The Florida Senate

BILL ANALYSIS AND FISCAL IMPACT STATEMENT

(This document is based on the provisions contained in the legislation as of the latest date listed below.)

Prepared By: The Professional Staff of the Budget Committee

BILL: CS/SB 1332

INTRODUCER: Banking and Insurance Committee and Senator Richter

SUBJECT: Financial Institutions

DATE: April 25, 2011 REVISED:

	ANALYST	STAFF DIRECTOR	REFERENCE	ACTION
1.	Arzillo/Johnson	Burgess	BI	**Fav/CS**
2.	Frederick	DeLoach	BGA	**Favorable**
3.	Frederick	Meyer, C.	BC	**Favorable**
4.			RC	
5.				
6.				

Please see Section VIII. for Additional Information:

A. COMMITTEE SUBSTITUTE.....	X	Statement of Substantial Changes
B. AMENDMENTS........................		Technical amendments were recommended
		Amendments were recommended
		Significant amendments were recommended

I. Summary:

This bill creates mechanisms to protect state financial institutions from failure. Due to the increased number of failures of state financial institutions and the unique circumstances that have arisen due to these failures, the financial institutions code is amended in several ways. The bill permits the Office of Financial Regulation (office) to approve special stock offering plans, which is currently prohibited if the financial institution's stock falls below par value. Additionally, the bill authorizes the office to pre-approve shelf charters, which create a more efficient acquisition process for failing state financial institutions. The bill also allows the office to appoint provisional directors or executive officers, if the financial institution does not have the statutorily required amount of directors and/or executive officers. The bill changes examination requirements and other provisions for greater effectiveness of the office's regulation of financial institutions.

The bill implements several provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Wall Street Reform Act) passed by Congress on July 21, 2010.[1] The bill amends

[1] Public Law 111-203.

the financial institutions codes concerning interstate branching and banking, the use of credit ratings for evaluating investment risks, and derivative lending limits.

The bill amends the following sections of the Florida Statutes: 288.772, 288.99, 440.12, 440.20, 445.051, 489.503, 501.005, 501.165, 624.605, 626.321, 626.730, 626.9885, 655.005, 655.013, 655.044, 655.045, 655.41, 655.411, 655.414, 655.416, 655.417, 655.418, 655.4185, 655.419, 655.947, 657.038, 657.042, 657.063, 657.064, 658.12, 658.165, 658.28, 658.2953, 658.36, 658.41, 658.48, 658.53, and 658.67.

The bill creates section 655.03855, Florida Statutes.

The bill repeals the following sections of the Florida Statutes: 658.20(3), 658.295, 658.296, 658.65, 665.013(33), and 667.003(35).

II. Present Situation:

The Office of Financial Regulation is responsible for the regulation of state-chartered financial institutions pursuant to the provisions of the financial institutions codes.[2] The office does not have jurisdiction to regulate federally chartered or out-of-state chartered financial institutions. Since 2009, 45 Florida banks have closed, 29 of those in 2010 alone.[3]

Protection of Failing Financial Institutions

Undercapitalization of Financial Institutions

State financial institutions cannot issue stock at less than par value, and par value cannot fall below $1.[4] Any changes, increase or decrease, in capital stock must be approved by the office.[5] Par value of capital stock is the stock's face value and it sets the minimum price at which the financial institution may introduce shares. Historically, the market value of stock has not fallen below the par value. Recently, however, the falling values of stock have brought many state financial institutions below par value, but the office is unable to assist in raising stock prices because of its lack of statutory authority.

Shelf Charters

Currently, an individual can apply for prior approval with the office to become a director or executive officer of a financial institution.[6] The individual is required to submit an application and pay a filing fee of $7,500. Upon filing an application, the office must consider things such as the character and fitness of the applicant[7] and the applicant's expertise and ability to run a state

[2] Chapters 655, 657, 658, 660, 663, 665, and 667, F.S.
[3] Federal Deposit Insurance Corporation, Failed Bank List, updated February 25, 2011, http://www.fdic.gov/bank/individual/failed/banklist.html (Last visited March 9, 2011).
[4] *See* s. 658.34, F.S.
[5] *See* s. 658.36, F.S.
[6] *See* s. 658.20(3), F.S.
[7] *See* s. 658.20(1)(a), F.S. ("Upon the filing of an application, the office shall make an investigation of: The character, reputation, financial standing, business experience, and business qualifications of the proposed officers and directors.")

financial institution.[8] Currently, business entities are not eligible for prior approval to merge or purchase a financial institution.[9] However, the ability of the office to allow prior approval of mergers and acquisitions of a failing financial institution would assist in the prevention of failures.

