

Approved

Date

Clyde D. Graeber 3/30/88

MINUTES OF THE HOUSE COMMITTEE ON COMMERCIAL AND FINANCIAL INSTITUTIONS

The meeting was called to order by Clyde D. Graeber at
Chairperson

3:30 ~~AM~~/p.m. on March 24, 1988 in room 527-S of the Capitol.

All members were present except: Clifford Campbell, Excused.

Committee staff present: Bill Wolff, Research Department
Myrta Anderson, Research Department
Bruce Kinzie, Revisor of Statutes
June Evans, Secretary

Conferees appearing before the committee: Terry Humphrey, Manufactured Housing
Bud Grant, Kansas Chamber of Commerce and Industry
Stanley Lind, Kansas Association of Financial
Services
Jim Maag, Kansas Bankers Association
Joe Morris, Kansas League of Savings Institutions
John Wine, Secretary of State's Office
Douglas Mays, Securities Commissioner

The Chairman called the meeting to order.

The hearing was opened on Senate Bill 507, an act amending the uniform consumer credit code; concerning charges and fees allowable on certain consumer credit transactions.

The first person to testify for Senate Bill 507 was Terry Humphrey, Executive Director for Kansas Manufactured Housing Association, stating that S.B. 507 allows for an alternate interest rate of 18% in retail lending. Since interest rates are set by market conditions, as well as competition within the market place, it is felt that this interest rate ceiling allows enough flexibility for home lending to be available in times of inflation.

In 1981 when the prime rate was very high, loans on manufactured housing reached highs of 18% a.p.r.. In 1983, as the national prime rate declined manufactured home loans were available at 15 and 16 a.p.r.. Rates have continued to drop even lower. Manufactured home loans are available today at 13% conventional fixed rate. However, in the past 12 months there have been major fluctuations in loan rates, with a high of 15.50% in May.

In July, 1987 manufactured home lending became more complex when the alternate rate of 21% sunset, and the interest ceiling dropped to 14.45%. In October, a volatile economy forced interest rates to the ceiling and manufactured home loans were available at 14.45% plus two points. In this situation, the manufactured home dealers paid the points in order to have financing for their customers.

Prime rate controls loan rates and that the usury ceiling must be set so lending can continue during times of inflation and the 18% alternate rate for retail lending is that this is the same lending rate permitted for supervised and licensed lenders now. (See Attachment #1).

Bud Grant, Vice President of Kansas Chamber of Commerce and Industry, was the next person to testify, stating he would limit his comments to the section dealing with open and closed-end credit sales. The most important rate change contained in S.B. 507 is the change in the bracket of \$0-\$1,000. Those who suggested the retailers' rates should be lowered do not do so in order to punish the retailer, but in hopes that it would benefit the consumer. However, keeping the rates artificially low in fact have the opposite effect and ultimately

CONTINUATION SHEET

MINUTES OF THE HOUSE COMMITTEE ON COMMERCIAL AND FINANCIAL INSTITUTIONS

room 527-S, Statehouse, at 3:30 ~~am~~/p.m. on March 24, 1988

hurts the consumer. An overly restrictive lid increases the cost of goods. Merchants are forced to recoup losses incurred in extending credit by passing these costs on to all consumers. This misallocation of costs is unfair to cash buyers who are forced to subsidize those who use credit.

Also, the finance charges of retailers is the sole source of revenue from credit. There are no annual fees or other sources of income which are available to other types of credit grantors. Estimates show that 47% of those who purchase with credit from retailers pay the entire amount of that purchase within 30 days. This means the retailer has given an interest free loan to these customers for 30 days, with no finance charge involved.

The merchants' credit card is the best credit buy available as it is free, offers a grace period and actually gives consumers a free loan if the bill is paid in full each month. The card has complete flexibility, provides convenience and security, shopping without cash is an excellent value which operates best for consumers when its not subjected to artificial governmental constraint. Credit is a service, like any other, and the merchant should be permitted to price that service so that it will be available to those who want it and so that it will be paid for only by those who use it. (See Attachment #2).

Joe A. Morris, Kansas League of Savings Institutions, was the next person to testify for Senate Bill 507, stating the League supports the changes in Sections 4 and 5 of the bill. The first change would allow a non-refundable origination fee of 3% of the amount financed or \$100., whichever is less, on unsecured loans and closed end consumer credit sales by striking lines 202-205 and inserting the language found in lines 227-235. By utilizing this fee it is felt lenders will have greater flexibility in making these loans -- flexibility that could compensate lenders for giving greater consideration to high risk loans, thereby expanding the opportunities available to consumers.

The second change eliminates the alternative \$2.50 delinquency charge and replaces it with a delinquency charge of a maximum of 5% of the unpaid installment or \$25.00, whichever is less. This would be the first change in the permissible delinquency fee in over 30 years. This change is necessary to cover the added expenses of phone calls, delinquency notices, postage, and lost personnel time incurred while servicing delinquent accounts. (See Attachment #3).

The next person to testify for S.B. 507 was Stanley L. Lind, Kansas Association of Financial Services, stating the consumer finance companies in Kansas endorses or urges passage of S.B. 507.

Consumer finance companies in Kansas are not doing well. The specific provision I make reference to is the S.B. 507 amendment to permit a 3% origination fee (with a \$100 maximum) on all consumer loans not secured by real estate as found on pages 6 and 7, lines 227 thru 244. Presently a 3% origination fee is authorized for loans secured by real estate.

The main reason that there is a decline of credit availability for loans of less than \$5,000. is that for 12 months the loan will generate a finance charge of \$600.76 - just slightly less than the break even point of \$607.68.

Senate Bill 507 would permit an origination fee of 3% on consumer loans, not secured by real estate, with a maximum of \$100.00 (See Attachment #4).

The last person to testify for Senate Bill 507 was Jim Maag, Kansas Bankers Association stating these amendments create a more equitable finance charge structure for those involved in open and closed-end credit sales. First, since the origination fee currently allowed by the Code is in addition to the finance charge, we believe it makes the Code easier to understand by removing the origination fee reference from K.S.A. 16-a-2-401 and placing it in K.S.A. 16-2-501 since that is the section dealing with other exceptions to the finance charge. Secondly, it is felt the extension of the origination fee

CONTINUATION SHEET

MINUTES OF THE HOUSE COMMITTEE ON COMMERCIAL AND FINANCIAL INSTITUTIONS

room 527-S Statehouse, at 3:30 ~~am~~ p.m. on March 24, 1988

to all consumer loans - not just those secured by real estate - is a positive move toward greater credit availability. Currently, many banks do not or are reluctant to make small loans because the finance charge alone is simply insufficient to cover the costs of processing the loan.

It was further stated that the \$2.50 maximum charge has not kept up with inflation and this needs to be changed. This charge applies only to pre-computed consumer transactions, it is felt the delinquency charge should be extended to all consumer transactions. The ability to apply delinquency charge to a simple interest transaction would definitely place the burden of cost for servicing delinquent loans on the delinquent customer and could have a positive impact on the finance charge available to all customers.

Mr. Maag then brought forth an amendment to SB 507 which is on page 10 by striking the period in line 364 and inserting after the word "method" the following: "on all consumer credit transactions made on and after July 1, 1988. (See Attachments 5, 6, and 7).

The hearing was closed on Senate Bill 507.

