HOUSE OF REPRESENTATIVES STAFF ANALYSIS

BILL #: CS/HB 455 Governance of Banks and Trust Companies
SPONSOR(S): Insurance & Banking Subcommittee; McClain
TIED BILLS: **IDEN./SIM. BILLS:** SB 416

REFERENCE	ACTION	ANALYST	STAFF DIRECTOR or BUDGET/POLICY CHIEF
1) Insurance & Banking Subcommittee	14 Y, 0 N, As CS	Hinshelwood	Luczynski
2) Commerce Committee			

SUMMARY ANALYSIS

In order to form a *de novo* (new) state-chartered bank or trust company, the law currently requires that a certain number of the proposed directors and the proposed president or chief executive officer have at least one year of relevant financial institution experience within the three years before the date of the application. The banking industry has observed that a current barrier to the formation of a new state-chartered bank is a lack of qualified officers and directors due to the duration of non-compete clauses, generally two to three years, in comparison to the timeframe within which the proposed president or chief executive officer and a certain number of proposed directors must have at least one year of relevant financial institution experience. Upon the expiration of a non-compete clause in effect for more than two years, former directors and officers are not qualified to be a president or chief executive officer of a new state-chartered bank and are not qualified to be counted as a director of a new state-chartered bank who possesses the required financial institution experience because their one year of relevant financial institution experience must have been *within the last three years*. The banking industry has indicated that the same concern regarding availability of qualified officers and directors for new banks holds for existing banks, and there is a need to maintain parity between the officer and director requirements of a new bank and similar requirements for an existing bank.

In relation to both new and existing state-chartered banks and trust companies, the bill expands from three years to five years the timeframe within which certain officers and directors must have the required one year of relevant financial institution experience. The result of these changes is an expansion of the pool of individuals qualified to be president or chief executive officer of either a new or an existing state-chartered bank or trust company, or qualified to be counted as a director who possesses relevant financial institution experience for either a new or an existing state-chartered bank or trust company.

The bill requires that at least a *majority*, rather than three-fifths, of the directors of a state-chartered bank or trust company must have resided in this state for at least one year preceding their election and must continue to reside in this state for the duration of their time in office. This change will align the residency requirement for Florida state-chartered banks with the residency requirement for national banks.

Lastly, the bill amends current law in order to clarify an ambiguity in the interpretation of investment limitations relating to corporate obligations or corporate bonds. Specifically, the bill clarifies that:

- The types of entities for which the limitation on investments in corporations applies are subsidiary corporations and affiliates.
- The limitation on investments in corporations applies to an aggregate of any combination of stocks, obligations, and other securities of subsidiary corporations and affiliates.
- The aggregate of such investments may not exceed 10% of the total assets of the bank.

The bill has an indeterminate fiscal impact on the state and the private sector. The bill has no impact on local governments.

The bill provides an effective date of July 1, 2018.

FULL ANALYSIS

I. SUBSTANTIVE ANALYSIS

A. EFFECT OF PROPOSED CHANGES:

Background

The Office of Financial Regulation (OFR) regulates banks, credit unions, other financial institutions, finance companies, and the securities industry.[1] The OFR's Division of Financial Institutions charters, licenses, and regulates various entities that engage in financial institution business in Florida, in accordance with the financial institutions codes (Codes) and the rules promulgated thereunder.[2] The specific chapters under the Codes are:

- Chapter 655, F.S. – Financial Institutions Generally
- Chapter 657, F.S. – Credit Unions
- Chapter 658, F.S. – Banks and Trust Companies
- Chapter 660, F.S. – Trust Business
- Chapter 662, F.S. – Family Trust Companies
- Chapter 663, F.S. – International Banking
- Chapter 665, F.S. – Capital Stock Associations
- Chapter 667, F.S. – Savings Banks

As of June 30, 2016, the Division of Financial Institutions regulates 206 financial institutions:[3]

- 103 banks
- 67 credit unions
- 23 international bank offices
- 13 trust companies

Regulation of Banks

Under the dual banking system in the United States, banks may be chartered under either state or federal law:

- *State-chartered banks* are chartered under the laws of the state in which the bank is headquartered. State-chartered banks have both a state regulator, which for banks chartered by the state of Florida is the Office of Financial Regulation, and a federal regulator. The primary federal regulator for state banks that are members of the Federal Reserve System is the Board of Governors of the Federal Reserve System (FRB), and the primary federal regulator for non-member state banks is the Federal Deposit Insurance Corporation (FDIC).[4]
- *National banks* are chartered by the Office of the Comptroller of the Currency (OCC) under the National Bank Act.[5] As such, the OCC is the primary federal regulator for national banks.[6]

Formation of a New State-Chartered Bank or Trust Company

In order to apply for authority to organize a new state-chartered bank or trust company, the proposed directors must file a written application with the OFR.[7] The application includes such information as the

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[1] s. 20.121(3)(a)2., F.S.
[2] chs. 655, 657, 658, 660, 662, 663, 665, and 667, F.S.; chs. 69U-100 through 69U-162, F.A.C.
[3] OFFICE OF FINANCIAL REGULATION, *Fast Facts* (4th ed., Dec. 2016), http://www.flofr.com/StaticPages/documents/FastFacts.pdf.
[4] 12 U.S.C. § 1813(q).
[5] 12 U.S.C. § 38.
[6] 12 U.S.C. § 1813(q).
[7] s. 658.19(1), F.S.

proposed corporate name; the community, including the street and number, if available, where the principal office of the proposed bank or trust company is to be located; the total initial capital; and detailed financial, business, and biographical information for each proposed director and executive officer.[8]

Upon the filing of an application, the OFR must make an investigation of:
1) The character, reputation, financial standing, business experience, and business qualifications of the proposed officers and directors.
2) The need for bank or trust facilities or additional bank or trust facilities, as the case may be, in the primary service area where the proposed bank or trust company is to be located.
3) The ability of the primary service area to support the proposed bank or trust company and all other existing bank or trust facilities in the primary service area.[9]

After making such investigation, the OFR must approve an application if it finds the following:[10]
1) Local conditions indicate reasonable promise of successful operation for the proposed state bank or trust company.
2) The proposed capitalization is adequate, but at least:
    a. $8 million for a bank.
    b. $3 million for a trust company.
3) The proposed capital structure is in such form as the OFR may require, subject to certain minimum requirements.
4) Regarding officers and directors:
    a. The proposed officers have sufficient financial institution experience, ability, standing, and reputation and the proposed directors have sufficient business experience, ability, standing, and reputation to indicate reasonable promise of successful operation.
    b. None of the proposed officers or directors has been convicted of, or pled guilty or nolo contendere to, any violation of s. 655.50, F.S., relating to the control of money laundering and terrorist financing; ch. 896, F.S., relating to offenses related to financial institutions; or similar state or federal law.
    c. At least two of the proposed directors who are not also proposed officers have had at least one year direct experience as an executive officer, regulator, or director of a financial institution *within the three years before the date of the application*. However, if the applicant demonstrates that at least one of the proposed directors has very substantial experience as an executive officer, director, or regulator of a financial institution *more than three years before the date of the application*, the OFR may allow only one director to have direct financial institution experience *within the last three years*.
    d. The proposed president or chief executive officer must have had at least one year of direct experience as an executive officer, director, or regulator of a financial institution *within the last three years*.
5) The corporate name of the proposed state bank or trust company is approved by the OFR.
6) Provision has been made for suitable quarters at the location in the application.

The banking industry has observed that a current barrier to the formation of a new state-chartered bank is a lack of qualified officers and directors due to the duration of non-compete clauses, generally two to three years, in comparison to the timeframe within which the proposed president or chief executive officer and a certain number of proposed directors must have at least one year of relevant financial institution experience. Directors and officers of a bank may be required to sign an employment contract containing a non-compete clause[11] that prohibits them from working in the banking sector for two to three years following separation from their current bank. Upon the expiration of a non-compete clause

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[8] *Id.*
[9] s. 658.20(1), F.S.
[10] s. 658.21, F.S.
[11] Although generally a contract in restraint of trade or commerce is unlawful, the “enforcement of contracts that restrict or prohibit competition during or after the term of restrictive covenants, so long as such contracts are reasonable in time, area, and line of business, is not prohibited.” *See* ss. 542.18 and 542.335(1), F.S.

in effect for more than two years, such former directors and officers are not qualified to be a president or chief executive officer of a new state-chartered bank and are not qualified to be counted as a director of a new state-chartered bank who possesses at least one year of relevant financial institution experience because the one year of relevant financial institution experience must have been *within the last three years*, as currently required by s. 658.21(4), F.S.

