Approved 3/26/90
Date

MINUTES OF THE SENATE COMMITTEE ON FINANCIAL INSTITUTIONS AND INSURANCE.

The meeting was called to order by SENATOR RICHARD L. BOND at
Chairperson

9:00 a.m./~~p.m.~~ on THURSDAY, MARCH 22, 1990 in room 529-S of the Capitol.

All members ~~were~~ present ~~except~~:

Senators Anderson, Karr, Kerr, Moran, Reilly, Salisbury, and Strick.

Committee staff present:
Bill Edds, Revisors Office
Bill Wolff, Research Dept.
Louise Bobo, Committee Secretary

Conferees appearing before the committee:
Grant Brooks, Kansas Banking Department

Chairman Bond called the meeting to order at 9:10 a.m.

HB 2994 - Transmission of money, telegraph companies.

Grant Brooks, Kansas Banking Department, addressed the committee in support of this bill. He explained that, under current law, telegraph companies are exempt from meeting the financial responsibilities imposed upon persons engaged in the transmission of money. (Attachment 1)

Discussion followed with a committee member inquiring if we were effectively putting Western Union out of business because of their inability to declare a net worth of $100,000. Mr. Brooks also stated that under this proposal, Western Union would no longer be able to wire money if they did not meet the financial criteria. He was asked if Kansans had money at risk today and he replied that Western Union continued to send money by wire. Senator Reilly suggested making publication in the Kansas Register the effective date of the bill. Mr. Brooks agreed.

Senator Reilly made a motion to amend the bill by making the effective date of the bill its publication in the Kansas Register. Senator Parrish seconded the motion. The motion carried.

Senator Kerr made a motion to move the bill out of committee favorably as amended. Senator Reilly seconded the motion. The motion carried.

HB 2995 - Banking: revocation of trust authority.

Grant Brooks explained to the committee that this bill would give the State Bank Commissioner the authority to revoke a bank's permit to operate a trust department only if the bank is failing to adhere to sound fiduciary practices. He further stated that the present statute has no provision for the revocation of trust authority. (Attachment 2)

Discussion followed Mr. Brook's testimony with distinction being made between a trust department of a bank and a free-standing trust company. Mr. Brooks said that another statute applied to free-standing trust companies. Mr. Brooks also informed the committee that, at the present time, the statute allowed the Bank Commissioner to grant authority to operate a trust department but not the authority to cease it. He said that this bill would only apply to state chartered banks.

Senator Reilly made a motion to amend the bill by giving the Commissioner the authority to revoke any entity that has trust authority. Senator Karr seconded the motion. The motion carried.

Senator Karr made a motion to pass HB 2995, as amended, out of committee favorably. Senator Reilly seconded the motion. The motion carried.

CONTINUATION SHEET

MINUTES OF THE SENATE COMMITTEE ON FINANCIAL INSTITUTIONS AND INSURANCE,

room 529-S, Statehouse, at 9:00 a.m./p.m. on THURSDAY, MARCH 22, 1990

HB 2992 - Banking: limitations on loans.

Chairman Bond requested Staff to brief the committee on this bill. Staff informed the committee that the main thrust of this proposal was to exclude limited partners from liability. The bill would also allow bank officers to borrow more money than they presently can. Staff explained that the third change in the bill was the codification of the Department's policy of determining the length of the loan under the lending limit. Jim Maag, Kansas Bankers Association, told the committee that Charles Henson, Legal Counsel for KBA, had a technical amendment to the bill. The Chairman announced that HB 2992 would have a hearing on Friday, March 23, 1990.

Minutes of Tuesday, March 20, 1990 were approved on a motion by Senator Salisbury with Senator Reilly seconded the motion. The motion carried.

Chairman Bond adjourned the meeting at 9:56 a.m.