Representative King moved and Representative Ott seconded that the amendment be passed. The amendment passed unanimously.

Judy Stringer, Consumer Credit Commissioner, stated they supported that this 3% should be in Senate Bill 552 and stay in Section 401, not Senate Bill 507.

Jim Maag stated either S.B. 552 or S.B. 507 would be alright with the Kansas Bankers Association.

After discussion it was moved by Representative Francisco and seconded by Representative Roper to offer an amendment to remove from the bill the 3% origination fee with a \$100.00 cap by striking lines 227 thru 235. The amendment carried by a majority vote.

Representative Ott moved and Representative King seconded to move out favorably Senate Bill 507 as amended. There was a question on the vote and a show of hands was requested. There were 8 yeas and 6 nays.

The motion passed favorably.

The Chairman opened the hearing on H.B. 3090, stating this bill would give the Secretary of State's Office and the Registers of Deeds flexibility to provide Uniform Commercial Code information using modern methods of information transfer. Fees for services could include the cost of establishing and maintaining the information system.

The Secretary of State's Office has the technology and equipment to communicate with other data processing systems, including the IBM System 36 computers acquired by the counties for reappraisal. This bill would authorize us to provide direct access to Register of Deeds, ASCS offices, and private groups or individuals (See Attachment 8).

After discussion by the committee Representative King moved and Representative Eckert seconded that House Bill 3090 be passed out of committee favorably. The bill passed unanimously.

The Chairman asked if the committee wished to have any action on Senate Bill 533. There were no supporters of this bill.

CONTINUATION SHEET

MINUTES OF THE HOUSE COMMITTEE ON COMMERCIAL AND FINANCIAL COMMITTEE,
room 527, Statehouse, at 3:30 ~~am~~/p.m. on March 24, 1988

Staff stated Senate Bill 533 amends a statute dealing with the price or method of determining the price of shares of professional corporations. The bill expands the law to include situations where a shareholder withdraws or retires. Current law covers only situations where a shareholder dies or no longer is qualified to own shares.

No action was taken on Senate Bill 533.

The Chairman then asked the Committee what their wishes were on Senate Bill 535.

Representative Justice felt in the last hearing on Senate Bill 535 that it is too broad and needs to be limited to banks and other lending institutions. There were only banking institutions here to testify on the bill.

Representative Justice moved and Representative Mary Jane Johnson seconded that amendment be added to Senate Bill 535. The amendment was passed. (See Attachment #9).

Representative Gatlin stated that he still opposed the bill and wished to be recorded as opposing the bill.

After discussion Representative King moved and Representative Ott seconded that the bill be moved out of committee as amended.

There was a call for a show of hands on the vote and the bill was approved favorably for passage to the full House.

Representative Gatlin asked to be recorded as voting "NO" on S.B. 535.

The next bill brought forward for action was Senate Bill 675.

M. Douglas Mays, Kansas Securities Commissioner, testified for an amendment to Senate Bill 675. In Section 6 (b) (8) line 138 insert the following: "compiled in accordance with generally accepted accounting principals by a certified or independent public accountant;"

Representative Long moved and Representative King seconded the amendment be added to the Senate Bill 675. The amendment was passed unanimously.

The second amendment Commissioner Mays recommended was:

Section 16(a) -- lines 382 - 384 strike:

"(or any independent public accountant engaged in the practice of public accountancy as defined in K.A.R. 74-5-2(g));"

and insert:

"or any independent public accountant engaged in the practice of public accounting whose service in relation to procurement of a loan is incidental to their practice." (See Attachment 10).

Representative Sand moved and Representative Ott seconded that Senate Bill 675 be amended as recommended. The amendment was passed unanimously.

Representative King moved and Representative Ott seconded that Senate Bill 675 be moved out of committee favorably. The bill was approved for passage unanimously.

Representative Russell moved and Representative Sand seconded the approval of the minutes of the March 22 meeting.

The meeting adjourned at 5:50 P.M.

Date: Mar 24, 1988

GUEST REGISTER

NAME	ORGANIZATION	ADDRESS
Jim May	KBA	Topeka
Chris F. Lewis	KBA CBT	Topeka
Harvey Humphrey	KMHA	"
and Grand	KCA	Topeka
Stan Lind	Ks. Assn. of Fin. Serv.	KCKs.
J. Stangier	CCE	Topeka
Ken Morris	KCSI	TOPEKA
Tom Palace	SLSI	Topeka
Chuck Stones	Ks Bankers Assn	"
Carol Beard	Sec of State	"
John Wine	Sec. of St.	"
Joel Wright	Ks Credit Union League	Topeka
Steve Wassom	Office of Sec. Comm.	✓
Roger Walker	"	✓
Don May	Securities Commissioner	"

KANSAS MANUFACTURED HOUSING ASSOCIATION

TESTIMONY BEFORE THE

HOUSE

COMMERCIAL AND FINANCIAL INSTITUTIONS

COMMITTEE

TO: Representative Clyde Graeber
and Members of the Committee

FROM: Terry Humphrey, Executive Director
Kansas Manufactured Housing Association

DATE: March 24, 1988

Mr. Chairman and members of the committee, I am Terry Humphrey, representing the Kansas Manufactured Housing Association and we are appearing today in support of Senate Bill 507.

We support the provisions of Senate Bill 507 that allow for an alternate interest rate of 18% in retail lending. Since interest rates are set by market conditions, as well as competition within the market place, we feel that this interest rate ceiling allows enough flexibility for home lending to be available in times of inflation.

In 1981 when the prime rate was very high, loans on manufactured housing reached highs of 18% a.p.r.. In 1983, as the national prime rate declined, manufactured home loans were available at 15 and 16% a.p.r.. In subsequent years, interest rates continued to drop even lower. Today, manufactured home loans are available at 13% conventional fixed rate. However, in the past 12 months there have been major fluctuations in loan rates, with a high of 15.50% in May.

This past July, manufactured home lending became more complex when the alternate rate of 21% sunset, and the interest ceiling dropped to 14.45%. In October, a volatile economy forced interest rates to the ceiling and manufactured home loans were available at 14.45% plus two points. In this situation, the manufactured home dealers paid the points in order to have financing for their customers.

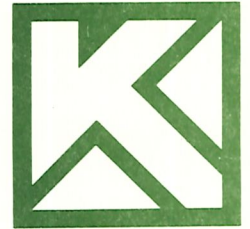
Atch #1

In closing, it is our belief that the prime rate controls loan rates and that the usury ceiling must be set so lending can continue during times of inflation. Additional rational for adopting the 18% alternate rate for retail lending, is that this is the same lending rate permitted for supervised and licensed lenders now.

KMHA respectfully requests your support of Senate Bill 507. Thank you.

LEGISLATIVE TESTIMONY

Kansas Chamber of Commerce and Industry



500 First National Tower One Townsite Plaza Topeka, KS 66603-3460 (913) 357-6321

A consolidation of the
Kansas State Chamber
of Commerce,
Associated Industries
of Kansas,
Kansas Retail Council

SB 507

March 24, 1988

KANSAS CHAMBER OF COMMERCE AND INDUSTRY

Testimony Before the

House Committee on Commercial and Financial Institutions

by

Bud Grant
Vice President

Mr. Chairman and members of the committee. My name is Bud Grant, vice president of the Kansas Chamber of Commerce and Industry and I appreciate the opportunity of appearing before the committee today in support of SB 507.

