Approved January 30, 1985
Date

MINUTES OF THE SENATE COMMITTEE ON FINANCIAL INSTITUTIONS AND INSURANCE.

The meeting was called to order by Neil H. Arasmith at
Chairperson

9:00 a.m./~~p.m.~~ on January 29, 1985 in room 529-S of the Capitol.

All members were present except:

Committee staff present:

Bill Wolff, Legislative Research
Myrta Anderson, Legislative Research
Bruce Kinzie, Revisor of Statutes

Conferees appearing before the committee:

Harold Stones, Kansas Bankers Association
John Suellentrop, Kansas Independent Bankers Association
Jim Turner, Kansas League of Savings Institutions
Karla Farabee, Kansas Retail Council and J. C. Penney Co.

The minutes of January 17 and 21 were approved.

The hearing began on SB 42, dealing with the prohibition of non-bank banks in Kansas, with the testimony of Harold Stones, Kansas Bankers Association, appearing in support of the bill. (See Attachment I.) He began by calling the committee's attention to a copy of a substitute for SB 42 attached to his written testimony. He informed the committee that the substitute bill is a take off on the Colorado plan which he feels is a more clear and direct plan. During his testimony he also drew the committee's attention to copies of articles relevant to the non-bank bank issue. (See Attachment II.) He concluded by asking the committee for serious consideration of the substitute for SB 42. The Chairman said that it would be taken under advisement.

The Chairman asked Mr. Stones if Congress would be acting on this soon, and Mr. Stones answered that there have been no predictions for fast action on the proposal. The Chairman inquired further if the Comptroller of Currency has the authority to grant applications for non-bank banks. Mr. Stones replied that there is pending litigation on this question. He added that he would rather see SB 42 pass now than take a chance of someone outside the state making a determination.

During some brief questions from Senators Karr and Strick, Mr. Stones noted that non-bank bank deposits are not insured by FDIC. He also said he feels that some of these non-bank banks owned by someone out of state would not be interested in helping Kansas agriculture and, therefore, should not be allowed to come into the state and take out deposits.

The hearing continued with the testimony of John Suellentrop, Kansas Independent Bankers Association, in support of SB 42. (See Attachment III.) He called attention to copies of articles naming those who have applied for non-bank bank charters in Texas. He noted that they are giant conglomerates which would possibly ignore the needs of agriculture. (See Attachment IV.) He concluded by noting that the Independent Bankers have filed suit in Florida regarding the question as to if the Comptroller has authority to grant charters to non-bank banks.

Jim Turner, Kansas League of Savings Institutions, followed with his testimony in support of SB 42 or the substitute bill offered by Mr. Stones. (See Attachment V.) He added that the agriculture economy has an impact on his banking colleagues in Kansas which in turn has an impact on his industry. Both financial segments cannot compete with non-banks which take deposits and take the money out of state. He would not advocate forbidding non-bank banks forever but feels that time is needed to discover the rules before they are allowed to come into the state. In reference to previous discussion as to if non-bank banks are insured by the FDIC, Mr. Turner said that once they are approved, they are insured and that, in essence, they are a bank even though they take deposits only. He concluded that since Congress has not yet acted, he would want Kansas to retain some jurisdiction over the state's financial community.

Karla Farabee, an attorney with the J. C. Penney Company, testified for the Kansas Retail Council in opposition to SB 42. She began with a review of the term "non-bank bank" which she defined as a term applied to any state or federally chartered banking institution which either does not accept deposits or which chooses instead to make loans to consumers in lieu of making any commercial loans. It is a term which merely distinguishes consumer banks from commercial lending banks which may not be owned by any organization engaged in trade and commerce unrelated to banking. Consumer banks which have been termed "loophole" banks have been falsely interpreted to mean that they enjoy powers and freedoms that give them an unfair advantage when, in fact, they have fewer powers than commercial banks. Consumer banks, like commercial banks, must have a banking charter from the Comptroller or state and are subject to exactly the same restrictions and supervision. Consumer banks are more restricted in that they cannot make commercial loans which is the more profitable part of the banking business. She continued that what has become to be known as the "non-bank bank loophole" implies that something was overlooked, but actually it is a provision that resulted from a decision by Congress and the Federal Reserve Board that the policies behind the Bank Holding Company Act do not apply to banks that do not make commercial loans because these banks do not present the opportunity for the types of abuses with which Congress was concerned. Ms. Farabee added that consumer banks have portfolios of relative low risk, high liquidity, and widely diversified assets which generate a constant cash flow, giving the Penney Company as an example. She said Penney intends to broaden its participation in financial services in the future and has been in the credit business for over thirty years, and if it is frozen out of that business, it will be competitively hurt. Furthermore, she stated that SB 42 is unconstitutional in that states may define the powers of their own state-chartered financial institutions, but they are clearly without authority to do so with regard to nationally chartered institutions. She concluded that she believes that more, not less, flexibility in the provision of financial services is in the best interest of consumers of those services and the economy as a whole and that involvement of companies such as Penney in the financial services marketplace has not produced adverse results but has the potential to significantly contribute to that market.

There being no further time, questions were not submitted to Ms. Farabee. The Chairman requested that she furnish the committee members with written copies of her testimony, and she agreed to do so.

The meeting was adjourned.

SENATE COMMITTEE

ON

FINANCIAL INSTITUTIONS AND INSURANCE

OBSERVERS
(Please print)

DATE	NAME	ADDRESS	REPRESENTING
1-29-85	Marvin Umholtz	Topeka	KCUL
"	Chip Wheelen	"	KIBA
	Jim Turner	Topeka	KLSI
✓	John Sudlendorf	Colwich	KIBA
	[illegible]	Topeka	KBA
✓	[illegible]	Denver CO	J.C. Penney Co
	Bud Grant	Topeka	KCCI
	John Trinkle	Lyndon	KIBA
	Pete McGill	Topeka	KIBA
✓	Mike Fahrbach	Haven	KIBA
	George D. Walker	Garden Plain	KIBA
	MaryAnn Bumgarner	Topeka	Sen. Burke - intern
	John Spurgeon	Lawrence	Budget
	DENNIS DEHN	TOPEKA	SEN. WERTS' INTERN
	Dr. William C. Miller	Olathe	—
	Martin Hawver	Topeka	Capital-Journal
	BEN NEILL	"	KIBA
	Linda McGill	"	"
	LARRY MAGILL	"	IIAK

Substitute for

SENATE BILL 42

BY SENATE COMMITTEE ON FINANCIAL INSTITUTIONS & INSURANCE

AN act concerning banks and other financial institutions insured by the Federal Deposit Insurance Corporation; requiring such institutions to have the legal right to provide certain services to the public.