GUEST LIST

COMMITTEE: FINANCIAL INSTITUTIONS & INSURANCE COMMITTEE DATE: Thurs. Mar. 22 1990

NAME (PLEASE PRINT)	ADDRESS	COMPANY/ORGANIZATION
Grant Brooks	Topeka	K.S. Banking Dept
Martin Hawver		Cap-Journ
Bill Dean		
John Peterson		
Jim Maag		

Testimony

Before

The Senate Committee on Financial

Institutions and Insurance

by Conferee:

Grant L.C. Brooks, General Counsel

Kansas Banking Department

House Bill 2994

This bill amends K.S.A. 9-511 which concerns the licensing requirements for the transmission of money.

The Transmission of Money Act (K.S.A. 9-508 to 513) regulates all entities that engage in the business of transmitting money: usually by money order or wire service.

The act requires before any person starts a money order business, they must have a net worth of at least $100,000 and file a surety bond of a minimum of $50,000 with the Bank Commissioner.

The logic being if a money order company goes bankrupt, at least the Commissioner will have a surety bond to cover a majority, if not all, of the money orders issued in Kansas.

It is amazing to realize that 25 percent of all United States' households do not have checking accounts. Instead, a majority of them rely on money order companies to pay bills and for their savings. Unfortunately, the majority of money order users are low income households; the one who can least afford to lose money if the money order company becomes insolvent, and all the outstanding orders become worthless.

K.S.A. 9-511 exempts certain institutions from the surety bond and net worth requirements. This statute exempts financial institutions: banks, savings associations and credit unions, and also telegraph companies that wire money from one agent to another, for you to pick up.

There is only one telegraph company, Western Union, that is operating under this exemption. Western Union has approximately, 196 agents in Kansas engaged in "telegraphing money."

Attachment 1
FI & I
3/22/90

S.O.S.

Western Union, Saved By a Junk-Bond Deal, Needs Rescuing Again

Interest of 19¼% and a Plunge In Telex Business Batter Investor Bennett LeBow

Those Pesky Fax Machines

By JANET GUYON
Staff Reporter of THE WALL STREET JOURNAL

UPPER SADDLE RIVER, N.J.—It was Christmas Eve, 1987, but at Western Union Corp. there was little cheer.

The petition was drafted, employee mailgrams readied, and a press release written. Western Union was about to file under Chapter 11 of the federal bankruptcy laws.

At the eleventh hour, the venerable communications firm got a reprieve. Balking bondholders finally accepted a complex refinancing plan that put New York investor Bennett S. LeBow, a client of Drexel Burnham Lambert, in control. "Life was breathed back into the patient," recalls one Western Union executive.

For a while, anyway. Less than two years later, the company whose name once meant American innovation is again gasping for air. Mr. LeBow's plan of salvation, sponsored by Drexel, has backfired. And for the fourth time in as many years, Western Union is begging creditors: Keep us alive a little bit longer.