The Kansas Chamber of Commerce and Industry (KCCI) is a statewide organization dedicated to the promotion of economic growth and job creation within Kansas, and to the protection and support of the private competitive enterprise system.

KCCI is comprised of more than 3,000 businesses which includes 200 local and regional chambers of commerce and trade organizations which represent over 161,000 business men and women. The organization represents both large and small employers in Kansas, with 55% of KCCI's members having less than 25 employees, and 86% having less than 100 employees. KCCI receives no government funding.

The KCCI Board of Directors establishes policies through the work of hundreds of the organization's members who make up its various committees. These policies are the guiding principles of the organization and translate into views such as those expressed here.

As indicated, the committee has before it today several expert witnesses to visit with you about various portions of SB 507, and with that in mind, I will limit my comments to the section dealing with open and closed-end credit sales.

Atch 2

In March, 1987, this committee recommended for passage to the full House HB 2406. You will recall that that bill would have made permanent the alternative 21% interest rate which had been requested by credit providers in the state. That bill was ultimately passed by the House after reducing the alternative to 18% on the House floor and was sent to the Senate Committee where it ultimately died.

Late in the session the House, by a vote of 102 to 21, passed SB 415 which would have extended for an additional three years the alternative 21% interest rate available for open and closed-end credit sales. As I'm sure you'll recall that bill was ultimately vetoed by the governor.

Because of the failure of HB 2406 and SB 415, as of July 1, 1987, Kansas Uniform Consumer Credit Code provides that for open and closed-end credit sales, finance charges are 21% on unpaid balances between \$0-\$300; 18% on unpaid balances from \$300-\$1,000; and, 14.45% on balances in excess of \$1,000. SB 507 would authorize on unpaid balances from \$0-\$1,000 a finance charge of 21%; on unpaid balances in excess of \$1,000 14.45%; and, an alternative interest rate of 18%. Obviously, these proposed rates contained in SB 507 are less than the 21% which this committee approved in 1987, however, they are offered as a compromise which hopefully, if agreed upon, will put this subject to rest.

The most important rate change contained in SB 507 is the change in the bracket of \$0-1,000. Those who suggested the retailers' rates should be lowered do not do so in order to punish the retailer, but in hopes that it would benefit the consumer. However, keeping the rates artificially low in fact have the opposite effect. In the matter of basic economics, experiences shown that price controls stifle competition, hurt small business (which is the backbone of the Kansas economy), and, when they result in requiring a service to be offered at a loss, they ultimately hurt the consumer. An overly restrictive lid increases the cost of goods. Merchants are forced to recoup losses incurred in extending credit by passing these costs on to all consumers. This misallocation of costs is unfair to cash buyers who are forced to

subsidize those who use credit. The fair system of pricing for all consumers is to allow retailers to charge creditcustomers the full cost of the credit services thereby keeping goods as pure as possible.

Also, please keep in mind that the finance charges of retailers is the sole source of revenue from credit. There are no annual fees or other sources of income which are available to other types of credit grantors. One very important factor is that estimates show that 47% of those who purchase with credit from retailers pay the entire amount of that purchase of within 30 days. This of course means the retailer has given an interest free loan to these customers for 30 days, with no finance charge involved.

Not Attached
At the request of the Kansas Retail Council, Dr. Ray McAllister from the College of Business of North Texas University appeared before this committee last year to discuss consumer credit with you. For your information, I have attached to my testimony the illustration Dr. McAllister made available to you last year indicating the yield on a retail revolving account assuming a 21% APR.

Mr. Chairman, members of the committee, the merchants' credit card is the best credit buy available. The card is free, it offers a grace period and actually gives consumers a free loan if the bill is paid in full each month. The card has complete flexibility, provides convenience and security, shopping without cash is an excellent value which operates best for consumers when its not subjected to artificial governmental constraint. Credit is a service, like any other, and the merchant should be permitted to price that service so that it will be available to those who want it and so that it will be paid for only by those who use it.

Thank you, Mr. Chairman for the opportunity and urge your support of SB 507.

KLSI Kansas League of Savings Institutions

JAMES R. TURNER, President • Suite 512 • 700 Kansas Ave. • Topeka, KS 66603 • 913/232-8215

March 24, 1988

TO: HOUSE COMMERCIAL AND FINANCIAL INSTITUTIONS COMMITTEE
FROM: JOE A. MORRIS, KANSAS LEAGUE OF SAVINGS INSTITUTIONS
RE: S.B. 507 (U.C.C.C. - ALLOWABLE CHARGES AND FEES)

The Kansas League of Savings Institutions appreciates the opportunity to appear before the House Commercial and Financial Institutions Committee in support of S.B. 507 which would alter charges and fees presently allowed on consumer credit transactions.

In particular, the Kansas League of Savings Institutions supports the changes in sections 4 and 5 of the bill. The first change would allow a non-refundable origination fee of 3% of the amount financed or \$100, whichever is less, on unsecured loans and closed end consumer credit sales by striking lines 202-205 and inserting the language found in lines 227-235. By utilizing this fee we feel lenders will have greater flexibility in making these loans -- flexibility that could compensate lenders for giving greater consideration to high risk loans, thereby expanding the opportunities available to consumers.

The second change eliminates the alternative \$2.50 delinquency charge and replaces it with a delinquency charge of a maximum of 5% of the unpaid installment or \$25.00, whichever is less. This would be the first change in the permissible delinquency fee in over 30 years. In addition to providing a more effective deterrent to late payments, this change is necessary to cover the added expenses of phone calls, delinquency notices, postage, and lost personnel time incurred while servicing delinquent accounts.

We would appreciate the committee's consideration of the need for these changes and would request that S.B. 507 be reported favorably for passage.

Joe A. Morris
Legislative Assistant

JAM:bw

A + ch 3

REMARKS PERTAINING TO S.B. 507 BEFORE
THE HOUSE COMMERCIAL AND FINANCIAL INSTITUTIONS
COMMITTEE ON MARCH 24, 1988

By
Stanley L. Lind, Counsel & Secretary
Kansas Assn. of Financial Services

Mr. Chairman and Members of the Committee:

The Kansas Assn. of Financial Services, the state trade association of Consumer finance companies in Kansas, endorses S.B. 507 and urges the committee to recommend it for passage.

Before addressing the specifics of S.B. 507, I would like to briefly review with the committee the general position of consumer finance companies operating in Kansas to give the committee an idea as to where we are coming from. I will do this by showing you the Net Profit consumer finance companies in Kansas have made when expressed as a percentage of the total Average Net Receivables. This is the generally accepted measuring stick used by the banking and finance industry.

Then I want to compare the Kansas figures with the national averages compiled by the First National Bank of Chicago - which is generally considered as the national standard.

Looking at Exhibit No. I, you will note a graph with the years 1975 thru 1986 listed at the bottom. Along the left side is seen a range of interest percentages between 1.00% to 4.00%. The black line shows this expression of interest of the Annual Net Profit of licensed lenders in Kansas as a percentage of the total Average Net Receivables of all licensed lenders.

Atch 7

The black line goes from a high of 2.25% in 1976 to a low of minus .31 of 1% in 1981 -and- minus .22 of 1% in 1982. Since 1982, there has been a gradual climb to .99 of 1% in 1986.