Be it enacted by the Legislature of the State of Kansas:

Section 1. No financial institution whose deposits are insured by the Federal Deposit Insurance Corporation shall conduct business in this state unless such institution has the legal right to accept deposits that the depositor has the legal right to withdraw on demand and to engage in the business of making commercial loans.

Section 2. This act shall take effect and be in force from and after its publication in the Kansas Register.

Non-bank facilities face ban

Denver Post

Denver Post Staff, Wire Reports 1/24/85

Limited banking institutions — known as "non-bank banks" — would be barred from operating in Colorado under a bill that cleared the state House of Representatives Wednesday with no debate and scarcely any explanation.

The measure, approved 65-0, already has won Senate approval and now moves on for the signature of the governor.

Kathy Richardson, Gov. Dick Lamm's press aide, said the governor is expected to sign the legislation, pending routine legal review for proposed laws.

Rep. Jim Scherer, R-Idaho Springs, discussed the measure only briefly on Tuesday as the measure was winning preliminary approval.

The bill says that any corporation with a banking institution in Colorado must both accept demand deposits and make commercial loans. Under federal regulations, only banks that provide one or the other service can be chartered across state lines.

Non-bank banks typically take demand deposits, but don't make commercial loans.

The bill excludes industrial banks and loan production offices from its provisions by defining a banking institution as national bank or a Colorado state bank.

The "near banks" to which the measure applies are able to engage in interstate banking, which is prohibited for ordinary banks in the state under federal law.

Nine major banking companies have applied for permission from the Comptroller of the Currency to establish non-bank banks in Colorado. Four have been approved, but would be prohibited under the bill approved Wednesday. Applications approved by the comptroller are by Ranier Bancorporation of Seattle for a Denver bank; Mellon Bank Corp. of Pittsburgh for Arvada; First Bank System Inc. of Minneapolis for Denver; and Chase Manhattan Corp. of New York for Denver.

1/29/85

Attachment I

TESTIMONY OUTLINE

KANSAS BANKERS ASSOCIATION
Tuesday, January 29, 1985

I. BACKGROUND: The authority being cited by the Comptroller of the Currency for the existence of "Non-Bank Banks" or "Loophole Banks" was created by very intelligent corps of legal experts who discovered a loophole when comparing statutory language in the Federal Bank Holding Company Act and in the Douglas Amendment to that Act. This wording has been in existence for years, but the loophole is a fresh discovery.

A. The McFadden Act [12 U.S.C § 36(c)] prohibits a national bank from establishing branches outside the state in which its main office is located. The McFadden Act applies to banks, however, and not to bank holding companies, which were not regulated by federal law.

B. In 1956, the Douglas Amendment [Section 3(d)] of the Bank Holding Company Act [12 U.S.C. §§ 1841 *et.seq.*] was passed to deal with the interstate issue for bank holding companies. It prohibits a bank holding company from acquiring a "**BANK**" outside its home state, unless the laws of the state in which the acquired bank is located, specifically permit such acquisition.

C. The Bank Holding Company Act, however, goes on to define the word, "BANK", as **any company that both accepts demand deposit accounts, and also makes commercial loans.**

D. A common practice is for insurance companies, large national chain retailers, brokerage houses, bank holding companies, savings and loan holding companies and other types of organizations to either seek a new national bank charter which performs all functions of a commercial bank, **except making commercial loans**---or to purchase an existing full-service commercial bank, and sell off the entire commercial loan portfolio. Thus they believe they have "slipped through the loophole" of the definition in the Bank Holding Company Act. Unfortunately, the Comptroller of the Currency, because of the inaction of the United States Congress in the 98th

Session, believes in this wholesale deregulation philosophy, and is granting such applications at a rapid rate.

E. There are now two "Non-Bank Bank" applications pending in the Office of the Comptroller of the Currency which request a Kansas location. Both request locations in Johnson County. They are applications from Holding Companies located in Kansas City, Missouri, and Minneapolis, Minnesota.

F. Over 350 Non-Bank Banks have been applied for nation-wide. The Comptroller of the Currency is approving them at a rapid rate, but the Federal Reserve Board appears to be applying the brakes. The Federal Reserve Board may not retard insurance company, brokerage house, department store, etc. acquisition, but it does have authority to approve or disapprove applications from bank holding companies. **It is clear that the federal regulators disagree on the legality and intent of Congress on Loophole Banks.**

II. Senate Bill 42 is a classic case of allowing the Kansas Legislature to make major policy decisions affecting Kansas. Some are as the following:

A. Is there now a significant group anywhere in our state who have difficulty obtaining financial services from existing chartered financial institutions, including our current 628 full-service commercial banks, plus Kansas Savings and Loan Associations, S & L branches, and Credit Unions? **HAS ANYONE EVER OUTLINED A LIST OF PRECISE AND SPECIFIC NEEDS, other than simply to call them "Consumer" banks?**

B. Is it in the best interest of our state to now suddenly allow within our borders a **nation-wide or even world-wide system of multi-banking** without any study on the effects of such a major change? How will such nation-wide acquisitions affect our Kansas-based banks, who currently have no authority for intra-state acquisitions?

C. Is it in the best interest of the Kansas economy to permit an entire new class of financial institution which will not even be authorized

to make commercial loans, which will basically be only **deposit exporting institutions**? Where will the funds come from for Kansas agriculture, small business, commercial real estate, manufacturing, high tech, etc. etc. loans?

D. We believe the Kansas Legislature, after careful reflection, will join the Legislatures of many other states in attempting to stop this "action by accident" until the issue receives serious and significant study.

III. We respectfully urge the members of the Senate Committee on Financial Institutions and Insurance to give favorable consideration to the passage of Senate Bill 42, or Substitute for Senate Bill 42.

Harold A. Stones

Nonbank Banks

Limited-Purpose Banks Flood Streets Of Financial Community

On March 11, 1981, the earth beneath the financial community trembled and a small fissure formed.

Now a little more than three-and-a-half years later that fissure has turned into a gaping gorge that gets wider every day. March 11 is the anniversary of the first nonbank bank.

On that date, the Federal Reserve formally permitted Gulf & Western Corp., New York, to acquire Fidelity National Bank, Concord, Calif., after the bank was divested of its commercial-loan portfolio.

Robert C. Zimmer, a Washington, D.C., attorney who oversaw the birth of the first nonbank bank, was the moderator for a recent one-and-a-half-day seminar on the subject. The Washington, D.C.-area seminar, sponsored by the Bureau of National Affairs Inc. and the Institute for Professional and Executive Development Inc., examined the nonbank-bank issue from the perspectives of Congress, the regulators and competitors in the financial services market.