Qualifications of Officers and Directors of an Existing State-Chartered Bank or Trust Company

At any given time, a state-chartered bank or trust company must have at least five directors.[12] At least a majority of the directors must be citizens of the United States.[13] At least *three-fifths* of the directors must have resided in this state for at least one year preceding their election and must continue to reside in this state for the duration of their time in office.[14] For a bank or trust company with total assets of less than $150 million, at least one director who is not also an officer of the bank or trust company must have at least one year of direct experience as an executive officer, regulator, or director of a financial institution *within the last 3 years*.[15] For a bank or trust company with total assets of more than $150 million, at least two directors who are not also officers of the bank or trust company must have at least one year of direct experience as an executive officer, regulator, or director of a financial institution *within the last 3 years*.[16] The president, chief executive officer, or other person who has equivalent rank or leads the overall operations of a bank or trust company must have at least one year of direct experience as an executive officer, director, or regulator of a financial institution *within the last 3 years*.[17]

The banking industry has indicated that the same concern regarding availability of qualified officers and directors for new banks holds for existing banks, and there is a need to maintain parity between the officer and director requirements of a new bank and similar requirements for an existing bank.

Permissible Investments for State-Chartered Banks

A bank is permitted to invest its funds, subject to certain limitations set forth in both Florida and federal law. The investment limitations under Florida law are found in s. 658.67, F.S., and include the following:

- "Up to 25 percent of the capital accounts of the purchasing bank . . . may be invested in . . . *[c]orporate obligations of any one corporation that is not an affiliate or subsidiary of the bank* . . . ."[18]
- "Up to an aggregate of 10 percent of the total assets of a bank may be invested in the stock, *obligations*, or other securities *of subsidiary corporations or other corporations or entities*, except as limited or prohibited by federal law, and except that during the first 3 years of existence of a bank, such investments are limited to 5 percent of the total assets."[19]

The banking industry has observed ambiguity in the interpretation of the above investment limitations due to overlapping provisions relating to corporate obligations or corporate bonds. As a result of the inclusion of "other corporations or entities" in the latter investment limitation seen above, it is unclear whether that provision operates as a limitation on corporate obligations even of non-affiliates and non-subsidiaries, which are covered by the first investment limitation seen above.

[12] s. 658.33(2), F.S.
[13] *Id.*
[14] *Id.*
[15] *Id.*
[16] *Id.*
[17] s. 658.33(5), F.S.
[18] s. 658.67(3)(b), F.S. (emphasis added).
[19] s. 658.67(6), F.S. (emphasis added).

Effect of Proposed Changes

Qualifications of Officers and Directors

The bill amends s. 658.21(4), F.S., to increase the timeframe within which a proposed president or chief executive officer and a certain number of proposed directors must have one year of relevant financial institution experience in order to organize a new state-chartered bank or trust company. The bill expands the timeframe within which to satisfy the required experience from three years to five years:

- The proposed president or chief executive officer must have at least one year of relevant financial institution experience *within the last five years*.
- At least two of the proposed directors who are not also proposed officers must have at least one year of relevant financial institution experience *within the last five years.* However, the OFR may allow the applicant to have only one director who has such experience if at least one of the proposed directors has very substantial experience as an executive officer, director, or regulator of a financial institution *more than five years before the date of the application*.

Similarly, the bill amends s. 658.33(2) and (5), F.S., to increase the timeframe within which a president or chief executive officer and a certain number of directors must have one year of relevant financial institution experience in order to serve at an existing state-chartered bank or trust company. The bill expands the timeframe within which to satisfy the required experience from three years to five years:

- The president, chief executive officer, or other person who has equivalent rank or leads the overall operations of a bank or trust company must have at least one year of direct experience as an executive officer, director, or regulator of a financial institution *within the last 5 years*.
- For a bank or trust company with total assets of less than $150 million, at least one director who is not also an officer of the bank or trust company must have at least one year of direct experience as an executive officer, regulator, or director of a financial institution *within the last 5 years*.
- For a bank or trust company with total assets of more than $150 million, at least two directors who are not also officers of the bank or trust company must have at least one year of direct experience as an executive officer, regulator, or director of a financial institution *within the last 5 years*.