Compare this to the blue line which shows the First National of Chicago averages to be:

°	98	basis	points	above	Kansas	in	1980
°	143	"	"	"	"	"	1981
°	227	"	"	"	"	"	1982
°	310	"	"	"	"	"	1983
°	301	"	"	"	"	"	1984
°	258	"	"	"	"	"	1985
°	275	"	"	"	"	"	1986

Expressed as an average over the last seven years, (1980 thru 1986) the average net profit for Kansas licensed lenders has been .28 of 1% compared to the national average of 2.59%. In other words, the national average is over 9 times the average for Kansas licensed lenders.

From this graph alone, it is apparent that consumer finance companies in Kansas are not doing well. Since almost 98% of the consumer finance assets in Kansas are furnished by out-of-state companies - it is obvious that these assets will flow to the state where they can expect the best return.

S.B. 507 contains provisions - that if enacted - would help improve the financial return to consumer finance companies -and- at the same time go a long way to induce lenders to service an area of consumer credit which is increasingly being over-looked.

The specific provision I make reference to is the S.B. 507 amendment to permit a 3% origination fee (with a \$100 maximum) on all consumer loans not secured by real estate as found on pages 6 and 7, lines 227 thru 244. Presently a 3% origination fee is authorized for loans secured by real estate.

How can the Legislature justify such a charge? This is what I would like to discuss with the committee.

Please turn with me to Exhibit No. II. This graph shows the loans made by licensed lenders in an amount over \$5,000 as a percentage of the total dollar amount of loans made in the years 1975 thru 1986. This graph show a generally increasing percentage rise of loans over \$5,000 from a low of 25% in 1976 to a high of almost 60% in 1983. The 1986 figure is at 47%.

A look at Exhibit No. III shows the opposite of Exhibit No. II -that is- the percentage of the total loans made in dollars by licensed lenders for less than \$5,000. This goes from a high of 74% in 1976 to a low of 41% in 1983 to approximately 52% in 1986.

Obviously - the consumer finance companies are getting out of the "small loan" business - the consequence of which is that the borrowing public is increasingly having a difficult time to find loan credit under \$5,000.

While there are several reasons for this - one of these is the rate of return on loans below \$5,000 in Kansas. If you will turn to Exhibit No. IV, you will note a graph with the years 1975-86 at the bottom and dollar amounts from \$10 thru \$60 on

the left side. This graph charts the rising cost per account per month for licensed lenders from 1975 thru 1986. This figure is obtained by totaling all expenses of licensed lenders and dividing that sum by the average number of loans held by these lenders. This graph show a low of \$19.47 in 1975 to a high of \$52.40 in 1985 -and- \$50.64 in 1986.

Multiplying the cost per account per month of 1986 of \$50.64 by 12, we find that the break-even point for loans in Kansas is \$607.68.

Looking at a rate chart for present Kansas licensed lender loans, we find that a \$5,000 loan for 12 months will generate a finance charge of \$600.76 - just slightly less than the break-even point of \$607.68. This is the main reason that there is a decline of credit availability for loans of less than \$5,000.

A comparison that should be made between Exhibit No. II and IV -is- the overall similarity of the graph lines. As the cost per account per month went up - so did the total dollar amount of loans made over the sum of \$5,000. This is a graphic picture of the concept that capital will flow to the profitable loan and away from the unprofitable loan.

While I have spent all of my time thus far discussing loans under \$5,000 and the need for a greater inducement to lenders for loans under \$5,000, the question that can be asked -is- what is the justification for an origination fee on loans over \$5,000?

The answer to that question is found in one of the fundamental concepts of consumer lending -namely- that the borrower of the larger sums of credit helps to pay for the smaller loans which are unprofitable to the lender because of the insufficient rate. That has been an accepted principle and public policy from the very first small loan act in 1913.

The rates provided by Kansas law for loans over \$5,000 plus the competitive factor will not permit a higher compensating rate to be charged. It is submitted that the concept of the origination fee will be an answer to this. Interest rates -as such- would not be raised. The origination fee would be disclosed to the public thru the Annual Percentage Rate required by Truth-in-Lending. The increased profitability to the lender on loans over \$5,000 will permit greater liberality on loans under \$5,000.

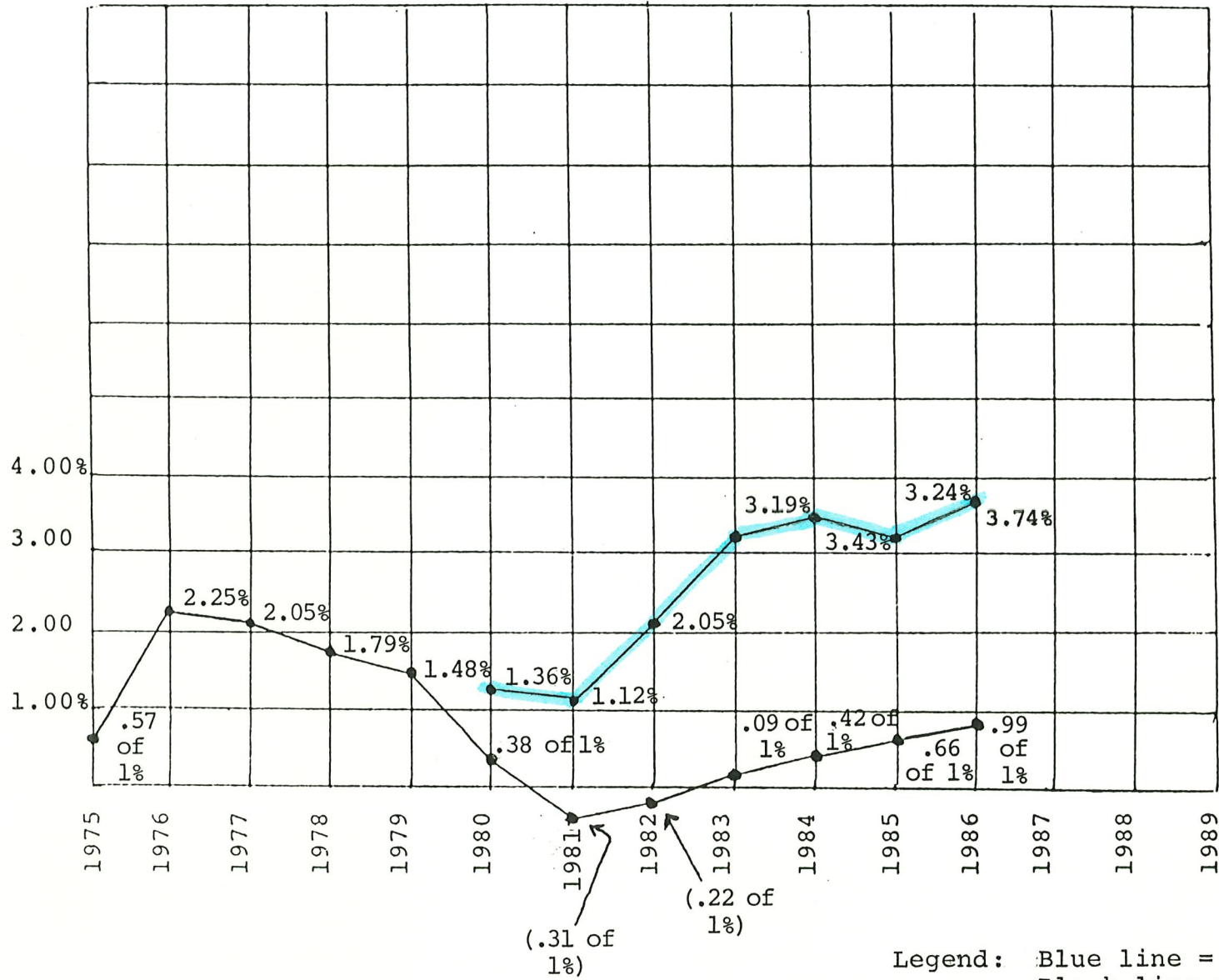
What I have attempted to do -is- to graphically present a problem area to the committee for its consideration. If the committee concludes that it is important to the state that the borrowing public have a source of consumer credit below \$5,000 - then it is obvious that the state will have to take such steps as will attract capital into this area of lending.

