The State of South Carolina

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The Honorable Robert C. Cleveland
Commissioner of Banking
Board of Financial Institutions
1026 Sumter Street, Room 217
Columbia, South Carolina 29201

Dear Commissioner Cleveland:

You have requested, on behalf of the Board of Governors of the Federal Reserve System, the written views of this Office on the apparent prohibition contained in Section 34-23-30(B), Code of Laws of South Carolina (1976), against an out-of-state bank holding company acquiring a "nonbank bank" in South Carolina and whether that section is consistent with the Commerce Clause of the United States Constitution. We would advise that Section 34-23-30 (B) of the Code has not been interpreted judicially; hence, your questions are novel and of first impression. We cannot second-guess the decisions of the courts of this State but will attempt to provide guidance as to how our courts would interpret the statute.

BACKGROUND

This Office has been advised that there is pending before the Board of Governors of the Federal Reserve System an application by an out-of-state bank holding company to acquire a "nonbank bank" in South Carolina. This particular bank will not make commercial loans but will conduct other unspecified banking activities. Additional applications of a similar nature are anticipated by the Federal Reserve System within South Carolina in the future, however.

The Federal Reserve System has advised that to the extent Section 34-23-30 (B) is valid under the United States Constitution, the out-of-state bank holding companies with applications before the Board of Governors would be prohibited from acquiring

"nonbank banks" which would have national bank charters and be located in South Carolina, should Section 34-23-30 (B) be viewed as prohibiting such acquisitions. Thus the questions of interpretation and constitutionality of Section 34-23-30 (B) have been raised.

STATUTORY CONSIDERATIONS

Section 34-23-30 (B) of the Code provides the following:

> Notwithstanding any language to the contrary herein, it shall be unlawful for any foreign holding company, whether a bank holding company or otherwise, to acquire, direct or indirect, ownership or control of any voting shares of any bank, if after such acquisition, such foreign holding company will, directly or indirectly, own or control more than twenty-five percent of the voting shares of any such bank. Provided, however, that no divestiture of any voting shares of any bank owned as of March 1, 1973 shall be required by this section.
>
> A foreign holding company as used in the preceding paragraph shall be defined as a corporation, partnership, business trust, voting trust, unincorporated association, joint stock association or similar organization created by or organized under the laws of the United States and not having its principal place of business in South Carolina or under the laws of any foreign state, kingdom or government or under the laws of any state of the United States other than South Carolina.

The term "bank" is defined by Section 34-23-20 (a) of the Code as

> any national banking association or any state bank, savings bank, trust company, and all institutions doing any kind of banking business, whether organized under the laws of this State, the laws of another state, or the laws of the United States, engaged or authorized to engage in the business of banking in this State. [Emphasis added.]

In Opinion No. 79-101, dated August 14, 1979, a copy of which is enclosed, this Office concluded that Section 34-23-30 (B) precluded an out-of-state bank holding company from acquiring more than twenty-five (25%) percent of the voting shares of a South Carolina trust company. The reasoning in that prior opinion appears to be applicable to the situation presented by your inquiry.

For purposes of this letter, we are assuming that the out-of-state bank holding company noted by the Federal Reserve System meets the definition of a "bank holding company" contained in Section 34-23-20 (b). We must then determine whether an institution which will not engage in making commercial loans but will engage in other banking activities will meet the definition of "bank," supra.

As emphasized above, the term "bank" includes "all institutions doing any kind of banking business." (Emphasis added.) From the information from the Federal Reserve System, it is unclear exactly what activities the institution whose application is pending will undertake. Because the System refers to the commonly-used definition of "nonbank banks" as those institutions which either will not accept demand deposits or, in the alternative, will not make commercial loans, 1/ it is assumed that the institution in question will most probably, at the very least, accept demand deposits, since it will not make commercial loans. Accepting demand deposits is undoubtedly one facet of the banking business. First Bancorporation v. Board of Governors of the Federal Reserve System, 728 F.2d 434 (10th Cir. 1984). Because the definition of "bank" is so broad that an institution involved in even one facet of banking business must be included, we would conclude that the institution described by the System would fall within the definition of "bank."

On the basis of the foregoing, the out-of-state bank holding company would thus be precluded from acquiring more than twenty-five (25%) percent of the voting shares of the so-called "nonbank bank's" voting stock.

1/ See, Florida Department of Banking and Finance v. Board of Governors of the Federal Reserve System, 760 F.2d 1135 (11th Cir. 1985).