Provisional Directors and Executive Officers

Current law requires that a state financial institution maintain a minimum of five directors on its board of directors.[10] However, the financial institutions codes does not provide for enforcement of this requirement. While historically the statutorily required number of directors has not fallen below five, recently a state credit union was forced into conservatorship. Each of the credit union's board of directors resigned, but due to its lack of statutory authority, the office was unable to appoint directors and possibly prevent the conservatorship.

Examinations

The office is required to conduct an examination of each state financial institution every 18 months, but it may accept examinations by an appropriate federal regulator. In addition, the office is required to perform its own examination of each state financial institution every 36 months. Further, to ensure the safe and sound practice of state financial institutions, the office is permitted to perform examinations more frequently than every 36 months.[11] Therefore, the 36-month examination requirement creates duplication in the process because the federally performed exams are sufficient to be relied upon by the office, and the office maintains authority to perform examinations more frequently.

Definition of Related Interest

The financial institutions codes prevents executives and certain shareholders of a financial institution from unfairly acquiring loans and other financial assistance from their financial institution.[12] Nevertheless, many executives and stockholders have circumvented these laws by using relatives to obtain loans and other financial benefits. The current definition of related interest does not encompass family members, but rather is limited to those who control parts of

[8] *See* s. 658.21(4), F.S. ("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, and none of the proposed officers or directors has been convicted of, or pled guilty or nolo contendere to, any violation of s. 655.50, relating to the Florida Control of Money Laundering in Financial Institutions Act; chapter 896, relating to offenses related to financial institutions; or any similar state or federal law. At least two of the proposed directors who are not also proposed officers shall have had at least 1 year direct experience as an executive officer, regulator, or director of a financial institution within 3 years of the date of the application.")
[9] This is called a "shelf charter" because the charter sits on "the shelf" until the applicant is in the position to acquire a failing institution.
[10] *See* ss. 657.021 and 658.33, F.S.
[11] See s. 655.005, F.S. (""Unsafe or unsound practice" means any practice or conduct found by the office to be contrary to generally accepted standards applicable to the specific financial institution, or a violation of any prior order of a state or federal regulatory agency, which practice, conduct, or violation creates the likelihood of loss, insolvency, or dissipation of assets or otherwise prejudices the interest of the specific financial institution or its depositors or members. In making this determination, the office must consider the size and condition of the financial institution, the gravity of the violation, and the prior conduct of the person or institution involved.")
[12] *See* ss. 657.039 and 658.48, F.S.

the financial institution. Therefore, the office is limited in its enforcement, and cannot regulate those in control of financial institutions that circumvent the regulation through family members.

Determination of Capital and Liabilities

Current law contains broad language for calculating capital and liabilities held by an individual or financial institution.[13] However, the proper determination of whether an amount should be included or excluded from the calculation may depend on the specific type of capital or liability. Consequently, the use of these amounts of capital and liabilities may misrepresent the financial condition of the individual or financial institution.

Dodd-Frank Wall Street Reform and Consumer Protection Act

The Wall Street Reform Act was enacted to address the catalysts of the recent financial crisis by promoting stability and transparency in the financial system. Although the Wall Street Reform Act is primarily aimed at large national financial institutions, some of its provisions affect the regulation of state financial institutions.

Interstate Banking and Branching

Currently, the only means of an out-of-state financial institution to establish its initial presence in Florida is through the merger or acquisition of an existing Florida financial institution that is more than three years old.[14] Restrictions also apply to the ownership of remote financial service units by non-Florida financial institutions.[15] The enactment of the Wall Street Reform Act by Congress requires open borders for financial institutions. The Wall Street Reform Act preempts the type of restrictions currently in place in State law; so, an out-of-state bank can now establish a de novo branch,[16] rather than merge or acquire a state financial institution.