One of those steps is found in S.B. 507 - which would permit an origination fee of 3% on consumer loans, not secured by real estate, with a maximum of \$100.

Percent Net Profit of Finance Charges to Total Average
Net Receivables of Kansas License Lenders for the Years 1975 to 1986

Black Line = Kansas Licensed Lenders

Blue Line = First National Bank of Chicago National Survey (1980-1986)



Amount in basis points, the national averages are greater than the state averages:
(100 points = 1%)

1980-98 basis pts.		
1981-143	"	"
1982-227	"	"
1983-310	"	"
1984-301	"	"
1985-258	"	"
1986-275	"	"

EXHIBIT NO. I

Legend: Blue line = national averages
Black line = state averages

Loans Over \$5000 Made By Licensed Lenders As a Percentage
of the Total Dollar Amount of Loans Made in 1975 thru 1986.

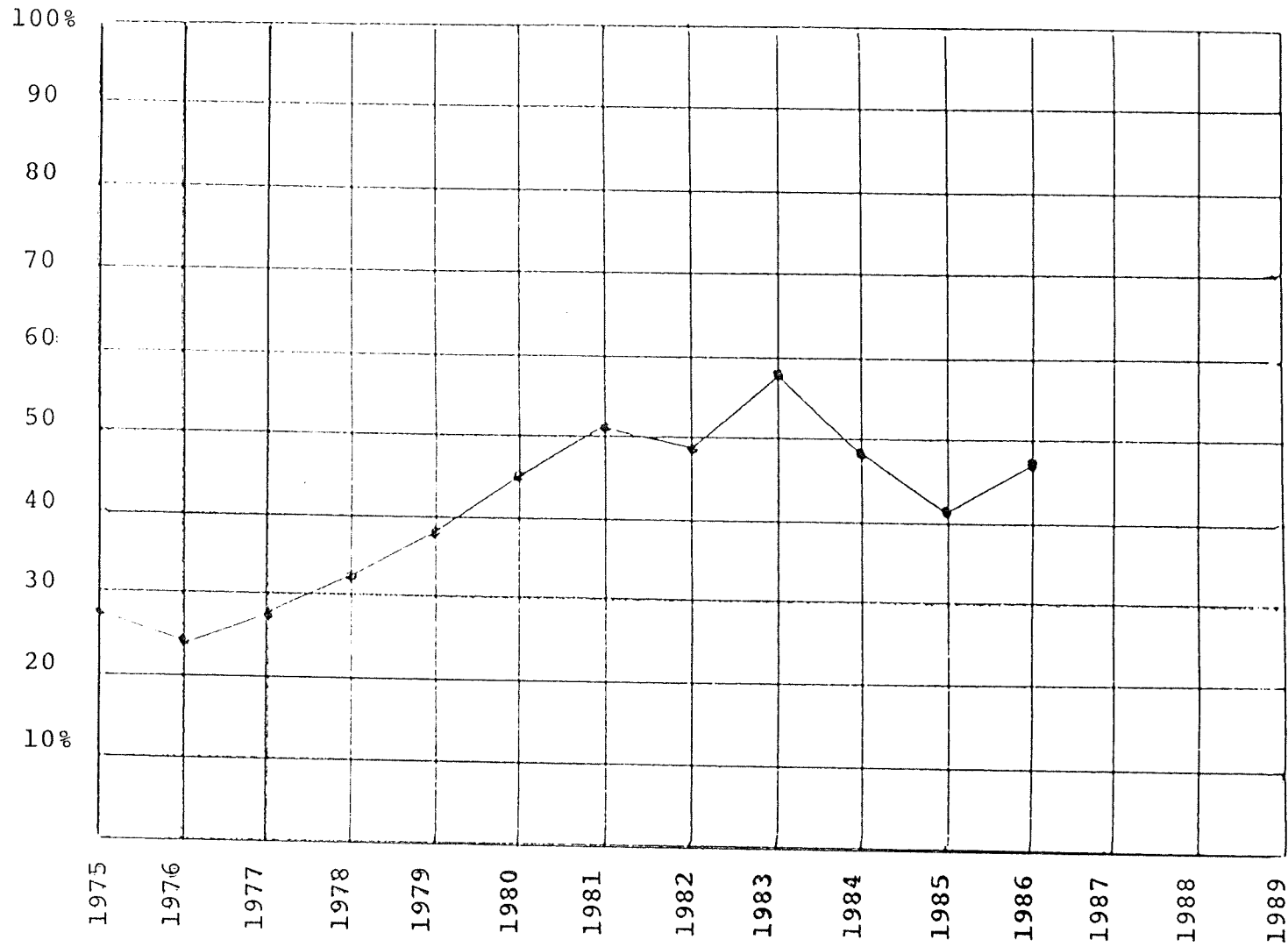


EXHIBIT NO. II

Loans Under \$5000 Made By Licensed Lenders As a Percentage
of the Total Dollar Amount of Loans Made in 1975 thru 1986.