The key to creating a nonbank bank is to remove either the bank's commercial-lending or deposit-gathering functions so it will not meet the definition of "bank" contained in the Bank Holding Company Act, Zimmer explained.

The debate about nonbank bank centers around two types of nonbank banks — those owned by diversified companies as a way to enter the financial services market and those owned by bank holding companies as a way to expand across state lines, said Robert A. Evans, president of the American Financial Services Association, which represents many of the diversified companies, such as Sears, that own nonbank banks.

Evans said diversified companies primarily want to own nonbank banks for five reasons — access to funds; access to the payments system; the ability to issue credit cards; a way to avoid interest-rate limitations; or as a method to offer consumers new financial services and products.

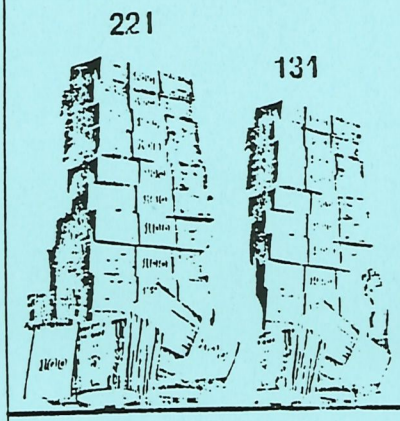
Evans did not believe nonbank banks will be a threat to community banks. There are "no economies of scale for large banks to go into small towns," he said.

It is "extremely difficult to open up a new store," he said and predicted many of the limited purpose banks will be up for sale if they are allowed to continue.

(Continued on page 4)

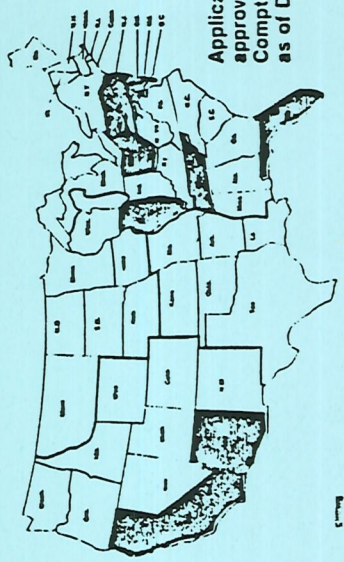
Nonbank-Bank Applications

Total as of Dec. 17: 355
Approved by Comptroller: 125



The Bank Holding Company Act defines a "bank" as any company that makes commercial loans and accepts demand deposits. Nonbank banks can only exercise one of the functions.

Most Popular Nonbank-Bank States



Companies Seek Nonbank Banks

(Continued from page 1)

Few mutual funds have shown interest in nonbank banks and those that have would like to get out of the business, according to Matthew P. Fink, vice president and general counsel for the Investment Company Institute, a trade group that represents mutual funds.

His thoughts were echoed by Sam Scott Miller, vice president and general counsel for PaineWebber Group Inc., New York, who said many nonbank banks have been set up without a well-defined purpose.

Securities firms are trying to "stake out a protective position," Miller said. They are afraid "if they don't have nonbank banks and their competition does, it may mean something down the line."

He said another primary force motivating the acquisition of nonbank banks is to obtain the valuable "bank" label. Banks have been successful with brokerage services not because of the discount, he said, but because consumers trust banks. This trust does not come from the natural integrity of banks, Miller added, but from the government support given to banks.

Nonbank Banks

Fed Board Opposes Spread Via Loophole, Seger Says

The Federal Reserve Board of Governors is solidly opposed to interstate banking through the nonbank-bank loophole, said the board's newest member.

Martha R. Seger warned banks planning to establish nonbank banks that "Congress has made its intentions known and those who assume that the cutoff for grandfathering will be changed are taking a major risk." Since banks have been warned in advance, "the case for grandfathering is not as convincing as it was in 1956 or 1970," she said.

A problem with nonbank banks is "there is a danger that everyone will try to enter the same attractive banking markets," Seger said. She noted 11 banking organizations have applied to establish nonbank banks in Phoenix, Ariz., and questioned how many new nonbanks the market can support at the same time. While opposing nonbank banks as the vehicle for interstate expansion, Seger said "all of the board members would probably favor some form of interstate banking."

"Entry restrictions often serve only to perpetuate the existing division of market shares, regardless of how well or how poorly the market is being served," she said.

Speaking before a meeting of the Association of Bank Holding Com-

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Fed Governor

(Continued from page 5)

panies in Baltimore, Seger noted her preference for an national approach to interstate banking, but predicted that the action would continue to come from the states with several more passing some form of interstate expansion in 1985.

A national interstate-banking approach would maximize the number of potential bidders for existing banks and the diversity of new entrants into markets, she said, and "should result in a better long-run banking structure."

The regional interstate-banking approach could have problems, she said, because it involves mergers between large banking organizations and leads toward regional consolidations.

Interstate banking should not be a threat to small banks, Seger said. Small banks "can exploit their knowledge of local market conditions, and while they may not have the resources to develop new products or operating systems, there are plenty of vendors to assist them in the delivery of high-quality banking services."

She predicted competition will be tougher for small banks than in the past. But "those willing to adapt to conditions and meet the needs of the marketplace will continue to do well, even in competition with large nationwide firms," she said.

"Even though many small banks will be acquired, most of the acquisitions will be by choice and not by necessity," Seger added.

'A Bank By Any Other Name Is Still A Bank'

Regardless of what reporters, lawyers and representatives of government may say, a nonbank bank is a bank.

There is nothing in the charter, bylaws or other corporate documents of a nonbank bank to indicate any difference between this type of institution and any other commercial bank, according to a report prepared by ABA's Federal Agency Relations Division.

Because nonbank banks are banks and are chartered as banks and not as a special class of financial institutions, they are regulated by the federal government and by state banking authorities just the same as all other banks.

Nonbank banks are subject to the same capital ratios, the same supervisory treatment, the same examinations, the same Community Reinvestment Act and other regulatory requirements other commercial banks are subject to. They are subject to the same branching restrictions and may not engage in any activities that are forbidden to other banks. They are also eligible for FDIC deposit insurance like any other bank.

So where did the term "non" in the name "nonbank bank" come from? The actual issue revolves

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Definition

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around the definition of the word "bank" in the Bank Holding Company Act. The act defines a "bank" as any company that makes commercial loans and accepts demand deposits. Any organization that fails to exercise one of those two functions, even though the charter specifically authorizes it to exercise both, is not a "bank" under the Banking Holding Company Act.

This distinction does not change the regulation of the banking entity itself, however, it completely removes the parent company that owns a nonbank bank from the restrictions of the Bank Holding Company Act unless the parent organization also owns a full-service bank that takes deposits and makes commercial loans.

