Approved February 11, 1987
Date

MINUTES OF THE Senate COMMITTEE ON Agriculture.

The meeting was called to order by Senator Allen at
Chairperson

10:08 a.m./~~p.m.~~ on February 10, 1987 in room 423-S of the Capitol.

All members were present ~~except:~~

Committee staff present: Raney Gilliland, Legislative Research Department
Jill Wolters, Revisor of Statutes Department

Conferees appearing before the committee: Michael Heitman, Assistant Banking Commissioner
State of Kansas

Senator Allen called the Committee to order and requested action on Committee minutes for February 9.

Senator Arasmith made a motion the minutes stand approved; Senator Gordon seconded the motion; motion carried.

The Chairman requested the Committee approve the request for a Senate Resolution to recognize the Kansas Experiment Station Centennial. Senator Warren made a motion the Committee accept the request for the resolution. Senator Gannon seconded the motion. Motion carried.

The Chairman welcomed Michael Heitman to answer Committee questions concerning SB 92.

Mr. Heitman gave copies to the Committee of information concerning clear title legislation (attachment 1).

In answer to Committee questions Mr. Heitman's comments included: He believes most banks are sending out notices, but because of limitations of staff and costs banks decide on which loans to send notifications; he believes banks need to be given management discretion in choosing which loans to send notices on and which ones to not send notices, he believes if agriculture products are to be part of the Uniform Commercial Code then all parties involved must be treated fairly, he stated that prenotification will not change the risk of loss because a borrower will just sell somewhere that he did not include in his list of possible purchasers, it is hard to get a county attorney to presecute these days due to the agricultural conditions, maybe an increased penalty for avoiding an agricultural loan along with increased discipline in lending would help prevent loan problems but only if they could get a case prosecuted when there is a problem loan, some of the banks problems are caused by borrowers not correctly filling out the forms, bank examiners won't critize any bank if they are doing prenotification on part of their loans, FDIC has not taken a position on prenotification, some states may require more notification than Kansas but it is too costly to notify all, he stated prenotification requires a bank to offer protection but the bank gets none, he said he believed prenotification is more private than a central filing system.

The Chairman thanked Mr. Heitman for his time to appear before the Committee and announced Committee discussion and action would follow in later Committee meetings as time permits. He adjourned the Committee at 11:00 a.m.

GUEST LIST

page 1

COMMITTEE: SENATE AGRICULTURE DATE: February 10, 1987

NAME (PLEASE PRINT)	ADDRESS	COMPANY/ORGANIZATION
Mike Beam	Topeka	Ks. Lvstk. Assn.
Dan Olsen	K.C. Mo.	Ks L/S Mktg Assn.
Joe Lieber	Topeka	Ks Co-op Council
Julie Andsager	Topeka	Ks. Co-op Council
Larry Coffman	Overbrook	Overbrook Co-op
Ann Languardt	Chapman	Livestock Auctions
Howard Languardt	Chapman	Livestock Auctions
Diane Nelson	Burdick	Farm Bureau
Richard Muller	Council Grove	Farm Bureau
Richard McKee	Topeka	Kansas Livestock Assn.
Jim Maag	"	KBA
[illegible]	Topeka	KBA
Paul E. Fleener	Manhattan	Kansas Farm Bureau
Dee Likes	Topeka	KLA
George Ackerman	Sabetha	Livestock Auctions
Brent Anderson	topeka	sec. of. State
Chip Wheelen	Topeka	McGill & Assoc.
John O. Miller	Topeka	
Lynn VanWalst	Topeka	KLSI
Harold Stone	KBA Topeka	KBA
Barbara Lutenbach	Herington	Farm Bureau
Ron Estes	Atchison	Livestock Auction
Chris Wilson	Hutchinson	KS Grain & Feed Ass'n
Bill Fuller	Manhattan	Kansas Farm Bureau
John Blythe	Manhattan	K F B

GUEST LIST

COMMITTEE: SENATE AGRICULTURE DATE: February 10, 1987

NAME (PLEASE PRINT)	ADDRESS	COMPANY/ORGANIZATION
Wilbur Leonard	Topeka	Comm. Ks. Farm Org.
JOHN REYNOLDS	TOPEKA	LAW STUDENT
MARK BODINE	TOPEKA	LAW STUDENT
Mary Jane Wilson	Topeka	Ks Pub. Records Search
Sue Armstrong	Topeka	State Banking Dept
Rita D'Agostino	Topeka	State Bnking Dept
Mike Heiman	Topeka	State Banking Dept
Glenn Kuntemeier	Hoisington	Farm Bureau
Alan Steppat	Topeka	McGill & Assoc.
Chuck Stones	Topeka	Kansas Bankers Assoc.

To: All Field Supervisors
Subject: Clear Title Legislation
Date: December 23, 1986

Section 1324 of the Food Security Act of 1985 (1985 Farm Bill) eliminates, under certain circumstances, the "agricultural exception" to product clear title established and governed by the Uniform Commercial Code.

The "agricultural exception" simply permits the lender's security interest in farm products to be enforced against the purchaser of those products if the debtor failed to repay the lender.

Section 1324 was implemented to eliminate the purchaser's risk of "double jeopardy" by establishing the following procedure:

1. Effective December 24, 1986, farm product purchasers will take title free of security interest unless notified of a lien prior to purchase. If notified, the buyer protects himself by making the check jointly payable to the seller and to the secured party. (Lender notifies potential purchasers pursuant to a listing received from debtor.)

2. States may opt to implement an alternative central notification system. With such a system, buyers would pay for access to the lien information and make joint payment when a lien exists.

