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CREATE STATE SAVINGS BANKS

House Bill 5853 as enrolled
Public Act 354 of 1996
Second Analysis (8-19-96)

Sponsor: Rep. Gary L.Randall
House Committee: Commerce
Senate Committee: Financial Services

THE APPARENT PROBLEM:

Savings institutions have been around since 1887 when Michigan's law governing savings and loan associations was first enacted. Since that time, the statute regulating savings and loans has been recodified twice--in 1964 and again in 1980. In both instances, the act needed to be updated to reflect changes that had occurred in the financial services industry, and to enable these institutions to remain competitive with banks, credit unions, and other providers of financial services. However, changes made to the federal law during the 1980s--after a massive number of S&Ls, mostly from other states, failed for various economic reasons--prompted all of Michigan's S&Ls to become chartered as federal savings banks. A savings bank is a type of financial institution that similarly devotes a majority of assets to housing-related loans, but has different organization, operating, and regulatory requirements--for instance, they are regulated by the Office of Thrift Supervision (OTS) as well as the Federal Deposit Insurance Corporation (FDIC). Also, a relatively recent provision of federal law requires savings institutions to invest at least 60 percent of their assets in home loans and related investments. (This threshold apparently was adopted in the Internal Revenue Code to provide special tax treatment to savings institutions that devote at least this portion of their assets to home-related lending.) But even with this floor, Michigan's savings institutions have, on average, 75 percent of their assets invested in home mortgages and mortgage-backed securities, according to the Michigan League of Savings Institutions.

However, in recent years it has become apparent that traditional ways of meeting the needs of financial services consumers have changed and continue to evolve, as technological advances and an expanding economy have dramatically increased levels of competition among providers of financial services. In some cases, the changes have prompted updates to obsolete provisions of law, such as statutory barriers enacted several years ago prohibiting certain types of institutions from providing certain kinds of products. For instance, Michigan recently granted banks and other financial institutions authority to sell insurance, with certain restrictions. It was argued that granting them this new power was justified since the lines of demarcation between insurance companies and depository financial institutions had, in many ways, already grown obsolete--evidenced by the fact that the former had begun to offer products and services traditionally offered by the latter (i.e., loans and other forms of credit), while banks routinely had begun selling credit insurance in connection with home mortgages and auto loans. Savings institutions, however, generally either have not had the powers granted to banks to engage in a more diversified number of products and services, or--due to their historic focus on the mortgage market--have statutorily been limited in the percentage of their portfolios that could be invested in commercial loans.

Moreover, legislation apparently is pending in Congress that would dramatically overhaul the way in which savings institutions are, among other things, governed and recognized for tax purposes. In fact, some people have proposed possibly merging the Savings Association Insurance Fund (SAIA), which is seriously underfunded, with the healthy Bank Insurance Fund, as well as merging oversight of both savings institutions and banks into one federal agency.

Some people believe that, considering the competitive environment in which Michigan's savings institutions now operate, they will need more flexibility and expanded powers in order to compete on an equal level with other depository financial institutions. Also, many savings banks have expressed an interest in coming out from under OTS supervision due to what they perceive as onerous federal requirements imposed on them and higher supervisory fees they must pay compared to what they would pay if they were supervised by a state regulator. But switching to another charter (such as a national bank) would have severe tax consequences for them, and reverting back to a state savings and loan

would prevent them from coming out from under the regulatory oversight of OTS. With all of this in mind, and considering dramatic changes being discussed at the federal level to laws governing savings institutions, legislation has been proposed similar to laws existing in 30 other states that would permit a new type of financial institution to be organized in Michigan--known as a "state savings bank." This essentially would be a hybrid between a bank and a traditional thrift, but would be regulated by the state and have unique new powers and different operating requirements than what now apply to federal savings banks.

THE CONTENT OF THE BILL:

The bill would create a new act, called the Savings Bank Act, to provide for the incorporation, regulation, supervision, and internal administration of state savings banks, and would grant certain rights, powers, and immunities to this new type of depository financial institution. The following is a brief summary of the major provisions of each chapter of the bill.