Removal of the Bank Holding Company Act restrictions allows diverse companies such as Sears to buy a nonbank bank without being subject to the non-banking activities defined by the Fed. For a bank holding company that establishes a nonbank bank, it allows it to acquire banks outside its home state without a legislative enactment by the state in which the nonbank bank is acquired.

Nonbank banks, therefore, raise two fundamental structural banking issues, the division said. These are whether a separation between banking and commerce should be continued and whether bank holding companies should be authorized to purchase banks in other states irrespective of state laws.

STATE NONBANK BANK PROHIBITIONS UNDER STUDY; LEGAL ISSUES RAISED

While the nonbank bank controversy continues to simmer at the federal level, the limited purpose institutions are beginning to cause a backlash at the state level where a number of state legislatures are planning to consider legislation that would outlaw nonbank banks within their borders.

Florida, North Carolina, and Connecticut already have adopted legislation that prohibits nonbank banks in their states. State legislatures in Colorado, Texas, Illinois, Arizona, and Oklahoma expect to address such legislation in 1985, and some states, including California, New Mexico, and Ohio still are considering ways to handle the problem.

However, as states scramble to impose prohibitions, questions are being raised even by supporters of such legislation about whether states can enforce laws that prevent nationally chartered institutions from entering their states. Some banking industry attorneys claim the state laws are unconstitutional and will not withstand court challenges.

Bid To Gain Time

By adopting prohibitions on nonbank banks, states are hoping to gain time for Congress or the courts to put an end to the loophole institutions. State banking officials, trade groups, and elected representatives are worried that they will lose control of their borders as out-of-state bank holding companies make use of the limited-purpose institutions to evade prohibitions on interstate banking and set up deposit taking or commercial lending businesses in their states.

State officials discuss the proposed prohibitions with some level of irony. An official with the Texas state banking department said the state is attempting to draft legislation that "is not obviously unconstitutional."

Arizona Superintendent of Banking Walter Madson said the department is considering legislation that would impose an outright ban on nonbank banks, as well as other alternatives, but he acknowledged that there are serious questions about whether such a law would be constitutional. However, he said it will take nonbank bank applicants some time to prove such a statute illegal. In in the meantime, the statute may discourage nonbank bank entry into the state, he suggested.

Keep Decisions in State Hands

The Arizona legislature also will be considering a bill this year to authorize out-of-state banking holding companies to enter the state by acquiring existing banks within the state, he said. Together, the interstate banking and nonbank bank bills would mean that the state would retain authority over what out-of-state institutions enter Arizona, he said.

The Comptroller of the Currency has granted national bank charters for about 130 nonbank banks in 20 states so far, and more than 200 applications still are pending at OCC. While members of Congress have promised to halt the proliferation of these "loophole banks," interest in setting up interstate networks of nonbank banks appears to be growing rather than diminishing. Most of the country's largest bank holding companies have applied for nonbank bank networks, and large thrift holding companies now are expressing interest in the institutions.

Nonbank banks are organizations that avoid one of the two functions that define a bank under the Bank Holding Company Act: accepting demand deposits and making commercial loans. By refraining from engaging in one of those activities, institutions can evade BHC Act restrictions on interstate banking and ownership of banks by commercial firms.

Most applications for nonbank banks now pending are from about 60 bank holding companies. In addition to receiving chartering authority from the OCC, these organizations also must receive Federal Reserve Board authority to acquire the limited purpose banks. So far the Fed has approved only a handful of nonbank bank applications, but Fed General Counsel Michael Bradfield said, as of Jan. 4, the Fed has accepted for processing applications from 13 bank holding companies to acquire 56 nonbank banks already chartered by the OCC. About 20 of those applications are for nonbank banks in Florida.

Stop the Flood

To hold back this flood, state legislatures in Florida, Connecticut, and North Carolina have adopted laws that prohibit nonbank banks by revising the definition of the term 'bank' in their state statutes and prohibiting organizations from acquiring any bank-like organization that does not meet the revised definition. As state legislatures begin to convene around the country, similar legislation will be debated in at least six other states, and possibly more.

In addition to specific legislative prohibitions on nonbank banks, some states also are considering administrative and legal remedies. Texas Attorney General James Mattox last fall warned the Comptroller of the Currency that his office would file suit against the OCC if it chartered any nonbank bank in the state, and the state may consider litigation against the Fed as well, according to an official in the state banking department.

Mattox has claimed that the Texas state constitution prohibits these institutions without any further actions on the part of the state. An Illinois Bankers Association official said litigation probably would result in that state as well if any nonbank banks receive final approval. Other states, such as Indiana, already have statutes in place that may prohibit nonbank banks, according to Beth Climo, an attorney with Washington, D.C.'s Bingham, Dana & Gould. Climo's firm is attempting to bring together a coalition of nonbank bank proponents.

Fed Will Consider Laws

The Fed will be forced to consider these state laws when it rules on bank holding company applications to acquire nonbank banks in states that have prohibited

the institutions. However, it is unclear whether the OCC also will take these state laws into consideration in its chartering decisions.

The Comptroller has been requiring bank holding companies to submit a legal analysis of the impact state laws have on nonbank bank applications, and an OCC spokeswoman said the agency is continuing to review such laws. Banking sources note that the OCC so far has not chartered any nonbank banks in states such as Texas where the impact of state law is unclear. The sources also point out that the OCC believes state laws come into play primarily under the Bank Holding Company Act, which is administered by the Fed.

Comptroller of the Currency C. Todd Conover said in a press luncheon Jan. 8 that there is some question as to whether the state laws are binding. OCC General Counsel Richard V. Fitzgerald acknowledged that the state laws could raise constitutional questions that might be argued in a suit against the OCC. However, he said the OCC is "pretty comfortable" with most of the state laws the agency is currently familiar with. "The banks we have been chartering are valid institutions," Fitzgerald said, "They're fully chartered national banks."

During a Jan. 9 Fed meeting on nonbank banks (see story in this issue), Fed General Counsel Michael Bradfield said the Fed will have to address the question of the constitutionality of these state laws when it considers bank holding company applications to acquire nonbank banks in states that have prohibited the institutions. He noted that if the laws are not unconstitutional, then many of the pending applications for nonbank banks would be blocked.

Bradfield did not give any indication of how the Fed will rule on the constitutional question. Climo pointed out that in the Fed's approval of a nonbank bank for U.S. Trust Corp. in Florida, the Fed said it would uphold state laws unless the laws are clearly unconstitutional. She predicted the Fed would give a much closer reading to state laws than the OCC.