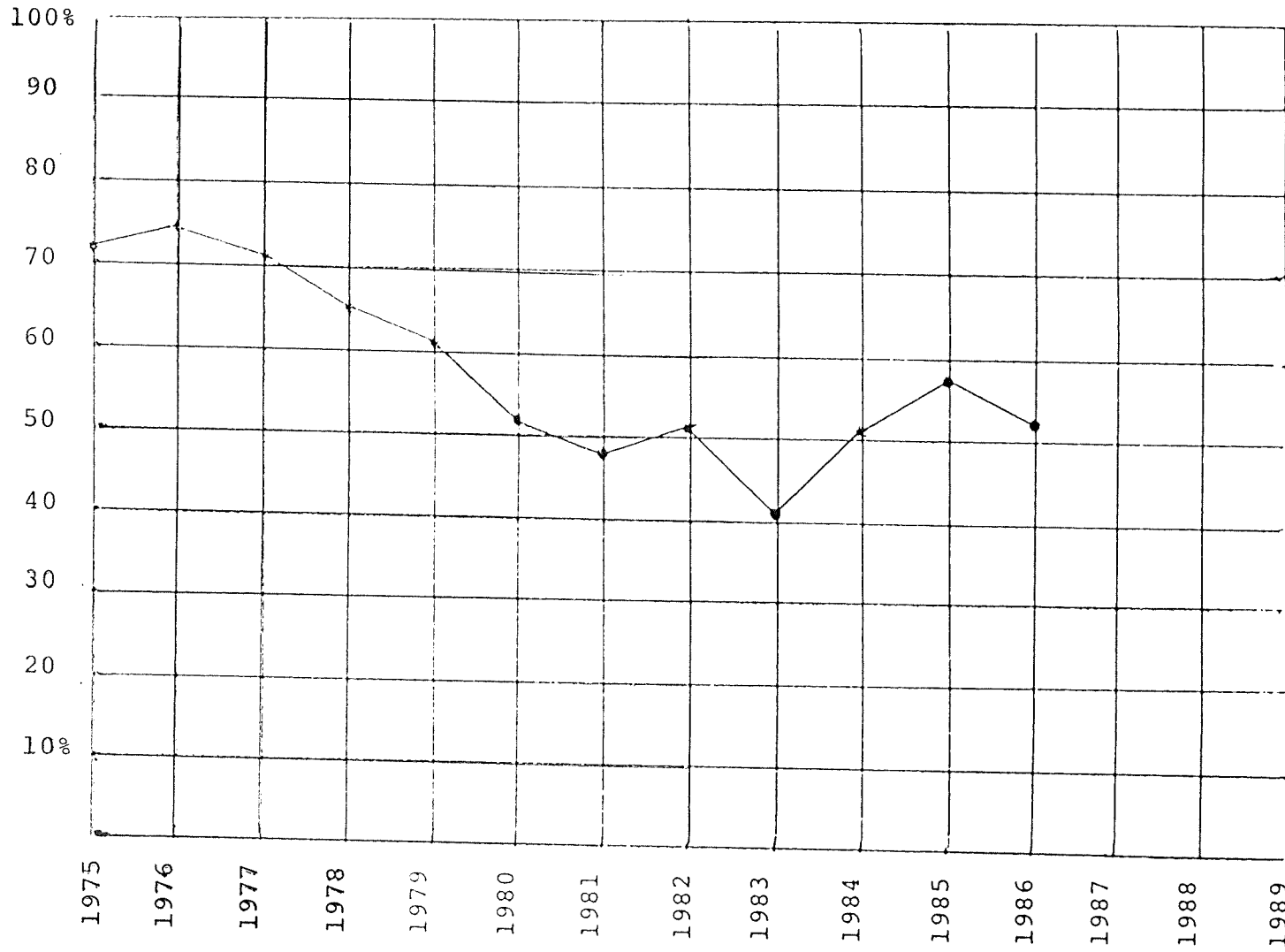


EXHIBIT NO. III

Cost Per Account Per Month to Handle Loans by Loan Licensees
(1975 - 1986)

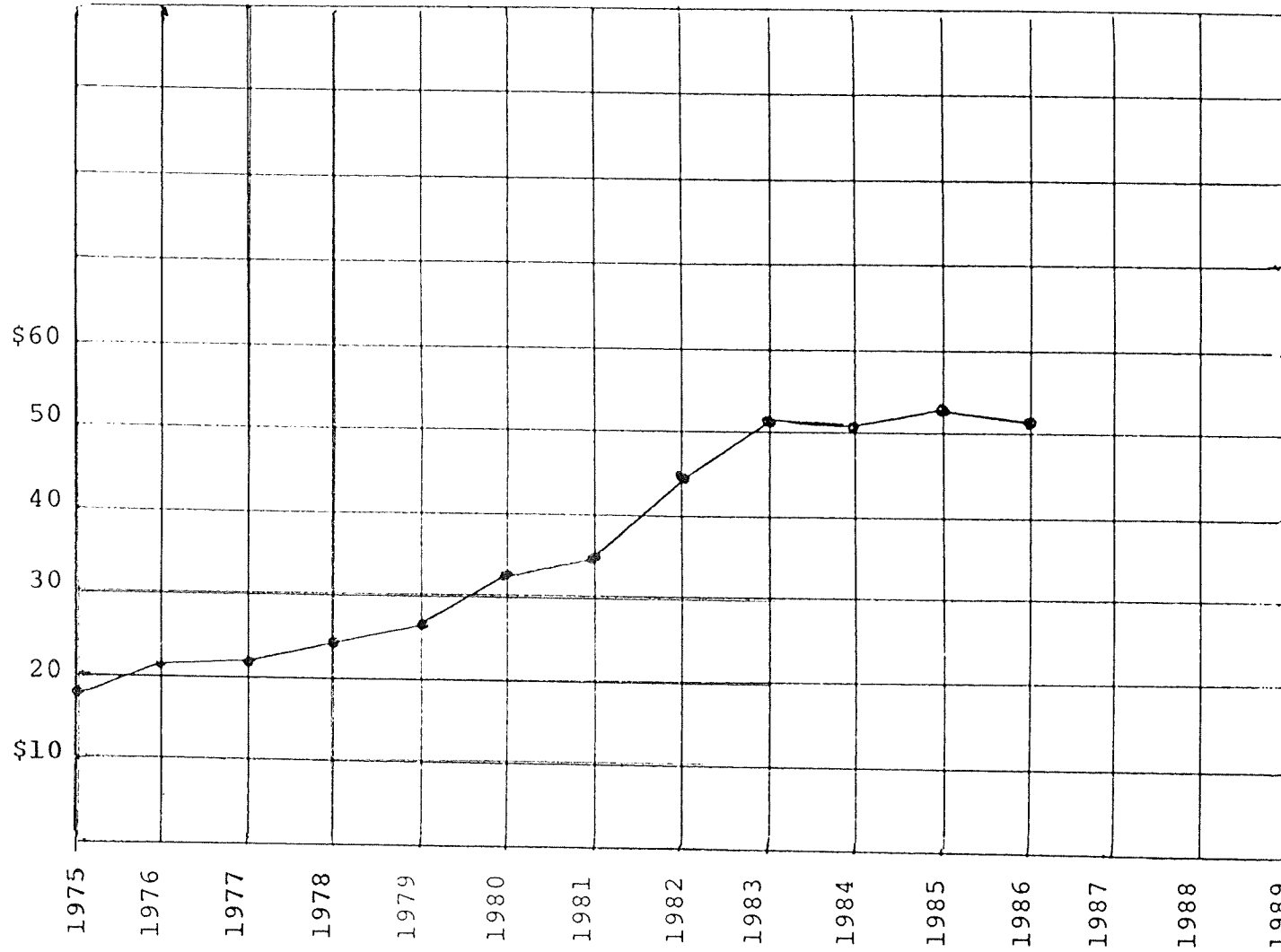
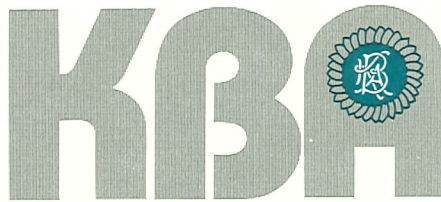


EXHIBIT NO. IV



The KANSAS BANKERS ASSOCIATION
A Full Service Banking Association

March 24, 1988

TO: House Committee on Commercial and Financial Institutions
FROM: James S. Maag, Director of Research
Kansas Bankers Association
RE: SB 507 - Amendments to the Uniform Consumer Credit Code

Mr. Chairman and Members of the Committee:

Thank you for the opportunity to appear before the committee in support of SB 507. This bill makes several significant amendments to the Uniform Consumer Credit Code and we would like to share with you the reasons why we believe these changes are necessary.