We note that, effective January 1, 1986, the new South Carolina Bank Holding Company Act, codified as Section 34-24-10 et seq., becomes effective. At that time the definition of "bank," to be found in Section 34-24-20 (2), will be changed to include

> any insured institution as the term is defined in Section 3 (h) of the Federal Deposit Insurance Act, 12 U.S.C. Section 1813 (h), or any institution eligible to become an insured institution as the term is defined therein, which, in either event:
>
> (A) Accepts deposits that the depositor has a legal right to withdraw on demand; and
>
> (B) Engages in the business of making commercial loans.

Upon the effective date of the new statute, the "nonbank bank" in South Carolina proposed to be acquired under the application pending before the System would no longer meet the definition of "bank" within South Carolina. As of January 1, 1986, limited interstate banking on a regional basis will be permitted. No comment is made herein as to whether such an acquisition as that presently under consideration by the System might be approved, as this Office does not have sufficient information to make such a determination.

CONSTITUTIONAL CONSIDERATIONS

Because we have concluded that the acquisition of more than twenty-five (25%) percent of the voting shares of a "nonbank bank" by an out-of-state bank holding company would be prohibited, you have asked us to consider whether Section 34-23-30 (B) may be violative of the Commerce Clause of the United States Constitution, which provides that Congress shall have power to "regulate commerce ... among the several states ... ." Article I, Section 8, clause 3. In considering the constitutionality of Section 34-23-30 (B), we will examine both state and federal regulation of interstate acquisition of "nonbank banks."

In considering the constitutionality of a statute, such statute is presumed to be constitutional in all respects. The statute will not be considered void unless its unconstitution-

ality is clear beyond any reasonable doubt. Thomas v. Macklen, 186 S.C. 290, 195 S.E. 539 (1937); Townsend v. Richland County, 190 S.C. 270, 2 S.E.2d 777 (1939). All doubts of constitutionality are generally resolved in favor of constitutionality. Moreover, while this Office may comment upon potential constitutional problems, it is solely within the province of the courts to declare an act unconstitutional.

A. Federal Regulation

Congressional exercise of regulatory authority in the banking industry is found, inter alia, in the Bank Holding Company Act of 1956, codified as 12 U.S.C. §§ 1841-1850. In particular, Section 3 (d) of the Act, 12 U.S.C. § 1842 (d), places certain restrictions on bank holding companies which would otherwise engage in interstate commerce:

> Notwithstanding any other provision of this section, no application ... shall be approved under this section which will permit any bank holding company or any subsidiary thereof to acquire, directly or indirectly, any voting shares of, interest in, or all or substantially all of the assets of any additional bank located outside of the State in which the operations of such bank holding company's banking subsidiaries were principally conducted ..., unless the acquisition of such shares or assets of a State bank by an out-of-State bank holding company is specifically authorized by the statute laws of the State in which such bank is located, by language to that effect not merely by implication. ...

This statute reserves for states the authority to create exceptions to the general prohibition of acquisitions by bank holding companies of banks located within another state. It would appear that Section 3(d) of the Act would not be applicable in the transaction being considered by the Board of Governors of the Federal Reserve System, however.

The term "bank," as used in the Act, is defined in 12 U.S.C. § 1841 (c) as

> any institution organized under the laws of the United States [or] any State of the United States ... which (1) accepts deposits

> that the depositor has a legal right to withdraw on demand, and (2) engages in the business of making commercial loans. ...

Use of the conjunctive "and" means that a financial institution must meet both prongs of the two-pronged definition. Bohlen v. Allen, 228 S.C. 135, 89 S.E.2d 99 (1955). Because the out-of-state holding company would acquire a financial institution within this State which does not make commercial loans, the out-of-state company would not be acquiring a "bank" as defined in the Act 2/ and thus the acquisition would not appear to be subject to regulation under this portion of the Act.

Section 7 of the Act, 12 U.S.C. § 1846, also empowers the states to regulate the banking industry:

> The enactment by the Congress of the Bank Holding Company Act of 1956 shall not be construed as preventing any State from exercising such powers and jurisdiction which it now has or may hereafter have with respect to banks, bank holding companies, and subsidiaries thereof.

This section has been judicially construed in numerous cases, including Commercial National Bank v. Board of Governors of Federal Reserve System, 451 F.2d 86 (8th Cir. 1971); Whitney National Bank v. Bank of New Orleans & Trust Company, 379 U.S. 411 (1965); Braeburn Securities Corporation v. Smith, 15 Ill.2d 55, 153 N.E.2d 806 (1958), app. dism'd. 359 U.S. 311 (1959); Florida Association of Insurance Agents, Inc. v. Board of Governors of Federal Reserve System, 591 F.2d 334 (5th Cir. 1979); and American Trust Company, Inc. v. South Carolina State Board of Bank Control, 381 F.Supp. 315 (D.S.C. 1974).