U.S. Trust Litigation

The Fed's approval of U.S. Trust's nonbank bank currently is being litigated in Florida (*Florida Bankers Association v. Federal Reserve Board*, No. 84-3270, CA 11, 4/23/84), but that litigation does not directly address the recently adopted Florida law banning nonbank banks (43 WFR 1008) because the Fed approved the U.S. Trust Corp. application before the law was passed.

The U.S. Court of Appeals for the Eleventh Circuit was recently asked to remand the U.S. Trust decision back to the Fed so that the Fed could rule on the Florida law, but the court declined to do so.

In a letter filed in connection with that petition, attorneys for U.S. Trust argued that the Florida law is unconstitutional. Vaughn C. Williams, with New York's Skadden, Arps, Slate, Meagher & Flom, which represents U.S. Trust in that case, told the court that the law clearly violates the Commerce Clause and Supremacy Clause of the U.S. Constitution.

The Florida law, enacted late last year, prohibits bank holding companies and any other company from owning a bank in Florida unless the bank meets the definition of a bank under the federal Bank Holding Company Act. The ban on nonbank banks would expire in July 1985. The law, which may be made into a permanent ban during the regular session of the legislature in April, allows limited-service banks in existence as of June 30, 1983, to remain in business. Those set up after that date would have to be divested.

Clear Intent of Law

Williams argued that the law's clear purpose and intent is to prohibit out-of-state bank holding companies from operating non-banking activities within Florida. He pointed to a staff analysis of the law by the Florida House of Representatives Committee on Commerce. That analysis, done before the bill was enacted, states, "This bill may have a constitutional problem with respect to the federal Commerce Clause and/or the federal Supremacy Clause. Though the bill does not treat out-of state bank holding companies any differently than in-state bank holding companies and therefore escapes being overtly violative of the federal Commerce Clause, it does attempt to impose a state law restriction on a federal institution that but for this restriction is able to operate a 'bank' under a federal charter within the state."

Skadden, Arps attorney William Sweet also pointed out that the Florida law has the effect of discriminating against out-of-state banking organizations, because a bank within the state could obtain a full-service bank under the law, and then simply refrain from engaging in one of the two activities that define a bank under the BHC Act.

The House staff analysis goes on to say, "Whether or not this bill may have constitutional problems is irrelevant to the expressed intent of the sponsor. This intent is to block to the extent possible the arguably extralegal actions of companies setting up non-bank banks through a nonintentional loophole in federal law. This bill's automatic repealer is to give Congress time to act responsibly."

North Carolina Litigation

A number of other suits involving nonbank banks currently are pending. The Independent Bankers Association of America has launched two suits against Comptroller of the Currency C. Todd Conover involving that agency's authority to charter nonbank banks, and it is possible those suits may raise state law issues as well (*Independent Bankers Association of America v. Conover*, No. 84-1403-Civ-J-12, MDFla., 12/14/84; 43 WFR 1077; and *Independent Bankers Association of America v. Conover*, No. 84 C 5638, ND Ill, 10/2/84; 43 WFR 630). However, so far there apparently is only one other case that deals with the validity of state laws prohibiting nonbank banks.

In North Carolina, Citicorp last July entered a contract to acquire a Morris plan industrial bank only a few days before the state legislature adopted a little-noticed provision in its regional interstate banking bill that prohibits banks, bank holding companies and any other company from owning or acquiring any nonbank bank subsidiaries. The statute permanently bars acquisition of institutions in the state unless the

organization meets the bank definition; that is, any institution that is insured or eligible for insurance by the FDIC, and that makes commercial loans and accepts demand deposits.

According to Robert Anderson, General Counsel for the North Carolina Banking Commission, the state banking commissioner denied Citicorp's acquisition based on the new state law, and Citicorp sued, claiming the state law is unconstitutional. That litigation may be the first test of a state's authority to adopt legislation prohibiting nonbank banks, Anderson said. The case is now being briefed before the state court of appeals.

Connecticut Statute

The only other state that already has adopted legislation on the issue is Connecticut, and so far no litigation has arisen over that statute.

However, in an address to the Savings Banks' Association of Connecticut Oct. 23, 1984, state commissioner Brian J. Woolf said, "If the Comptroller and the Federal Reserve Board approve these [pending applications for nonbank banks in Connecticut], it is highly likely I will ask the State Attorney General to begin legal proceedings against the applicants, the Comptroller and/or the Federal Reserve Board."

Demonstrating some prescience, the Connecticut legislature last May adopted legislation imposing a permanent prohibition on bank holding companies owning a nonbank bank in the state and giving the state banking commissioner power to enforce the prohibition. A state banking association official said almost everyone believed at that time that Congress would adopt legislation prohibiting nonbank banks, but the bankers association endorsed the statute to be on the safe side.

Other States Are Considering

State legislatures in Colorado, Arizona, Oklahoma, Texas, and Illinois probably will be presented with legislation prohibiting nonbank banks soon, if such legislation has not already been submitted, according to officials in those states.

While Texas believes its constitution prohibits the institutions, an official with the state banking department told WFR that the office also is attempting to draft legislation to prohibit the institutions. Such legislation probably would be endorsed by the state bankers association, banking officials said.

In Colorado, both the Colorado Bankers Association and the Independent Bankers Association in the state support legislation to prohibit nonbank banks. Jim Thomas, head of the independent bankers group, said he expects the majority of state legislators to sign on as co-sponsors of the bill. The Colorado bill probably will be modeled after the North Carolina statute, according to Bill Buell, General Counsel for the Colorado Bankers Association.

Two different ways of closing the nonbank bank loophole are now being discussed in Arizona, according to state bank superintendent Walter Madson. One alternative is to submit legislation that provides for an outright ban on ownership of the institutions for any organization in the state. The other idea is to give the state bank superintendent jurisdiction over any nonbank bank applications.

Madson noted the irony that the state is considering a prohibition on nonbank banks at the same time that it is considering legislation to eliminate restrictions on out-of-state bank holding company entry. However, he said if the interstate banking legislation passes, then there is no need for nonbank banks in the state, and the state would like to retain control over what organizations can enter the state and in what form.

The board of directors of the Oklahoma and Illinois bankers associations both voted to support legislation prohibiting nonbank banks in the 1985 legislature, and officials with both organizations said they would work to see such legislation adopted.

Support for Bill in Ohio?

The independent bankers association of Ohio currently is canvasing members of the state legislature to see if there is support for bill on the issue, according to legislative council Scott Williams. Williams said he should know by the week of January 14th whether the trade group's board of directors will endorse such legislation, and whether there is any support for it in the legislature.

In addition, Ohio Banking Superintendent Linda Page has asked the Fed to refrain from chartering nonbank banks. In a Jan. 9 letter to the Fed, Page asked the Fed to "exercise its discretion and authority and prohibit the expansion of the 'nonbank bank' problem by denying the pending applications" for nonbank banks in Ohio and across the country. Page told WFR that the Fed asked the department to comment on pending applications. Page also said she probably would support legislation to close the loophole in the state.