The proposed amendments in Section 1 to K.S.A. 16a-2-201 do not directly impact our industry, but we do believe these amendments create a more equitable finance charge structure for those involved in open and closed-end credit sales. Without these changes, any significant increase in inflation will make the extension of credit under the provisions of this section much more difficult.

We strongly endorse the proposed amendments to the Code in Sections 2 and 3 of the bill. First, since the origination fee currently allowed by the Code is in addition to the finance charge, we believe it makes the Code easier to understand by removing the origination fee reference from K.S.A. 16a-2-401 and placing it in K.S.A. 16a-2-501 since that is the section dealing with other exceptions to the finance charge. Secondly, we believe the extension of the origination fee to all consumer loans - not just those secured by real estate - is a positive move toward greater credit availability. Currently many banks do not or are reluctant to make small loans because the finance charge alone is simply insufficient to cover the

Atch 5

costs of processing the loan. A functional cost analysis done by the Federal Reserve System in 1983 on the instalment loans made by 608 banks throughout the country showed that the cost to a bank for putting a loan on the books ranged from \$69 to \$92. Obviously that cost would be even higher today given the amount of inflation which as occurred in the past six years. The greater availability of a nonrefundable fee would be a strong incentive for creditors to seriously consider making smaller loans to a wider range of customers. We have no objection to the maximum placed on this fee by the House committee.

The amendment to K.S.A. 16a-2-502 contained in Section 4 of the bill is of particular interest to our industry. The maximum amount which a creditor may collect for a delinquency charge when a loan installment has not been paid within 10 days of the due date is \$2.50. This maximum charge has been part of Kansas law for over thirty years and due to the sizeable amount of inflation which has occurred in that time period it no longer constitutes a meaningful charge. In fact, given the average size of an installment loan today it gives the delinquent customer a better effective rate on the loan than customers making prompt payment.

Since creditors have no way of forcing the delinquent customer to bear a higher per cent of the burden for servicing the delinquency, it means those costs impact the other end of the loan process in the form of higher finance charges or fees which affect all customers - good and delinquent alike. We strongly believe it is time to update this section of the Code to more accurately reflect the inflation which has occurred.

Some committee members will recall the extensive interim study conducted on the UCCC in the summer of 1983. During the interim committee's deliberations one of the Commissioners for the Uniform Code, Professor Fred Miller of the University of Oklahoma, made the following comments to the committee about the delinquency charge section of the Kansas UCCC:

"Not only is the \$2.50 figure in 2-502 below the \$5 of the U3C but this figure is tied to the dollar adjustment section [of the U3C] and in Oklahoma, for example, it is now \$10.50. Given larger credit amounts, the limitation should be modernized.[emphasis added]"

The interim committee ultimately decided to increase the maximum delinquency charge from \$2.50 to \$10.00 and made that recommendation in SB 472 which was introduced during the 1984 legislative session.

While the current \$2.50 maximum charge applies only to precomputed consumer transactions we also believe the delinquency charge should be extended to all consumer transactions. The ability to apply the delinquency charge to a simple interest transaction would definitely place the burden of cost for servicing delinquent loans on the delinquent customer and could have a positive impact on the finance charge available to all customers. Again I would like to quote from Professor Miller's comments to the 1983 interim committee:

"Also the U3C provision [on delinquency charges] was drawn looking only at yield. That is, a payment out longer in a precomputed transaction would lower yield unless an extra charge was allowed. Today the most serious impact may be the extra cost involved with delinquency. Thus some thought might be given to allowing delinquency charges across the board." [emphasis added]

Therefore, we would request that the committee endorse the extension of the delinquency charge to all consumer credit transactions.

Section 6 of SB 507 amends the UCCC also by repealing the provisions in K.S.A. 16a-2-510 which allows the use of the "Rule of 78s" in calculating the refund of precomputed finance charges. The statute is then amended to require that the unearned portion of the finance charge must be calculated according to the actuarial method. This section was added by the Senate FI&I Committee after the Senate Judiciary had recommended the passage of SB 443 which also repealed the use of the Rule of 78s. The Senate committees considered the Rule to constitute a "hidden finance charge" which is not understood by the average consumer. While the repeal of the Rule will result in a reduction of income to creditors, proponents argued that the 3% origination fee provided for in Section 4 would offset the loss of income caused by the repeal of the Rule of 78s.

We appreciate your consideration of these important amendments to the Code and we strongly urge you to give favorable consideration to S507.

Pay't No.	Interest	Reduction of Debt	Total Pay't
1	\$ 28.13	\$ 186.87	\$ 215.00
2	26.25	188.75	215.00
3	24.37	190.63	215.00
4	22.50	192.50	215.00
5	20.63	194.37	215.00
6	18.75	196.25	215.00
7	16.87	198.13	215.00
8	15.00	200.00	215.00
9	13.13	201.87	215.00
10	11.25	203.75	215.00
11	9.37	205.63	215.00
12	7.50	207.50	215.00
13	5.63	209.37	215.00
14	3.75	211.25	215.00
15	1.87	213.13	215.00
	\$225.00	\$3,000.00	\$3,225.00

How Much Is the Rebate?

Now let's assume Ann and Dan want to pay off the loan with the fifth payment. We know the total interest is divided into 120 parts. To find out how many parts will be rebated, we add up the digits for the remaining 10 installments which will be prepaid:

$$\frac{10}{2} \times (10+1) = 5 \times 11 = 55$$

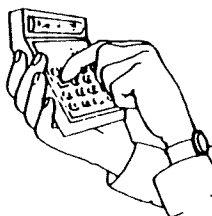
Now we know that 55/120's of the interest will be deducted as a rebate; it amounts to \$103.12.

$$\frac{55}{120} \times \$225 = \frac{12375}{120} = \$103.12$$

We see that Ann and Dan do not save two-thirds of the interest (which would be \$150.00) by paying off the loan in

one-third of the time. But the earlier they repay the loan the higher the percentage of interest they do save.

Check It Out



Perhaps you would like to try using The Rule of 78's. Here is a problem for you. Assume that Ann and Dan pay off their loan at Second Street National Bank with the eleventh payment. How much interest will they save? Remember that the interest over 15 months is divided into 120 parts, and you need to know the number of payments that will be prepaid. Fill in the blanks.

$$\frac{N}{2} \times (N+1) = \frac{\quad}{2} \times (\quad+1) = \quad \times \quad = \quad$$

Now multiply the rebate fraction by the total amount of interest on the loan:

$$\frac{\quad}{\quad} \times \$ \quad = \$ \quad \text{rebate}$$

Your answers should be as follows:

$$\frac{4}{2} \times (4+1) = 2 \times 5 = 10$$

$$\frac{10}{120} \times \$225 = \frac{2250}{120} = \$18.75$$

Other pamphlets available include:

How to Establish and Use Credit

Your Credit Rating

How the New Equal Credit Opportunity Act Affects You

The Equal Credit Opportunity Act and...Age

The Equal Credit Opportunity Act and...Women

The Equal Credit Opportunity Act and...Doctors, Lawyers, Small Retailers

The Equal Credit Opportunity Act and...Credit Rights in Housing

Fair Credit Billing

Truth in Leasing

The Fair Debt Collection Practices Act

If You Use a Credit Card

For further information or copies of pamphlets, you may write or call:

Department of Consumer Affairs
Federal Reserve Bank of Philadelphia
P. O. Box 66
Philadelphia, Pennsylvania 19105

Telephone (215) 574-6116

Rev. 4-79

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THE RULE OF 78's

or

What May Happen When You Pay Off a Loan Early

DEPARTMENT OF
CONSUMER AFFAIRS
FEDERAL RESERVE BANK
OF PHILADELPHIA

When you borrow from a bank or other lender, you usually arrange to repay the loan with interest by a specific date in a number of equal installments.