Conversions, Mergers and Acquisitions

Section 612 of the Wall Street Reform Act prohibits the conversion of a state or federal institution if the financial institution is subject to a cease and desist order issued by the appropriate regulatory agency, whether state or federal. However, an exception exists that requires notice of an application of conversion to the appropriate state regulatory agency by the appropriate federal agency after the conversion. The federal regulatory agency is required to introduce a plan to address the matter causing the cease and desist order by the state regulatory agency. The Wall Street Reform Act intends to prohibit financial institutions from "forum shopping" for regulators that are more lenient.[17] Florida law currently allows for the conversion of a financial institution's charter subject to certain considerations, but those considerations do not include the existence of cease and desist orders or other regulatory suspensions.[18]

[13] *See* ss. 655.005, 658,038, 658.48, and 658.53, F.S.
[14] See s. 658.2953, F.S.
[15] See s. 658.65, F.S.
[16] Section 655.0385, F.S. defines de novo bank /branch as a bank/branch that is has been established no more than 2 years in the state.
[17] Skadden, Arps, Slate, Meagher & Flom LLP & Affiliates, Dodd-Frank Act: Commentary and Insights, July 12, 2010.
[18] Section 655.411, F.S.

Lending Limits and Derivatives

Section 611 of the Wall Street Reform Act allows state financial institutions to engage in derivative transactions, only if the state in which the financial institution is chartered has enacted laws that take into consideration credit exposure to derivative transactions.[19] Current state law requires that financial institutions consider total liabilities of a person, including all loans endorsed or guaranteed. However, there is no requirement that the credit exposure of borrowers be considered in derivative transactions.

Credit Ratings

The Wall Street Reform Act eliminates the use of credit ratings for a determination of risk for investments.[20] The Wall Street Reform Act replaces the use of credit rating agencies with internal rating guidelines that each financial institution must develop to determine risk. Federal regulators no longer rely on credit rating agencies because of their conflicts of interest in determining credit rating grades.[21] However, state financial institutions are currently required to use credit ratings in assessing investment risks.[22]

III. Effect of Proposed Changes:

Protection of Failing Financial Institutions

Undercapitalization of Financial Institutions (Sections 12, 16, 25, and 27-28)

Although the market value of capital stock of financial institutions historically has not fallen below par value, this has been a growing problem for state financial institutions in recent years. The bill permits the office to approve special stock offering plans if the capital stock of a state financial institution falls below par value and it cannot reasonably issue capital stock to restore the value of the shares. The bill permits the office to approve a plan by a state financial institution that may call for stock splits, change voting rights, dividends, and the addition of new classes of stock. However, the plan must be approved by a majority vote of the financial institution's board of directors and holders of two-thirds of outstanding shares of capital stock. Nevertheless, the office is required to assess the fairness of benefits of the plan, and disallow a plan that would not effectively restore capital stock prices to sufficient levels. In emergency situations, a failing financial institution does not have to perform a vote for the plan to be approved by the office.[23]

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[19] Section 611, Dodd-Frank Wall Street Reform and Consumer Protection Act. Derivative is defined as a contract the value of which is based on the performance of an underlying financial asset, or other investment. It is not a stand-alone asset because it has no value of its own.

[20] Section 939, Dodd-Frank Wall Street Reform and Consumer Protection Act.

[21] American Bankers Association, Dodd-Frank Summary and Analysis, http://www.aba.com/regreform/default.htm (Last visited March 9, 2011).

[22] Sections 657.042 and 658.67, F.S. (None of the bonds or other obligations described in this section shall be eligible for investment by credit unions/any amount in any amount unless current as to all payments of principal and interest and unless rated in one of the four highest classifications, or, in the case of commercial paper, unless it is of prime quality and of the highest letter and numerical rating, as established by a nationally recognized investment rating service, or any comparable rating as determined by the office.).

[23] *See* s. 655.4185, F.S.

Shelf Charters (Section 12)

Section 658.4185(3), F.S., is created to expand the prior approval privilege from only officers to business entities. The bill allows holding companies to apply for prior approval to merge or acquire control of a failing financial institution. The bill mandates that an entity must file an application for prior approval and submit the $7,500 filing fee. This expansion creates a new pool of potential buyers of failing banks, and increases the available equity capital in the bidding process used to procure failing institutions by the Federal Deposit Insurance Corporation's bid process.

Provisional Directors and Executive Officers (Section 3)

The bill creates s. 655.03855, F.S.,[24] which allows the office to temporarily place a provisional director, for reasonable compensation by the financial institution, onto a state financial institution's board. Additionally, the bill allows the appointment of a provisional director if the director(s) are not equipped to operate the financial institution in a safe and sound manner. Nevertheless, prior to the placement of a provisional director, the office must allow the financial institution 30 days to acquire the minimum number of directors. Allowing the placement of provisional directors avoids a possible conservatorship of the state financial institution. The appointment of a provisional director also assists the office in the prevention of failure of the financial institution because the bill requires the provisional director to submit reports, if directed by the office, concerning the condition of the state financial institution and any corrective actions the director believes should be taken.