In her letter to the Fed, Page suggested that the benefits of nonbank banks do not outweigh their probable adverse effects. Since nonbank banks are being pursued primarily by large corporations, "there will be a tendency to concentrate depository resources, something Ohio statutes recognize as unacceptable." She also claimed the institutions will result in unfair competition.

New Mexico and California

In New Mexico, the state financial institutions commissioner has been discussing a nonbank bank prohibition bill with the state bankers association, but so far those discussions have had no concrete results, according to Mark Douglas, director of government relations for the New Mexico Bankers Association. That trade group has not taken an official position on legislation at the state level. Douglas said the group has some concern over whether such a law would be constitutional.

The subject apparently is not likely to be the subject of legislation in California, but a state banking official said the banking commissioner is interested in ensuring that the department has jurisdiction over any nonbank banks that attempt to set up shop in the state.

WHY TWO BANK BILLS CRUMBLED

Jake Garn: the easy passage of his banking bill through the Senate took Fernand St. Germain by surprise

Neither Senator Garn nor Congressman St. Germain has succeeded in changing bank laws. So who won? Sears?
By Sarah Martin

The banking legislation that could have reshaped the US financial services industry has crashed at the close of the 98th Congress – an event that may mean Congress has permanently lost control over financial deregulation in the United States.

The demise of the legislation may, however, open the door to more scrambling by institutions to take advantage of the so-called non-bank bank loophole (*Euromoney*, July 1984).

A bill introduced by Senate Banking Committee chairman Jake Garn, which would have closed the loophole, but would also have substantially expanded banks' powers, passed the Senate by an overwhelming majority on September 13. However, the St. Germain bill, its rival in the House of Representatives, never even made it to the floor before being withdrawn by its sponsor, Fernand "Freddie" St. Germain, a Rhode Island Democrat. The result: no legislation at all, at least in this session.

Election-year jitters were partly at fault. As *Euromoney* predicted last July, a deadlock was a strong possibility from the start. The forces lined up on both sides of the legislation were powerful. Not enough members, at least in the House, wanted to risk offending either side. And the way in which the legislation fell apart has caused some observers to question whether St. Germain, the chairman of the House Banking Committee, may be losing his touch.

"St. Germain was simply not confident about his ability to control the bill to the extent that he wanted to," explained a spokesman for the American Bankers' Association (ABA).

St. Germain first brought out his bill, which would have increased regulation and *restricted* bank activity, in the wake of the Continental Illinois disaster last spring.

House aides were confident they were riding a tide of popular opposition to expanded powers for banks. They also had little regard for the Garn bill, which after months of hearings was bogged down in the Senate Banking Committee, where members were still trying to reach a consensus on the final version.

At the time the St. Germain bill was introduced, one House aide said: "We've got this bill on a fast track . . . We'll be here the very last night of this session in October, putting the final touches on it."

One of St. Germain's aims in bringing out a bill just after the Continental affair was that he wanted an opportunity to roast the regulatory authorities, of whom he has a low opinion. As he commented during the Continental Bank hearings before his Committee, "For those of us who have ridden the failed bank circuit, the *déjà vu* qualities of Continental are discouraging. It appears that the only thing the regulators have improved is their ability to make excuses. . . We will explore every aspect of the statutes which the regulators claim gave them the authority to proceed with the Continental bailout. If, indeed, the authority is clear – as the regulators steadfastly contend – then we have responsibility to review whether or not this power should remain in its unbridled form."

St. Germain had wanted to hold the Continental hearings early in the summer in the hope that they would give him the ammunition he needed to achieve some kind of restrictive, loophole-closing legislation. But, much to his displeasure, the regulators refused to appear, claiming that testifying then might jeopardize the Continental rescue package. As a result, St. Germain had to wait until September to hold the hearings, by which time the Senate had stolen a march on him and had a marked-up bill ready for consideration by the Senate floor.

According to one House staffer, St. Germain was "totally taken aback" by the size of the vote in favour of the bill in the Senate. The big banks had concentrated their lobbying efforts in the Senate while, in the House, lobbying by the banks was fragmented.

"The sentiment in the House was

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disorganized," observed Steve Verdier, spokesman for the Independent Bankers Association (IBA) a lobbying organization that represents many smaller bankers. "St. Germain found himself in an ambiguous situation. He didn't feel that he had enough support to control his bill in conference; on the other hand there was not sufficient pressure from the House to force him to conference." One week after the Senate vote, St. Germain told the House: "I regret that it is not possible to move the loophole-closing legislation in this session. It is obvious that the Senate will not consider it unless we buy off on new and greatly expanded powers for banks and other financial institutions."

Bankers themselves were split over the two bills. The IBA, for example, saw as its top priority the closing of the non-bank loophole, since it has been largely the smaller banks that have felt threatened by the burgeoning competition from so-called consumer banks. Thus the IBA supported the St. Germain bill, even though St. Germain opposed any new powers for banks.

The ABA, on the other hand, opposed the St. Germain bill and lobbied for the Garn bill, albeit in an oddly lopsided fashion. "The people who wanted broader powers really didn't do any work in the House," said Verdier. "I guess they figured the Senate could get the Garn bill through by immaculate conception."

One of the prime movers against the bill in the House was Sears, the merchandizing and financial conglomerate. "Sears brought a tremendous lobbying force to Capitol Hill. They hired former Congressmen and generally made the St. Germain bill very controversial," noted one lobbyist.

Sears' official line was that it supported the Garn bill and financial deregulation, and that it welcomed more competition in the financial services industry. The House bill, however, contained a provision, backed by St. Germain, that would have extended the Glass-Steagall Act (the law that prohibits commercial banks from underwriting securities) to thrift banks. Thus Sears would have had to divest itself either of its savings bank in California or of Dean Witter, its investment banking and securities trading arm. Sears may have feared that, if the bill reached conference, that provision might stay in it, possibly as a tradeoff for some extra powers for banks. Sears concentrated its lobbying effort in the small rules committee, which was where the bill went after the banking committee, and where it died without ever reaching the floor of the House.

There was substantial support in the House for liberalizing the Bank Holding Company Act, which would have allowed banks to do some revenue bond underwriting. The Securities Industry Association (SIA) was strongly opposed to that, as it was to the banks being able to underwrite mortgage-backed securities. "In an election year, where a lot of races are much tighter than expected, House members simply did not want to choose between the banking industry and the securities industry, both of which are big political action committee contributors," said an ABA spokesman.