Kansas' central filing system does not meet the requirements established pursuant to Section 1324. Hence, effective December 24, 1986, if a lender desires to maintain the ability to pursue collection against a purchaser of farm products, the lender must have given prenotification to the buyer.

In correspondence dated October 2, 1986, Commissioner Barrett outlined this department's position regarding lender notification of buyers and its effect upon credit risk assessment and loan classification. (Copy attached. Please review.)

The question of whether a lender should notify potential purchasers will remain a management decision. In reality, a debtor contemplating selling out-of-trust will undoubtedly sell off-list; hence, prenotification will probably have little impact upon the credit risk embodied within the loan account. Inasmuch as risk components are relatively unaffected, examination classifications will not be materially affected by prenotification or the lack thereof. In other words, don't change what you were doing prior to December 24, 1986.

attachment 1
Senate agriculture
2-10-87

When you find instances where management is not notifying potential purchasers and you determine that certain loan accounts portray significant loss exposure to the bank if dissipation were to occur, comments suggesting management's reassessment and consideration of utilizing prenotification procedures (in select cases) would be in order. Granted, it's hard to be critical when the dishonest debtor will simply sell off-list; however, it may prove beneficial to management and the board if they can show they took every reasonable step to protect the bank's interests; impact upon officer and director liability as well as a possible impact upon future litigation of security interests are potential considerations.

It appears that management should be encouraged to utilize prenotification in instances where collateral dissipation would have a significant adverse impact upon the bank and the risk of dissipation is escalating due to debtor operating and financial difficulties.

STATE OF KANSAS

Eugene T. Barrett, Jr.
Bank Commissioner

Michael D. Heitman
Deputy Commissioner

OFFICE OF

BANKING DEPARTMENT
TOPEKA

October 2, 1986

Mr. James S. Maag
Kansas Banker's Association
707 MNB Building
Topeka, Kansas 66603

Re: Clear Title Legislation

Dear Jim:

On September 12, 1986 you sent to my attention information outlining the Oklahoma State Banking Department's position pertaining to the referenced matter. Additionally, you asked for a position statement from this department.

Jim, I realize your members are concerned about the additional risks this legislation may embody including regulatory interpretation and resulting examination implications. In this regard, I will try to clearly convey our perception of the risk consideration and the resultant implication upon our examination findings.

I discussed this matter with my staff to determine how loans secured by agricultural products were analyzed prior to the referenced legislation and what impact "clear title" may have on our previous position.

For an example, let's assume the loan properly lists a security interest in agricultural products and the lender has properly recorded a UCC-1 filing. Our examiner would ascertain the present fair market value of the product as a part of the consideration in determining the credit risk portrayed. This assumes that no unusual circumstances exist such as a lapsed UCC-1 filing, a deficient security agreement, debtor known to be out-of-trust, etc. Such adverse circumstances may or may not result in a loss of the security value of the agricultural products purported to be pledged as collateral; it will depend upon the examiner's assessment of the facts and the resulting likelihood that there is any real value associated with the bank's collateral position.

-more-

700 JACKSON, SUITE 300, TOPEKA, KANSAS 66603-3714 (913) 296-2266

Prior to clear title legislation, I find that our examiners gave no value to agricultural products known to have been sold out-of-trust unless the lender could document a viable and collectible claim against the purchaser of the products. As far as I can determine, this generally resulted in a loss of the collateral value once associated with the products because the bank could not identify the purchaser. In 1985 one of our bank failures was due in part to a borrower being out-of-trust on $500,000 in livestock and the bank recovered nothing. This is certainly not to say a recovery is not possible, it just seems difficult and has resulted in a loss of the collateral value even prior to clear title legislation.

As I understand the referenced legislation, it simply restricts the secured lender's potential claim against a purchaser of agricultural products if the borrower misapplies the proceeds. All other aspects of the lender's security interest remain the same. In other words, the lender could still enforce a security interest in the products provided they remain the property of the debtor. Hence, it is only when the debtor is out-of-trust that the exposure is present. As I indicated, we already find this exposure to be significant under present circumstances.

In this regard, I must conclude that a loan referencing a security interest in agricultural products will <u>not</u> automatically be considered as unsecured following the implementation of clear title legislation. Such treatment would be arbitrary and requires the assumption that the debtor <u>will</u> sell out-of-trust; a conclusion I would find indefensible.

The obvious conclusion is that the <u>likelihood</u> of a debtor selling out-of-trust must be a part of the credit decision making process regardless of clear title legislation. That is why our examiners will not automatically exclude such collateral from present loan classification decisions; the risk of dissipation is already a very real threat.

I find that several bankers have already questioned my staff regarding a possible forthcoming regulatory requirement pertaining to mandatory notification to potential buyers. Again, our response has been that it remains a credit risk decision. A regulatory requirement that the debtor <u>must</u> supply a list of potential buyers and that the lender <u>must</u> notify these potential buyers in all cases does not appear practical nor warranted. This would mean that whether the debtor is a major producer of agricultural products or simply buying livestock for a 4-H project, notifications would be required. It is obvious that management's discretion should be permitted.

-more-

I would, however, expect the lender to ascertain the risk of dissipation and take all appropriate steps to minimize this risk when the debtor's financial condition is suspect and dissipation would result in significant loss exposure to the bank. Our examiners will assess the safety and soundness aspects of the lender's policy and procedures pertaining to this matter and will certainly be critical of lax lending practices which expose the bank to significant unnecessary risk.

If you have any questions or comments, please let me know. Also, please share this with Harold as he expressed an interest in this subject as well.

Sincerely,

Eugene T. Barrett, Jr.
State Bank Commissioner

ETBjr:mdh:jas

cc: Field Office Supervisors
FDIC
File: (R)C

5

attachment 1
2-10-87