In holding that Section 7 empowers states to prohibit the acquisition of local banks by out-of-state banking holding

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2/ See especially the legislative history found in S.Rep. No. 91-1084, 91st Cong., 2d Sess., 1970 U.S. Code Cong. & Adm. News 5519, 5541, as to exclusion of institutions which do not make commercial loans from the definition of "bank."

See also additional legislative history set forth in Northeast Bancorp, Inc. v. Board of Governors of Federal Reserve System, 53 U.S.L.W. 4699 (U.S. June 10, 1985) (No. 84-363) and in Florida Department of Banking and Finance v. Board of Governors of Federal Reserve System, 760 F.2d 1135 (11th Cir. 1985).

companies, the court stated:

> [Section 7] reserves to the states all power and jurisdiction in effect before the Act, [and] there can be no doubt that prior to the passage of the Act, the states were free to regulate in-state bank acquisitions by out-of-state bank holding companies.

Iowa Independent Bankers v. Board of Governors of Federal Reserve System, 511 F.2d 1288, 1296 (D.C. Cir.), cert. den. 423 U.S. 875 (1975). Likewise, in Lewis v. BT Investment Managers, Inc., 447 U.S. 27 (1980), the Supreme Court recognized that under Section 7 states could enact legislation as to out-of-state bank holding companies even more restrictive than the federal legislation but cautioned that such state legislation must pass muster under the Commerce Clause. Thus, applicable state law vis a vis the Commerce Clause must be considered.

B. State Regulation

The applicable State laws concerning the proposed acquisition are detailed above. For the State to prohibit the acquisition of more than twenty-five percent (25%) of the voting shares of a "non-bank bank" (which falls within the definition of "bank" in this State), the applicable statutes must not be deemed to be violative of the Commerce Clause.

As is stated in Federal Deposit Insurance Corporation v. American Bank Trust Shares, Inc., 460 F.Supp. 549, aff'd 629 F.2d 951 (4th Cir. 1980), the legislature "has broad discretion to draft regulatory legislation especially in the area of banking." 460 F.Supp. at 559. However, the validity of such state regulation must be evaluated, for Commerce Clause purposes, under the test of Pike v. Bruce Church, 397 U.S. 137, 90 S.Ct. 844, 25 L.Ed.2d 174 (1970): "Where the statute regulates even handedly to effectuate a legitimate local public interest, and its effects on interstate commerce are only incidental, it will be upheld unless the burden imposed on such commerce is clearly excessive in relation to the putative local benefits." 397 U.S. at 142, 25 L.Ed.2d at 178. Thus, the Commerce Clause acts as a restriction on permissible state regulation even where, as here, there is no conflicting federal regulation. Hughes v. Oklahoma, 441 U.S. 322, 99 S.Ct. 1727, 60 L.Ed.2d 250 (1979).

The public interests to be protected by state law included the protection of the public, especially the depositors of a particular banking institution, Floyd v. Thornton, 220 S.C. 414, 68 S.E.2d 334 (1951), and "to prevent undue concentration of

control of banking by bank holding companies and to prevent bank holding companies from controlling at the same time both banks and nonbanking enterprises." Op. Atty. Gen. No. 79-101, dated August 14, 1979. Banking is recognized as a particular area of local concern in American Bank Trust Shares, Inc., supra. Arguably, the local economy is promoted by keeping financial assets and investments within the State. These appear to be legitimate public interests to be furthered by State regulation.

Whether the statutes operate evenhandedly must also be considered. We would note that not all involvement by out-of-state bank holding companies is prohibited; by Section 34-23-30 (B), only ownership of more than twenty-five percent (25%) of the voting share of a bank by an out-of-state banking holding company would be prohibited. While similar ownership by an in-state bank holding company is not prohibited outright, it is tightly controlled by Section 34-23-30 (A):

> It shall be unlawful, except with the prior written approval of the [State Board of Bank Control], (1) for any action to be taken which results in a company becoming a bank holding company; 3/ (2) for any bank

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3/ "Bank holding company" is defined by Section 34-23-20 (b) as

> any company (1) which, directly or indirectly, owns, controls or holds with power to vote twenty-five per cent or more of the voting stock of each of two or more banking institutions; or (2) which controls the election of a majority of the directors of any two or more banking institutions; or (3) for the benefit of whose stockholders or members, twenty-five per cent or more of the voting stock of each of two or more banking institutions, is held by one or more trustees; any successor to any such company shall be deemed to be a bank holding company from the date as of which such predecessor company became bank holding company. Notwithstanding the foregoing, no bank shall be a bank holding company by virtue of its ownership or control of stock in a fiduciary capacity, except where such stock is held for the benefit of the stockholders of such banking institution.

