operation of remote financial service units (e.g., ATMs) by a bank which is not authorized to do business in Florida or does not have its principal office and place of business in Florida.[13]

Under current law, a credit union may make a loan to its member based on approved security and terms contained in written loan policies established either in law or by its board of directors. All loans endorsed or guaranteed by the member and any related interest must be included when computing the member's total liabilities.[14] For a bank making a loan to a person, the computation of total liabilities is the same.[15] There are no statutory requirements that potential liabilities and obligations be considered in computing total liabilities.

The law prohibits a bank or trust company from issuing capital stock with a par value[16] of less than $1.[17] No state bank or trust company can reduce its capital stock without OFR approval, and notice must be given to the OFR prior to any increase in its capital stock.[18] Historically, the market price of a bank's stock has not fallen below the par value. Should that occur, it would be a serious impediment to a bank's efforts to raise capital. OFR reports that this situation has occurred during the current economic downturn.[19]

Under current law, a banker's bank is either an FDIC insured bank or holding company which owns and controls such a bank, where 100% of its stock is owned by other banks. A banker's bank exclusively provides services for other financial institutions and their officers, directors, and employees.[20] In the current economic environment, the financial ability of other banks to purchase new stock offered for sale by a banker's bank is limited. Therefore, a banker's bank is limited in its ability to increase its capital accounts through sale of stock, as is necessary to offset losses.

Effect of the bill:

CS/HB 1121 authorizes the OFR to appoint provisional directors if a bank or credit union lacks the minimum number of directors to meet statutory requirements for a period of 30 days or greater. A provisional director has all the rights and powers of a duly elected director.
The bill also authorizes the OFR to appoint provisional executive officers if there is an insufficient number of qualified executive officers to operate the financial institution in a safe and sound manner. A provisional executive officer has all the rights and powers as provided in the financial institution's articles of incorporation or bylaws, or as specified by the OFR in the appointment order.

As specified in the bill, a provisional director or executive officer:

- Must be an impartial person who is not a shareholder, member, nor a creditor of the financial institution, nor of any subsidiary, affiliate, or service corporation of the financial institution.

[13] s. 658.65, F.S.
[14] s. 657.038(7), F.S.
[15] s. 658.48(5)(f), F.S.
[16] The value of the security set by the company issuing it, having no relationship to market value.
[17] s. 658.34(1), F.S.
[18] s. 658.36, F.S.
[19] Office of Financial Regulation HB 1121 Bill Analysis dated March 3, 2011 on file with the Insurance & Banking Subcommittee.
[20] s. 658.12(3), F.S.

- Must be qualified, as determined by the OFR consistent with the provisions of the Code.
- Shall serve until such time as the provisional director's or executive officer's tenure is ended by order of the OFR.
- Is not liable for any lawful action taken or lawful decision made, except as provided in the financial institutions codes and s. 607.0831, F.S.
- Must submit to the OFR, if so directed, reports as to the financial and operating condition of the financial institution and recommendations as to the appropriate corrective actions.
- Is to be reasonably compensated by the financial institution for services rendered, and receive reimbursement for costs and expenses.

The bill requires that the OFR consider examination guidelines from federal regulatory agencies in order to facilitate, coordinate, and standardize examination processes. It reduces regulation by removing the requirement that the OFR conduct its own evaluation of each state-chartered bank at least once during each 36-month period,[21] thereby reducing potential duplication of activities by federal regulators. It provides that the frequency of examination may be based upon the risk profile of the institution, prior examination or visitation results, or significant changes in the institution or its operations. In addition, it allows the OFR to enter into agreements with other appropriate state and federal financial institution regulatory agencies to facilitate the efficient utilization and coordination of resources in the examinations. The OFR is permitted to use methods of continuous, phase, or other flexible scheduling examination methods for very large or complex state financial institutions, and financial institutions owned or controlled by a multi-financial institution holding company.[22]

The bill also expands the actions that the OFR can take under an emergency order. These are:

- Authorizing the direct or indirect acquisition of control of the failing financial institution.
- Appointing provisional directors, executive officers, or other employees for the failing financial institution.
- Authorizing any other capital or liquidity restoration plan or action deemed prudent by the OFR.

The bill authorizes the OFR to grant prior approval of a bank charter which would remain inactive until the investor(s) acquire a troubled institution. This is often referred to as a "shelf charter", and is a process already utilized by the Office of the Comptroller for federally-chartered banks. By granting preliminary approval, the pool of potential buyers for troubled institutions is expanded. This may result in new equity capital available to bid on troubled institutions through the Federal Deposit Insurance Corporation (FDIC) bid process. The FDIC has already established a modified bidder qualification process to accommodate "shelf charters".[23] Under CS/HB 1121, the current application fee of $7,500 for pre-approval of proposed directors and executive officers[24] will also encompass processing the application for prior approval of a "shelf charter".