St. Germain: not confident of his ability to control his bill

The most controversial point in the St. Germain bill was whether non-bank banks in existence up to a certain date should be grandfathered – that is, treated as if their age gave them legitimacy. St. Germain originally denounced "the snakepit of grandfathering". But by the time his bill left the banking committee it had the same grandfather date as the Garn bill: July 1, 1983.

Why the hurry to produce a banking bill? One reason was the threat which the Comptroller of the Currency, C. Todd Conover, made to Congress. He was processing some 300 applications for new non-bank banks, and would not let any of them through while Congress debated legislation closing the non-bank loophole. But this moratorium would come to an end if there was no legislation. (It has now come to an end and the Comptroller is processing the applications.)

Another reason was the ruling by a US Circuit Court that the Federal Reserve was overstepping its bounds by attempting to redefine what constitutes a commercial loan. This redefinition was an attempt by the Fed to rope some of the non-bank banks back into the bank regulatory framework.

Chalmers P. Wylie, the leading Republican on the House Banking Committee, has now called on St. Germain "to make hearings and action on a wide-ranging banking bill an immediate priority as soon as Congress convenes in 1985".

Both Garn and St. Germain are counting on this awareness of the necessity for some kind of bill. They issued a joint statement: "Legislation addressing the competitive and regulatory framework of the financial system will be the first priority of the banking committees of the House and Senate, as soon as the 99th Congress convenes in 1985. Both of us agree on a need for a final resolution of all the issues early in the next Congress. As regards the specific issue of the so-called 'non-bank loophole', it is our intention that the grandfather date of July 1, 1983 become law. Those who invest funds now, assuming this grandfather date will be extended, will, in our opinion, end up having to divest, no matter what the cost."

Because of the lack of action in Congress, future battles may well be fought by states and groupings of states. The popularity of regional reciprocal banking arrangements among states is significant. However, these regional pacts are in limbo because Citicorp is suing the state of Connecticut in connection with the New England regional pact. Citicorp lost at the court of appeals and has taken its case to the Supreme Court.

Passing no legislation at all may turn out to be the most deregulatory action Congress could take, remarked an ABA official. He pointed out that even the Garn legislation might not have helped the smaller banks very much. Securities trading is not particularly important to many of them, and the grandfather date agreed on by Garn and St. Germain would allow enough to remain in business to represent a very potent competitive threat. "As bad as it is, I suppose it could get a lot worse," the ABA spokesman said. "Every Fortune Five Hundred company could start buying a bank."

Without clear guidance from the Federal Government, the process of deregulation seems likely to shift to the states more by default than by planning. As one top House aide put it: "Title XII [existing Federal banking law] is really old stuff, full of entrenched old interests. The issue is not really one of closing loopholes – that's minor. The basic issue is whether the Federal Government is going to continue to control financial institutions. Or are those powers going to adjourn to the states?"

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American Banker 1/28/85

Nonbanks Expanding Their Financial Services

K mart Widens Testing; Sears Gets Delaware Bank

By JEFFREY MARSHALL

The nonbank-bank express continued to pick up speed last week, both through regulatory action and plans announced by financial services firms.

Warmed by success in selling a limited range of financial services in its stores, K mart, the nation's second largest retailer, said it will expand those services this summer at 31 test locations. In distinctly marked sections toward the rear of selected K mart stores, customers will be able to shop for consumer loans, mortgages, or real estate brokerage services.

An intriguing aspect of K mart's latest proposal is that it has signed separate one-year agreements with five companies for the delivery of services — with only one type of product available in each store. The contracts cover stores in Virginia, Indiana, Michigan, Wisconsin, and Illinois.

K mart already has had some limited success with insurance and savings and loan centers in some stores. And Robert E. Brewer, senior vice president for finance, said the chain plans to more than double the number of insurance centers from the 100 in operation now.

Sears, Roebuck and Co. — the only retailer bigger than K mart — was told by the Federal Deposit Insurance Corp. that the agency would not oppose its plan to buy a Delaware bank and turn it into a limited-service institution. A Sears spokesman said the company plans to take possession of the Greenwood Trust Co. this week.

Meanwhile, the Office of the Comptroller of the Currency approved 30 more applications to launch limited-service banks, bringing the total number of such approvals to 166. Twenty-seven of the latest batch would be located in Texas. Dallas, in particular, was chosen by a virtual Who's Who in American banking, with names such as Chase Manhattan, Chemical, Citicorp, Mellon, First Interstate, and Security Pacific.

Texas Attorney General Jim Maddox doesn't cotton to the idea of nonbank banks, however, and threatened to sue to bar the out-of-state banks that garnered approval for such facilities last week. Mr. Maddox, who noted that Texas has never allowed such institutions, said he fears that deposits made by Texans would be taken out of the state and lent overseas "to governments that cannot pay back the loans." □

THE FINANCIAL INSTITUTIONS AND INSURANCE COMMITTEE OF THE KANS. STATE SENATE ON JANUARY 29, 1985.

SENATOR NEIL ARASMITH, COMMITTEE CHAIRMAN

SUBMITTED BY KANSAS INDEPENDENT BANKERS ASSOCIATION

IT IS TIMELY THAT ONE WEEK AGO TODAY COMPTROLLER OF THE CURRENCY TODD C. CONOVER APPROVED APPLICATIONS FOR 30 LIMITED SERVICE INTERSTATE BANKS. THIS BRINGS TO 166 THE NUMBERS OF APPROVALS GIVEN TO THE MORE THAN 300 APPLICATIONS RECEIVED BY THE COMPTROLLER. MR. CONOVER HAS RESIGNED HIS OFFICE WITH AN ANNOUNCED EXIT OF SPRING, 1985.

BY THESE APPROVALS MR. CONOVER WOULD REWRITE EXISTING BANK STRUCTURE LAWS IN THIS STATE AND NATION - THEN HE WOULD WALK OUT AND LET THE CHIPS FALL WHERE THEY WILL. HE WOULD UNDO YEARS OF WORK BY LEGISLATURES AND THE CONGRESS TO ESTABLISH SAFETY AS THE NUMBER ONE PLANK IN THE FOUNDATION OF OUR BANKING SYSTEM.

ALSO BY THIS ACTION THE COMPTROLLER WOULD TAKE AWAY THE RIGHTS OF THIS LEGISLATURE TO CONTROL AND REGULATE BANKS IN THIS STATE - A STATES RIGHT ESTABLISHED LONG AGO BY OUR CONGRESS.