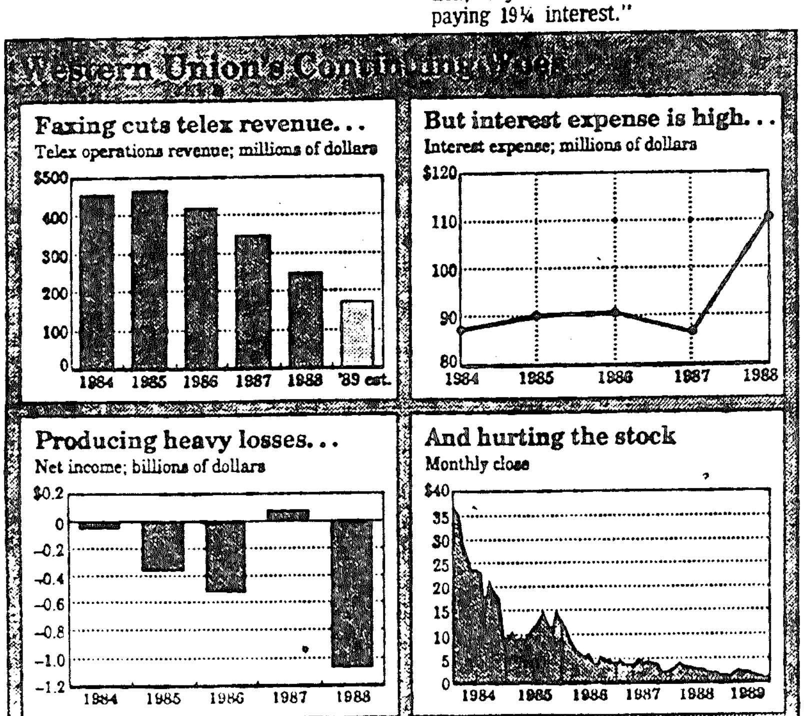

Bennett S. LeBow

Western Union now has a negative net worth of $766 million. Including pension liabilities, it has $1 billion of long-term debt—but cash flow of only $70 million. Its telex business is in a breathtaking decline, devastated by facsimile. A company that some Wall Streeters thought a takeover candidate at $30 a share 5½ years ago closed on the Big Board yesterday at $1.

The bane of Western Union just now is a $500 million junk-bond offering that Drexel underwrote as part of the plan that gave control to Brooke Partners, which is 65% owned by Mr. LeBow and partner William Weksel. Its interest is adjustable, and in June it leapt to 19¼%.

Time for a Change

"Look, the company has got to be restructured," says Mr. LeBow, sitting in the massive boardroom at his Manhattan-based management company, LeBow, Weksel & Co. This summer the 51-year-old financier proposed swapping the bonds for notes, and rearranging things so the money-transfer business could be used as collateral for bank loans. Then came the turmoil in the junk-bond market. That "is going to make us rethink that transaction," says Mr. LeBow. "But we can't keep paying 19¼ interest."



Western Union's chief financial officer, Stewart Paperin, is more emphatic. If the company can't refinance the bonds and lower its interest payments, he says, "we'll be in nuclear meltdown."

The Western Union story is about a company that played ostrich while technological and regulatory changes fundamentally altered its business. Its current predicament suggests how even the sharpest financial minds—those of Mr. LeBow and his Drexel partners—can stumble in the face of a revolution in technology. The question now is, can these turnaround/takeover specialists—having seen Western Union from the inside—revise their strategies, persuade their creditors, and ultimately get the company back on its feet?

Hanging Up

Western Union's troubles grew out of a parochial mind-set that dates back 113 years. Then a high-tech giant sending messages by Morse code, the company turned down rights to the telephone, telling Alexander Graham Bell that sending voice over wire would never replace telegraph, particularly for business communication. Mr. Bell instead sold his rights to the predecessor company of American Telephone & Telegraph Co.

AT&T went on to become the biggest corporation in the world, before the 1984 Bell System break-up. Western Union, through the mid-1970s, managed under protective regulation to carve out a profitable niche sending written messages by wire through its telex network and through another, similar business called TWX, acquired from AT&T in the mid-1970s.

Then, management seemingly panicked. Responding to competition stirred by new technology and deregulation of the telecommunications industry, Western Union embarked on a series of diversions. But unable to decide where to place its bets, it tried everything: cellular-phone manufacturing, satellite launching, airplane phone service, electronic mail, long-distance telephone. To pay for its gambles, the company took on debt, layering on 10 issues of bonds and nine of preferred stock by 1986.

"We made some fundamental mistakes," says Theodore Kheel, the New York labor lawyer, who was a director until Mr. LeBow took over. "We went into a number of tangential acquisitions instead of thinking how to be a competitor in the communications business. Then we fell too far behind the communications leaders and didn't have access to the funds to catch up."

Since 1984, the company has never been far from crisis. That year, banks pulled their credit lines, and the company had three different chairmen in six months. Soon, it was trying to sell itself, hiring Drexel to help. When that didn't work, it proposed a recapitalization, but preferred shareholders wouldn't have it. While the banks held off for fear of forcing the company into bankruptcy proceedings, Drexel banker Paul Levy kept trying to find someone to put in some money.