CHAPTER 1 -- Title, definitions. This chapter establishes the title of the proposed act and defines various terms used throughout the bill.

CHAPTER 2 -- Role of the Financial Institutions Bureau. This chapter establishes the powers and duties of the Financial Institutions Bureau, and specifies that the FIB commissioner would be authorized or required, among other things, to do all of the following:

* provide for savings banks to be examined at least once annually;

* periodically establish a schedule of annual supervisory fees to be paid by savings banks, based on the estimated cost of supervising them. Under the bill, annual supervisory fees would be based on an institution's total assets, but could not be less than $1,000, and would be used to fund examinations;

* promulgate rules under the provisions of the Administrative Procedures Act. The commissioner could issue temporary orders to restrict actions that were determined to be violations of the act or unsafe operating practices likely to cause insolvency or substantial loss of assets. Also, the bill would establish a formal hearing process under which a savings bank dissatisfied with a cease and desist order made by the commissioner could request reconsideration of the matter.

The bill would also require a person or persons who intended to organize as a savings bank to publish notice of this within 10 days of an application, and would establish a process whereby persons opposed to the application could protest to the commissioner. To protest an application, those opposing would have to submit various items explaining why the organization would be harmful. The commissioner would have to decide whether or not to approve an application within 100 days of its submission.

Deposit insurance. The bill would require each savings bank incorporated under its provisions--unless the commissioner, for good cause shown, waived the requirement--to secure insurance of its deposit accounts backed by the full faith and credit of the U.S. government (i.e., via the Federal Deposit Insurance Corporation, or FDIC) prior to commencing business.

Asset test. Under the bill, a savings bank would have to satisfy an asset test under which at least 50 percent of its total assets, as measured by monthly averages calculated at the close of each calendar month in at least nine months of the immediately preceding 12-month period, consisted of various types of housing-related loans, securities, equities, and other investments, or, failing this, an asset test prescribed by an order or declaratory ruling of the commissioner. The bill also includes provisions that would permit a savings bank that failed to meet these tests to either requalify or take other appropriate actions.

CHAPTER 3 -- Organizational process, corporate structure. The bill would permit one or more persons to organize a savings bank and would require an application to be filed with the commissioner before this could occur. Various requirements would have to be met for a person(s) to obtain approval to organize, as specified in the bill, and the commissioner would have to investigate various matters pertaining to the applicant and to "persons, conditions, and circumstances" affecting or related to whether or not organization should be permitted. The bill also would enable other depository institutions to incorporate under its provisions and details how this would have to occur.

Articles of incorporation. Following approval of the application to organize, at least two original articles of incorporation executed by a majority of the applicants would have to be filed with the commissioner, and if the commissioner found they conformed to law and that all fees and charges had been paid, he or she would have to approve and file one of the original articles in his or her office and certify and forward one of the original articles to the incorporators. The bill details various information that the articles of incorporation would have to include, and would permit a majority of the members or voting shares of a savings bank--with the

commissioner's approval--to amend the articles in any way not inconsistent with the bill.

Capital requirements. Generally, a stock savings bank organized under the bill's provisions would have to have capital of at least $100,000 or in an amount the commissioner considered adequate based on the population of the area to be served and the anticipated nature of the savings bank's business. Also, a savings bank could not commence business until it had surplus of at least 20 percent of its capital, and other capital requirement provisions would apply.

Issuance of stock, shareholder provisions. The bill would authorize savings banks to issue shares of common and preferred stock, and specifies that membership in a mutual savings bank would consist solely of every depositor or holder of a deposit account issued by a savings bank. Members or shareholders would have to meet at least once annually. The bill also includes numerous provisions that would apply to the issuance of shares, shareholder and member rights, and shareholder or member meetings.

Board of directors. The bill would require each savings bank to be managed by a board of directors with at least five members but not more than 25, elected by a majority of either the original incorporators (before commencing business) or, once incorporated, at the annual meeting of shareholders or members. The board would have to meet at least six times annually, although the commissioner could call a special meeting of the board with three days notice. The bill includes numerous provisions establishing the rules and requirements that would apply to the board and its activities.