Examination Requirements (Section 5)

The bill eliminates the required examination of state financial institutions by the office every 36 months. The bill requires that the office perform examinations every 18 months, but the office may accept examinations conducted by the appropriate federal regulatory agency. This eliminates unnecessary examinations by the office, and allows the office to target examination resources to those state financial institutions that are near failure, or operating in a risky manner.

Definition of Related Interest (Section 1)

The bill moves the definition of "related interest" to s. 655.005,.F.S., and expands the definition of "related interest" to include relatives and those who reside in the same household of one who is in control of a financial institution. Consequently, the office can ensure that executives and shareholders do not attempt to circumvent caps and limits on lending.

Determination of Capital and Liability (Sections 1, 15, and 27-28)

The bill specifies the types of capital and liabilities that a financial institution must use in order to calculate total amounts of capital and liability. This ensures that capital and liability calculations are fairly and accurately determined.

[24] *See* s. 658.20(3), F.S. for original language. This section was moved from s. 658.20(3), F.S. and amended to include holding companies.

Dodd-Frank Wall Street Reform and Consumer Protection Act

The bill makes the following conforming changes to comply with the Wall Street Reform Act.

Interstate Banking and Branching (Sections 6, 9. 12, and 22-24)

The Wall Street Reform Act requires that state regulators allow for de novo banking for out-of-state financial institutions. To conform, the bill allows an out-of-state financial institution to establish a de novo bank without merging or acquiring a state financial institution.[25] The bill also allows for the creation of additional branches in accordance with state law as if the out-of-state financial institution was chartered in Florida. The bill removes restrictions on the ability of out-of-state financial institutions to establish remote financial service units within Florida.

Conversions, Mergers and Acquisitions (Sections 6-13)

The Wall Street Reform Act prohibits state regulatory agencies from accepting the conversion of a charter of a federal financial institution when the converting financial institution is subject to regulatory action or a cease and desist order.[26] To conform, the bill amends s. 655.411, F.S., by requiring the applicant to prove that the resulting financial institution will comply with all regulatory actions in effect before the date of conversion and that the appropriate federal regulatory agency does not object to the conversion.

Lending Limits and Derivatives (Sections 16 and 27)

The Wall Street Reform Act requires that in order to participate in the derivatives market, a state financial institution must consider borrower exposure in the evaluation of its risk.[27] To conform, the bill adds the evaluation exposure to risk in derivative transactions.

Credit Ratings (Sections 16 and 30)

The Wall Street Reform Act disallows the use of credit ratings in determining investment risk by requiring financial institutions to develop their own risk evaluations. To conform, the bill requires that all financial institutions develop and use internal policies and procedures to determine risk of investments, and prohibits the financial institution from using credit ratings as the sole means of determining investment risk.

IV. Constitutional Issues:

A. Municipality/County Mandates Restrictions:

None.

B. Public Records/Open Meetings Issues:

None.

[25] *See* s. 613, Dodd-Frank Wall Street Reform and Consumer Protection Act.
[26] *See* s. 612, Dodd-Frank Wall Street Reform and Consumer Protection Act.
[27] *See* ss. 610, 611, and 614, Dodd-Frank Wall Street Reform and Consumer Protection Act.

C. Trust Funds Restrictions:

None.

V. Fiscal Impact Statement:

A. Tax/Fee Issues:

None.

B. Private Sector Impact:

The bill may assist undercapitalized financial institutions in raising capital by authorizing the sale of stock below par value.

The shelf-charter provisions may increase the pool of potential buyers of troubled institutions and, therefore, avoid failures.

The streamlining of the examination process may reduce regulatory burden on financial institutions by eliminating potential duplication of effort by federal regulators.

C. Government Sector Impact:

According to the Office of Financial Regulation, no additional resources will be required to implement the provisions of this bill.

VI. Technical Deficiencies:

None.

VII. Related Issues:

None.

VIII. Additional Information:

A. Committee Substitute – Statement of Substantial Changes:

(Summarizing differences between the Committee Substitute and the prior version of the bill.)

CS by Senate Banking and Insurance Committee on 3/16/2011:
The Committee Substitute makes technical conforming and clarifying changes to the definition of "Banker's Bank" to create uniformity with federal regulations and other technical conforming changes.

B. Amendments:

None.

This Senate Bill Analysis does not reflect the intent or official position of the bill's introducer or the Florida Senate.