The result of these changes is an expansion of the pool of individuals qualified to be president or chief executive officer of either a new or an existing state-chartered bank or trust company, or qualified to be counted as a director who possesses relevant financial institution experience for either a new or an existing state-chartered bank or trust company.

Residency Requirements for Directors

The bill amends s. 658.33(2), F.S., to require that at least a *majority*, rather than three-fifths, of the directors must have resided in this state for at least one year preceding their election and must continue to reside in this state for the duration of their time in office. This change will align the residency requirement for Florida state-chartered banks with the residency requirement for national banks.[20]

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[20] The OCC's director qualifications statute states that "[e]very director must, during his whole term of service, be a citizen of the United States, and *at least a majority of the directors must have resided in the State, Territory, or District in which the association is located*, or within one hundred miles of the location of the office of the association, *for at least one year immediately preceding their election, and must be residents of such State* or within one-hundred-mile territory of the location of the association *during their continuance in office*, except that the Comptroller may, in the discretion of the Comptroller, waive the requirement of residency, and waive the requirement of citizenship in the case of not more than a minority of the total number of directors." 12 U.S.C. § 72 (emphasis added).

Permissible Investments for State-Chartered Banks

The bill amends s. 658.67(6), F.S., in order to clarify that:

- The types of entities for which the investment limitation of this subsection applies are subsidiary corporations and affiliates.
- The investment limitation of this subsection applies to an aggregate of any combination of stocks, obligations, and other securities of subsidiary corporations and affiliates.
- The aggregate of such investments may not exceed 10% of the total assets of the bank.

The bill also makes technical changes to s. 658.67(6), F.S., for further clarity.

B. SECTION DIRECTORY:

Section 1. Amends s. 658.21, F.S., relating to approval of application; findings required.

Section 2. Amends s. 658.33, F.S., relating to directors, number, qualifications; officers.

Section 3. Amends s. 658.67, F.S., relating to investment powers and limitations.

Section 4. Provides an effective date of July 1, 2018.

II. FISCAL ANALYSIS & ECONOMIC IMPACT STATEMENT

A. FISCAL IMPACT ON STATE GOVERNMENT:

1. Revenues:

   See Fiscal Comments.

2. Expenditures:

   None.

B. FISCAL IMPACT ON LOCAL GOVERNMENTS:

1. Revenues:

   None.

2. Expenditures:

   None.

C. DIRECT ECONOMIC IMPACT ON PRIVATE SECTOR:

Expanding the pool of individuals who are qualified to serve as a director, president, or chief executive officer of a new state-chartered bank or trust company may have a positive impact on efforts to form new banks and trust companies chartered by the state of Florida. However, the fiscal impact of the bill is indeterminate at this time, as it is unknown how many state-chartered banks or trust companies may form as a result of these changes.

D. FISCAL COMMENTS:

In the event of the formation of a new state-chartered bank or trust company, the OFR would receive $15,000 as a nonrefundable application fee. Additionally, each state-chartered bank and trust company must pay the OFR a semi-annual assessment of $2,500 and a semi-annual assessment that is set by rule and varies depending on the bank's or trust company's assets. However, the fiscal impact of the

bill is indeterminate at this time, as it is unknown how many state-chartered banks or trust companies may form as a result of changes made by the bill.

III. COMMENTS

A. CONSTITUTIONAL ISSUES:

1. Applicability of Municipality/County Mandates Provision:

   Not applicable. This bill does not appear to affect county or municipal governments.

2. Other:

   None.

B. RULE-MAKING AUTHORITY:

Subsection 658.67(6), F.S., which is amended by section 3 of the bill, currently allows the Financial Services Commission to further limit by rule any type of investment made pursuant to this subsection if it finds that such investment would constitute an unsafe or unsound practice. Subsection 658.67(6), F.S., as amended, maintains this rulemaking authority.

C. DRAFTING ISSUES OR OTHER COMMENTS:

None.

IV. AMENDMENTS/ COMMITTEE SUBSTITUTE CHANGES

On November 15, 2017, the Insurance and Banking Subcommittee considered one amendment, which was adopted, and reported the bill favorably as a committee substitute. The committee substitute replaces “entities that provide services incidental to the business of banking” with “affiliates” in order to clarify that s. 658.67(6), F.S., limits permissible investments in subsidiaries and affiliates versus s. 658.67(3), F.S., which limits permissible investments in non-subsidiaries and non-affiliates.

The staff analysis has been updated to reflect the committee substitute.