Repaying It Early

But after several payments, you may decide to repay the entire loan earlier than originally scheduled. You ask the creditor for a payoff figure. You may be disappointed to learn that the balance due is higher than you anticipated.

Why is it higher? Perhaps because you thought the interest on the amount borrowed was divided evenly over the number of payments you agreed to make. Thus, you may have believed that if you paid the loan in 10 months instead of 30 you would owe only one-third as much interest.

This is not the way creditors compute interest, however.

The Rule of 78's

Creditors use tables based on a mathematical formula called "The Rule of 78's" - or sometimes "The Sum of the Digits" - to determine how much interest you have paid at any point in a loan. This formula takes into consideration the fact that you pay more interest in the beginning of a loan when you have the use of more of the money, and you pay less and less interest as the debt is reduced. Because each payment is the same size, the part going to pay back the amount borrowed increases as the part representing interest decreases.



When you decide to pay off a loan early, the creditor uses The Rule of 78's to determine your "rebate" - the portion of the total interest charge you won't have to pay.

The Rule is recognized as a practical way to calculate rebates of interest. There are other methods, but this one is widely used, and it is reflected in a number of state lending laws.

Reminders

The final payoff figure on your loan depends primarily on the original time to maturity, but it may be affected by other factors, such as variances in the payment schedule or a lag between the date of calculation and the date of payment.

Keep in mind that paying off a loan in, say, 15 months instead of 30 as originally planned will not produce a saving of one-half of the interest.

You may, however, be entitled to a rebate of certain other charges when you prepay a loan, such as part of a premium for credit insurance.

Finally, the Truth in Lending law requires that your creditor disclose how interest will be computed if you pay the debt in full before maturity. Look for the prepayment disclosure before you sign a loan agreement. Ask for an explanation of anything you do not understand.

HOW TO USE THE RULE OF 78's

The first step is to add up all the digits for the number of payments scheduled to be made. For a 12-installment loan, add the digits from 1 through 12:

$$1+2+3+4+5+6+7+8+9+10+11+12 = 78$$

The answer is "the sum of the digits" and explains how the rule was named. One might say the total interest is divided into 78 parts for payment over the term of the loan.

To add all the numbers in a series of payments is rather tedious. One can arrive at the answer quickly by using this formula:

$$\frac{N}{2} \times (N+1)$$

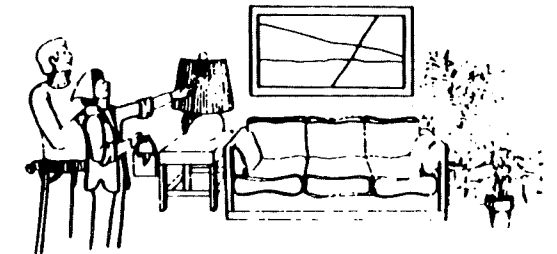
N is the number of payments. In a 12-month loan, it looks like this:

$$\frac{12}{2} \times (12+1) = 6 \times 13 = 78$$

In the first month, before making any payments, the borrower has the use of the whole amount borrowed and therefore pays 12/78's of the total interest in the first payment; in the second month, he still has the use of 11 parts of the loan and pays 11/78's of the interest; in the third, 10/78's; and so on down to the final installment, 1/78.

A Loan for Ann and Dan

Let us suppose that Ann and Dan Adams borrow \$3,000 from the Second Street National Bank to redecorate their home. Interest comes to \$225, and the total of \$3,225 is to be paid in 15 equal installments of \$215.



Using the Rule of 78's, we can determine how much of each installment represents interest. We add all the digits from 1 through 15:

$$\frac{15}{2} \times (15+1) = 7.5 \times 16 = 120$$

The first payment will include 15 parts of the total interest, or 15/120's; the second, 14/120's; and so on.

Notice in the following table that the interest decreases with each payment and the repayment of the amount borrowed increases with each payment.

I move to amend SB 507 as amended by the Senate Committee of the Whole on page 10 by striking the period in line 364 and inserting after the word "method" the following: "on all consumer credit transactions made on and after July 1, 1988."

Bill Graves
Secretary of State



2nd Floor, State Capitol
Topeka, KS 66612-1594
(913) 296-2236

STATE OF KANSAS

HOUSE COMMERCIAL AND FINANCIAL INSTITUTIONS

House Bill No. 3090

March 24, 1988

House Bill 3090 would give this office and the Registers of Deeds flexibility to provide Uniform Commercial Code information using modern methods of information transfer. Fees for services could include the cost of establishing and maintaining the information system.

This office now has the technology and equipment to communicate with other data processing systems, including the IBM System 36 computers acquired by the counties for reappraisal. This bill would authorize us to provide direct access to Registers of Deeds, ASCS offices, and private groups or individuals.

Fees would be charged based upon the total cost of maintaining the system. This would permit the cost of collecting, entering, verifying and indexing data to be recovered and deposited into the Uniform Commercial Code fee fund.

In the short term, we would be able to increase the amount of money that counties can keep when conducting telecopier searches and negotiate with ASCS to provide access that would ultimately aid farmers obtaining commodity loans.

In the long term, this bill would enable us to provide information services using the appropriate methods to meet the changing needs of the customers.

We request that the committee report House Bill 3090 favorably for passage.

John R. Wine, Jr.
Assistant Secretary of State

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Further amend S.B. 535, as amended by Senate Committee as follows:

In line 17, by inserting after the word "agreements" the phrase "of financial institutions";

In line 21, by inserting after the word "agreement" the phrase "by a financial institution";

In line 24, by striking the words "person who" and inserting in lieu thereof the words "financial institution which";

In lines 28 and 29, by striking the word "creditor" and inserting in lieu thereof the words "financial institution";

Following line 29, by inserting the following: "(d) 'financial institution' includes a bank, savings and loan association, savings bank, and credit union."

STATE OF KANSAS



OFFICE OF THE SECURITIES COMMISSIONER

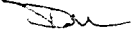
Landon State Office Building
900 Southwest Jackson St., Suite 552
Topeka, Ks 66612-1220
(913) 296-3307

Mike Hayden,
Governor

M. Douglas Mays
Securities Commissioner

M E M O

TO: Committee Members

FROM: M. Douglas Mays 
Kansas Securities Commissioner

DATE: March 24, 1988

RE: Senate Bill No. 675 -- Loan Brokers Act

The following are suggested amendments to SB 675.

Sec. 6(b)(8) -- line 138 insert:

"compiled in accordance with generally accepted accounting principals by a certified or independent public accountant;"

Sec. 16(a) -- lines 382 - 384 strike:

"[or any independent public accountant engaged in the practice of public accountancy as defined in K.A.R. 74-5-2(g)];"

and insert:

"or any independent public accountant engaged in the practice of public accounting whose service in relation to procurement of a loan is incidental to their practice."

MDM:dec

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