> holding company to acquire, direct or indirect, ownership or control of any voting shares of any bank if, after such acquisition, such company will, directly or indirectly, own or control more than five percent of the voting shares of such bank, (3) for any bank holding company or subsidiary thereof, other than a bank, to acquire all or substantially all of the assets of a bank; (4) for any bank holding company to merge or consolidate with any other bank holding company. ...

While any action taken by a bank holding company either within or without the State is subject to prior approval by the State Board of Bank Control, in-state bank holding companies may acquire more than twenty-five percent (25%) of the voting shares of a bank; indeed, acquisition of all or substantially all of a bank's assets is contemplated by Section 34-23-30 (A). Thus, on its face, the statute does not appear to provide even-handed treatment to all bank holding companies.

If the disparate treatment of out-of-state bank holding companies may be justified as an incidental burden necessitated by legitimate local concerns, Pike v. Bruce Church, supra, the statute will be deemed not violative of the Commerce Clause. The local concerns are outlined above. The State must justify the disparate treatment in terms of "local benefits flowing from the statute and the unavailability of nondiscriminatory alternatives adequate to preserve the local interests at stake." Hunt v. Washington State Apple Advertising Commission, 432 U.S. 333, 353, 97 S.Ct. 2343, 53 L.Ed.2d 383, 400 (1977). Balancing the concerns as stated above, we believe a court could conclude that the statute presently in effect is not burdensome, though this is a very close question.

The State seeks to protect its depositors, keep financial resources within the State, promote local economic interests, and prevent undue concentrations of control of the banking business. It is undisputed that South Carolina's economy has not been strong over the last several years, due in part to the declining textile industry. While out-of-state bank holding companies may not acquire complete ownership or control of a bank at this time, these foreign bank holding companies are not completely shut out of the South Carolina financial market either; such is certainly less burdensome than being totally excluded from the South Carolina market altogether. Moreover, this State has numerous small, "hometown" banks which might not survive the rigors of interstate competition, thus depleting the

economy and resulting in the loss of jobs and financial resources and the close community relationship between those who provide banking services and those who need such services. We do not see a less restrictive alternative in this instance. We would further note that with the implementation of South Carolina's new Bank Holding Company Act on January 1, 1986, allowing regional interstate banking, such incidental burdens imposed on foreign bank holding companies may only be temporary.

The Eleventh Circuit Court of Appeals recently held that a foreign bank holding company's application to acquire a "nonbank bank" under Florida law should not have been granted by the Board of Governors of the Federal Reserve System in Florida Department of Banking and Finance, supra. The court stated that

> we believe U. S. Trust's argument that its nonbank will have an innovative and competitive effect on the market for financial resources in Florida to be erroneous. Since U. S. Trust cannot make commercial loans in Florida from the deposits it attracts, it is patent that Florida's policy of having local money available for local development will be hindered. While it is true that funds can be secured from out-of-state -- indeed from U. S. Trust in New York -- such a policy is directly contrary to the accepted notion that local funding of local projects is a significant and important incident of state control over banking. It suffices that Florida has spoken clearly that it does not want out-of-state bank holding companies to establish banking operations in Florida. [Footnote 17] To approve the U. S. Trust application would destroy Florida's state policy to not allow the unfettered expansion of out-of-state bank holding companies. More importantly, such approval would also destroy the important federal policy embodied in the Douglas amendment [12 U.S.C. § 1842(d)] -- a federal policy which allows the state to choose for itself whether to open its borders to out-of-state banks.
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> Footnote 17: The Board's and U. S. Trust's reliance on Lewis v. B. T. Investment Managers, 447 U.S. 27, 100 S.Ct. 2009, 64 L.Ed.2d 702 (1980), is misplaced. In that

> case the Court struck down a Florida statute which prohibited out-of-state bank holding companies from offering investment advisory services despite Board approval. Such services are incidents of banking requiring Board approval under the [Bank Holding Company] Act. This decision cannot be relied upon for the proposition that banks -- deposit-taking institutions -- can be established across the state lines.

760 F.2d at 1143.

While the court did not address the constitutionality of the Florida statute, which appears to be even more restrictive than South Carolina's, the concerns which the court addressed and approved are much the same as those to be found in this State.

We therefore believe a court faced with this issue could reasonably conclude that Section 34-23-30 (B) is constitutional should it be challenged as violative of the Commerce Clause.

With kindest regards, I am

Sincerely,

Patricia D. Petway

Patricia D. Petway
Assistant Attorney General

PDP/an

Enclosure

REVIEWED AND APPROVED BY:

Robert D. Cook

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