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Testimony to the House Financial Institutions
& Rural Development Committee
HB 2398
March 22, 2021

Chairman Kelly and Members of the Committee, thank you for the opportunity to appear as a neutral conferee on HB 2398.

Early this session, Representative Owens and the proponents of this legislation met with me and my staff about their proposal. We appreciate the time they took to explain to us their unique business concept and to involve us upfront on this legislation.

We are a neutral on this bill, as our office does not decide policy: you do. We believe we can regulate this new entity called a technology-enabled trust bank (TETB). However, we will say to the legislature—and go on record—saying that we have concerns. Notably, we are concerned about the following:

1. Our office, and others in the banking industry, do not understand the business model used by the TETB. Therefore, we cannot make conclusions as to the likely success of this entity. As you will hear from the proponents, this entity will be unique to the Kansas market.
2. The entity's lending practice relies on "alternative assets" such as venture capital funds, private equity, and private real estate funds, which are generally considered volatile. Because the OSBC is not accustomed to examining these types of assets, there is no historical data that demonstrates the expected cash flow levels for these types of assets.
3. The bill does not allow the OSBC to review the profitability of the TETB during examination (see Section 7(c)). It is our position that an entity cannot be successful without generating profit, and that profitability is a necessary component of any examination. Furthermore, the bill creates additional exceptions to our typical examination process for financial institutions. The standard formulas and rules for financial metrics, capital requirements, asset quality, concentration risk, usury rate, unusually high compensation, and conflicts of interest are modified, and an exception to GAAP is included. All these items significantly impact the ability of the OSBC to conduct a proper safety and soundness examination.

4. This entity is not FDIC insured. If the entity fails, will any other entities step in to take over the operation? Does the OSBC have any authority to close it or resolve its issues, like we do for failed banks? The first TETB will be a pilot program before other TETB's are allowed in the state. To us, this approach indicates an experimental concept, which raises concern for any financial regulator where conservative prudent measures are generally followed.

I am happy to answer any questions. I appreciate the committee's consideration of my comments.

David L. Herndon
State Bank Commissioner