ALL BUT THREE OF THESE APPROVALS WERE FOR NON-BANKS IN TEXAS. TEXAS ATTORNEY GENERAL JIM MADDOX HAS THREATENED TO SUE THE COMPTROLLERS OFFICE OVER THESE CHARTERS. MADDOX COMMENTED, "THE MAJOR DANGER IS THAT DEPOSITS MADE BY TEXANS WOULD LEAVE THE STATE AND BE LENT OVERSEAS TO GOVERNMENTS THAT CANNOT PAY BACK THE LOANS.' - 'TEXAS HAS NEVER ALLOWED OUT-OF-STATE BANKS TO OPERATE HERE, AND WE DO NOT WANT TO START NOW."

TWO OF THE 160 APPLICATIONS REMAINING ON COMPTROLLER CONOVER'S DESK ARE FOR NON-BANKS IN KANSAS.

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Attachment III

WE BELIEVE YOU WOULD BE INTERESTED TO KNOW WHO WILL BE OPENING OFFICES IN TEXAS BY VIRTUE OF THOSE 30 APPROVALS MADE LAST TUESDAY:

IN DALLAS:

FROM NEW YORK: CHASE MANHATTAN - CHEMICAL NEW YORK - CITICORP - IRVING BANK - MARINE MIDLAND BANKS
FROM DETROIT: COMERICA, INC.
FROM PITTSBURGH: MELLON BANK
FROM LOS ANGELES: FIRST INTERSTATE BANCORP - SECURITY PACIFIC - UNION BANK

IN HOUSTON:

BANK OF BOSTON - CHASE - CITICORP - FIRST UNION OF NORTH CAROLINA - HONGKONG & SHANGHAI BANKING CORP OF LONDON - FIRST INTERSTATE, RANIER OF SEATTLE - SECURITY PACIFIC - UNION BANK.

BARCLAYS BANK OF LONDON WILL BE IN EL PASO AND PLANO.

CHASE MANHATTAN WILL BE IN FORT WORTH AND SAN ANTONIO.

FIRST INTERSTATE WILL BE IN SAN ANTONIO AND AUSTIN.

RANIER WILL BE IN AUSTIN.

THE FLORIDA BANKERS ASSOCIATION HAS SUED TO BLOCK NON-BANK ACTIVITY IN THAT STATE. THE INDEPENDENT BANKERS ASSOCIATION OF AMERICA HAS ENTERED THAT SUIT TO CHALLENGE THE COMPTROLLER'S AUTHORITY TO APPROVE THESE NON-BANKS. WE NEED SENATE BILL 42 TO AVERT ANY POTENTIAL DRAIN OF KANSAS' RESOURCES.

American Banker

January 23, 1985

Texas Heads List Of the Approvals For Nonbanks

By BART FRAUST

NEW YORK — The Office of the Comptroller of the Currency said Tuesday it has approved 30 more applications to establish limited-service interstate banks.

With the latest approvals, the Comptroller's office has cleared 166 limited-service banks out of a total of over 300 applications the agency has received since last February.

The bulk of the latest approvals were for offices in Texas. Texas Attorney General Jim Maddox has threatened to sue the Comptroller's office and the Federal Reserve Board if any limited-service banks are chartered in that state.

"The major danger is that deposits made by Texans would leave the state and be lent overseas to governments that cannot pay back the loans," Mr. Maddox said after hearing of the Comptroller's decision. "Texas has never allowed out-of-state banks to operate here, and we do not want to start now."

Getting approval to establish limited-service banks in Dallas were Chase Manhattan Corp., Chemical New York Corp., Citicorp, Irving Bank Corp., Marine Midland Banks Inc., all of New York; Comerica Inc. in Detroit; Mellon Bank Corp. in Pittsburgh; and First Interstate Bancorp Inc., Security Pacific Corp., and Union Bank, all of Los Angeles.

Getting the Comptroller's nod for offices in Houston were: Bank of Boston Corp., Chase, Citicorp, First Union Corp. in North Carolina, Hongkong & Shanghai Banking Corp. in London, First Interstate, Rainier Bancorp Inc. in Seattle, Security Pacific, and Union Bank.

Other Texas banks approved include: Barclays Bank of London in El Paso and Plano, Chase in Fort Worth and San Antonio, First Interstate in San Antonio and Austin, and Rainier in Austin.

The Comptroller also allowed Equitable Bancorp Inc. of Baltimore to establish a limited-service bank in the District of Columbia and permitted First Omni Bank of Delaware to establish units in the District of Columbia and Allentown, Pa.

The applications also are subject to approval by the Federal Reserve Board.

Under the Douglas Amendment to the Bank Holding Company Act, bank holding companies are generally prohibited from expanding across state lines. However, the limited-service banks will not offer either checking accounts or commercial loans, thus skirting the act's definition of banks as institutions that both accept demand deposits and make commercial loans.

Federal regulatory agencies received a flood of these applications after the Federal Reserve Board's decision in February 1984 allowing U.S. Trust Corp. in New York to convert its Florida trust subsidiary into an institution that accepts all forms of deposits and makes consumer loans, but does not offer commercial loans.

The Florida Bankers Association has sued to overturn the Fed's U.S. Trust decision. In a separate lawsuit, the Independent Bankers Association of America, a trade group, has challenged the Comptroller's authority to approve limited-service bank charters. ■

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Attachment IV

KLSI Kansas League of Savings Institutions

JAMES R. TURNER, President • Suite 612 • 700 Kansas Ave. • Topeka, KS 66603 • 913/232-8215

January 29, 1985

TO: SENATE COMMITTEE ON FINANCIAL INSTITUTIONS AND INSURANCE

FROM: JIM TURNER

RE: S.B. 42 (NON-BANK BANKS)

The Kansas League of Savings Institutions appreciates the opportunity to appear before the Senate Committee on Financial Institutions and Insurance to support the passage of S.B. 42 which would prohibit the establishment of non-bank banks in Kansas.

Non-bank banks are organizations that avoid one of the two functions that define a bank under the Bank Holding Company Act: accepting demand deposits and making commercial loans. By refraining from engaging in one of those activities, institutions can evade BHC Act restrictions on interstate banking and ownership of banks by commercial firms.

In an effort to retain State control over this type of chartering, and to "buy time" while Congress debates closing the non-bank bank loophole, the states of Florida, North Carolina, and Connecticut have adopted legislation that prohibits non-bank banks in their states. State legislatures in Colorado, Texas, Illinois, Arizona, Oklahoma, and Virginia are considering such legislation.

The advent of the non-bank bank has been disruptive to the process of supervising and insuring financial institutions and arguably can be considered to place conventional financial institutions at a competitive disadvantage. Until such time as Congress addresses the structure and supervision of non-bank banks and the role of States has been clearly defined in this process, it would appear appropriate to place a two year moratorium on the establishment of non-bank banks in Kansas.

Accordingly, the KLSI supports the passage of Senate Bill No. 42.

James R. Turner
President

JRT:bw

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Attachment V