This chapter includes other provisions governing the buying or selling of savings bank assets, indemnification of the directors, officers, employees or agents of savings banks, liquidation procedures, or the buying or selling of a savings bank, its subsidiaries, or its branches.

CHAPTER 4 -- General powers. A savings bank would be authorized to engage in the business of banking and could exercise all powers incidental to the business of banking, including, among other things, the authority to:

* receive and permit withdrawals of deposits;

* become a member of the federal reserve system;

* make, sell, or participate in loans for consumer, agricultural, business, corporate, or commercial purposes;

* sell mortgage loans to the Federal National Mortgage Association (i.e., "Fannie Mae");

* close and service loans for a fee;

* engage in any aspect of the insurance and surety business as an agent, broker, solicitor, or insurance counselor;

* own and operate a messenger service;

* conduct business using electronic information processing;

* sell or issue bonds, notes, or other obligations on behalf of the United States or a state government and act as a fiscal agent in these transactions, with certain limitations;

* issue common stock and other securities;

* purchase various types of government and commercial obligations and private securities;

* engage in underwriting of various kinds of public and commercial obligations, with certain limitations;

* make venture capital investments;

* engage directly in the real estate brokerage business, or own wholly or partially a real estate brokerage business (although a savings bank could not engage in the former before April 1, 1997, and could not engage in the latter before April 1, 1996). The bill includes numerous provisions that would apply to savings banks that engaged in real estate brokerage services, and would specifically prohibit certain activities by those that offered these services;

* engage in any other activities which the commissioner allowed by promulgated rule, declaratory ruling, or an issued order.

Trust powers. The bill would authorize the commissioner to grant to a savings bank, when it applied, full trust powers subject to certain conditions, limitations, and restrictions, and specifies various requirements and responsibilities that would apply when such powers were granted. (It should be noted that any legislation granting trust powers requires at least a two-thirds majority vote of the legislature for approval.)

CHAPTER 5 -- Regulation. This chapter would grant specific powers to the commissioner related to the regulation of savings banks. Specifically, he or she

would regulate matters such as capital requirements, activities of directors, officers, and employees, reporting requirements, and the financial relationships of savings banks with other institutions.

CHAPTER 6 -- Conservatorship and receivership. This chapter would grant the commissioner authority to appoint a conservator or apply to the circuit court for a receiver if a savings bank refused or couldn't pay its deposits or obligations as specified in contractual agreements or otherwise became insolvent. The chapter establishes the powers and duties of a conservator or receiver in the event one or the other was appointed to oversee the operations of a financially impaired or unsound savings bank.

CHAPTER 7 -- Consolidations, mergers, and conversions. This chapter would permit savings banks to consolidate or merge with, or convert to, other types of qualified financial institutions, subject to the commissioner's approval, and includes numerous provisions governing such occurrences.

CHAPTER 8 -- Tax exemption, other provisions. This chapter specifies that a savings bank would have the same tax exemptions granted to a savings and loan association under Public Act 156 of 1964, and includes other provisions regarding the applicability of other laws and various provisions in the bill to state savings banks.

FISCAL IMPLICATIONS:

The Financial Institutions Bureau says it would incur costs under the bill associated with supervising and regulating savings banks organized under its provisions, but that these costs--which would depend on the number of savings banks chartered under the bill--would be recouped via supervisory fees that would have to be paid in order to operate as a state-chartered savings bank. (8-19-96)

ARGUMENTS:

For:

The bill would create a new act to allow for the organization and incorporation of state savings banks in Michigan, similar to laws adopted in 30 other states that permit this type of depository financial institution. Under the bill, a savings bank would have the powers typically held by a commercial bank (plus some additional powers), but would still have to devote a major portion--at least 50 percent--of its assets to home-related lending and mortgage-backed securities. In fact, of the 27 savings institutions currently headquartered and operating in Michigan, 25 are federal savings banks and two are federally-chartered savings and loans; none, however, is chartered at present under Michigan's Savings and Loan Act (Public Act 307 of 1980). Many of these institutions apparently believe a number of good reasons exist for establishing a state savings bank law under which they, or even other kinds of existing depository financial institutions, could organize and operate. These include the following:

* Currently, savings banks are insured by the Federal Deposit Insurance Corporation (FDIC) but are regulated by the Office of Thrift Supervision (OTS), although federal funds that insure savings institutions are kept separate from bank insurance funds. Congress, however, apparently is considering legislation that would abolish federal savings institutions, meaning the state's 25 federal savings banks would have to switch their charters to some other form of financial institution. However, a number of savings banks apparently could find themselves facing unfavorable tax treatment by the Internal Revenue Service if federal changes were made and they had to choose from among existing charters (i.e., a state or federal commercial bank). And if they chose to revert back to being a state-chartered savings and loan, they would still be regulated by the federal OTS. The bill would enable them to switch their charter to a state savings bank and avoid a possibly costly tax penalty without having to remain under the purview of federal regulators.

* Many of the state's savings institutions, all but two of which are chartered as federal savings banks, apparently desire to come out from under the federal OTS's authority in order to be supervised at the state level by the commissioner of the Financial Institutions Bureau. This is because the OTS imposes onerous burdens and expensive capital requirements, many of which are a result of the S&L crisis that occurred in recent years, on Michigan's savings institutions, even though Michigan's thrift industry was relatively strong and experienced few of the problems that many S&Ls did in other states. Also, federal savings banks that chose to be chartered as state savings banks under the bill would generally pay less in supervisory fees and other costs related to being regulated than they currently do. It should be noted, however, that the FDIC still would have to approve a federal savings bank's change in charter to a state savings bank, and that even with the resulting change in supervision from the OTS to FIB the FDIC still would retain some regulatory purview over state savings banks.

* Current state and federal laws regulating savings institutions make it difficult for them to remain competitive with other financial institutions since they generally are limited to investing a relatively small portion of their portfolios in commercial lending activities (only 10 percent of the 40 percent that is not required to be invested in housing-related loans and

securities). The bill would expand both the types and percentage of commercial investments in which savings institutions could invest, and would expand their powers to include such activities as offering real estate brokerage services (something that no financial institution in Michigan has yet been granted). Thus, the bill would ensure that, pending action at the federal level that may entirely eliminate the current organizational structure of savings institutions, those operating in Michigan could both maintain their primary mission of serving consumers needs for mortgage-related loans, while offering a larger variety of other financial products and services in order to remain competitive with other financial institutions.

Against:

The bill should establish a threshold for the percentage of assets that would have to be devoted to housing-related loans and securities closer to the current 60 percent floor which applies to thrifts, instead of the 50 percent floor being proposed in the bill. The mission of savings institutions historically has been to serve the lending needs of consumers looking to obtain the dream of home ownership, and this is certainly reflected in current data showing that, on *average*, 75 percent of the assets among state savings institutions are invested solely in housing-related loans or mortgage-backed securities. However, the increasingly competitive nature of the financial industry could tend to draw them away from focusing on this unique mission if they felt it would not be as profitable. Reportedly, other states with savings banks laws have thresholds that range anywhere from 50 percent to 60 percent.

Response:

Some people believe establishing a lower percentage threshold of total assets that would have to be devoted to housing-related loans than what is required by current federal law (from 60 percent to 50 percent) could spur interest among other types of financial institutions--or among those considering organizing--to become chartered as a state savings bank, and actually work to increase the amount of capital provided for housing-related needs.

Against:

The bill proposes to give additional new powers to savings banks which other depository financial institutions, including commercial banks, do not currently have--such as the ability to offer real estate brokerage services. Considering the so-called "most-favored lender" doctrine, similar powers should also be extended to commercial banks and credit unions, which not only would put them on a level playing field with savings banks but would also encourage a more competitive financial services industry in Michigan.

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■This analysis was prepared by nonpartisan House staff for use by House members in their deliberations, and does not constitute an official statement of legislative intent.