The bill removes references to or requirement for reliance on credit ratings as regards a financial institution's investment of funds. It replaces those provisions with a requirement that

[21] s. 655.045(1)(a), F.S.

[22] A "multi-financial institution holding company" is a financial institution holding company that owns or controls more than one financial institution.

[23] http://www.fdic.gov/news/news/press/2008/pr08127.html (Last visited on March 14, 2011)

[24] s. 658.20(3), F.S.

financial institutions establish written policies and procedures to evaluate the risks and benefits associated with authorized investments. The applicable federal agencies have already been directed to make similar modifications to federal regulations.[25]

The bill requires state-chartered credit unions to take into account potential liabilities and obligations resulting from derivatives transactions, repurchase agreements, securities lending and borrowing transactions, credit default swaps, and similar contracts. This is consistent with similar requirements for state-chartered banks.[26]

The bill provides for de novo branching by an out-of-state bank as required by the Wall Street Reform and Consumer Protection Act[27] which preempts the current prohibition in law.[28] It allows for establishment of additional branches by an out-of-state financial institution as though it was chartered in Florida, and removes the prohibition regarding ownership and operation of remote financial service units.

The bill authorizes the OFR to approve special stock offering plans to assist undercapitalized banks in raising capital. To be eligible, a bank would need to meet the following criteria:

- The capital accounts have been diminished by losses to less than the minimum thresholds required under the Codes.
- The market value of its share of capital stock is less than par value.
- The bank cannot reasonably issue and sell new shares to restore its capital accounts[29] at the share price of par value.

Plans could include such things as stock splits, revaluations of par value, and creation of new classes of stock.

Prior to approval by the OFR, a special stock offering plan must be approved by majority vote of the bank or trust company's entire board of directors and by a two-thirds vote of the outstanding shares of stock. The OFR may not approve of any plan that provides unfair or disproportionate benefits to existing shareholders, directors, executive officers, or their related interests, or that is unlikely to restore the capital accounts to sufficient levels to achieve a sustainable, safe, and sound financial institution. If the OFR makes a determination that the bank or trust company is a failing financial institution, per statute, it may approve special stock offering plans without shareholder approval.

The bill aligns Florida law with federal regulations[30] regarding the ownership and incidental business operations of a banker's bank. It authorizes the sale of up to 25 percent of a state-chartered banker's bank's stock to persons who are not financial institutions. In addition, the bill allows for limited deposit and lending activity by a banker's bank to entities and persons other than financial institutions. These activities cannot exceed 10 percent of the banker's bank's total liabilities and assets, respectively.

[25] H.R. 4173, Public Law 111-203, Sec. 939A.
[26] H.R. 4173, Public Law 111-203, Sec 614.
[27] H.R. 4173, Public Law 111-203, Sec 613.
[28] s. 658.2953(5), F.S.
[29] s. 655.005(1)(c) defines "Capital accounts" as unimpaired capital stock, unimpaired surplus, and undivided profits or retained earnings of a financial institution.
[30] 12CFR204.121 (2007).

The bill provides for an effective date of July 1, 2011.

II. FISCAL ANALYSIS & ECONOMIC IMPACT STATEMENT

A. FISCAL IMPACT ON STATE GOVERNMENT:

1. Revenues:

None.

2. Expenditures:

Indeterminate. See Fiscal Comments.

B. FISCAL IMPACT ON LOCAL GOVERNMENTS:

1. Revenues:

None.

2. Expenditures:

None.

C. DIRECT ECONOMIC IMPACT ON PRIVATE SECTOR:

- By authorizing the OFR to grant prior approval of a bank charter which would remain inactive until the investor(s) acquire a troubled institution, the pool of potential buyers for troubled institutions is expanded, potentially resulting in new equity capital available to bid on troubled institutions. This may assist in precluding future bank failures.
- By allowing for the possibility of a bank or trust company to sell stock at less than par value, the bill may assist undercapitalized financial institutions in raising new capital.
- The reduction in duplicative efforts necessary to satisfy separate and independent examinations by federal and state regulators may result in decreased costs for state-chartered banks.
- By providing for limited ownership of a banker's bank's stock by persons who are not financial institutions, banker's banks will have an increased ability to raise capital. In addition, authorizing incidental deposit and lending activities will allow the banker's bank greater flexibility in providing services which could generate revenue.

D. FISCAL COMMENTS:

The elimination of the requirement to conduct its own independent evaluation of each state-chartered bank at least once every 36-month period may have an insignificant positive fiscal impact on the OFR.