1-2

Gary Winnick, a former Drexel senior vice president, agreed to do so. A plan was devised that would give him control. But Mr. Winnick had trouble finding operating management. Enter Mr. LeBow, then a little-known turnaround artist, who had earlier spurned Drexel's entreaties. This time, where every other big deal maker saw a tar baby, Mr. LeBow thought he saw opportunity.

He had been buying companies, such as cigarette maker Liggett Group Inc., that were in declining markets but could be combined with competitors to generate high cash flow. Was telex such a business? Both Mr. LeBow and an associate, former Bunker Ramo Corp. president Robert Amman, thought telex was ripe for consolidation. Mr. LeBow already had an option to buy ITT Corp.'s telex business for about $144.5 million.

"We felt we could buy two telex companies, put them together and make it a very profitable business," says Mr. Amman, now Western Union's president. "We would use the cash to build other businesses" that had greater growth prospects, such as money-transfer and electronic mail.

Robert Amman

Mr. LeBow, through borrowings of Brooke Partners, put up a minimum amount of cash—$25 million—for a 63% controlling equity stake that, once Western Union returns to profitability, gives him rights to 79.4 million newly issued common shares. To satisfy Mr. Winnick and his partners, Mr. LeBow granted the Winnick group options on nine million of his Western Union shares for 25 cents a share—which is about the same price Mr. LeBow paid for his stake in the company's common equity. Western Union also paid the Winnick group $8.1 million in fees and expenses.

Proxy Fight

Then came six arduous months of negotiating with bondholders, banks and preferred stockholders for repayment of debt at a discount and a swapping of securities. One dissident stockholder launched a proxy fight, which was settled only when Mr. LeBow's group agreed to put him on the board. To get 70% of the bondholders to exchange, Western Union agreed to pay them a one-time cash sweetener of $20 million.

By the time the company had sweetened the pot for various constituencies, its annual carrying costs in interest and dividends had risen to $148 million, up $44 million from the original LeBow plan of May 1987.

And more danger lay ahead. The plan included a $500 million junk-bond offering to pay off the banks and buy ITT's business. But to sell the bonds to its clients, Drexel insisted the terms provide that interest could be reset twice by investment bankers. For its work in 1987, Drexel collected $25 million in fees and underwriting commissions.

Mr. LeBow planned to oust current management once he got control, but, to gain the cooperation of Western Union's three top officers, he agreed to employment contracts totaling $850,000 in annual salaries. All three have since left, but are still drawing their pay. Robert Leventhal, the former chairman, is currently dean of the business school at the University of Washington in Seattle. He is in the second year of a five-year, $400,000-a-year consulting contract.

Mr. Amman and Mr. LeBow figured that costs saved by combining the telex businesses of Western Union and ITT would generate an extra $100 million in cash a year. Unwanted assets, such as satellite and long-distance businesses, would be sold, cutting operating losses as well as overhead.

But, just as the telephone had blindsided Western Union 100 years ago, facsimile machines blind-sided Mr. LeBow. Customers who routinely used telex began converting to fax in droves as fax machine prices plunged and the number of them in use reached "critical mass." Telex revenue, which had been declining 6% a year, started dropping at a 35%-to-40% rate. Western Union's total revenue of $875.9 million last year fell 14% from 1987 and was some $100 million less than originally anticipated.

In addition, the telex debacle forced Western Union to write off $80 million in good will associated with the ITT telex purchase. A new Western Union telex network built only nine years ago was junked, pushing total write-offs last year to over $1 billion.

"In my career, I have never seen a market of this size decline at such rates," says Peter S. Anderson, who was hired as senior vice president of Western Union's business-services division seven months ago. "Everybody was surprised that the rate of decline kept increasing." (In April, Western Union told investors it expected telex revenue to plunge to $172 million in 1989 from $250 million last year, but now it calls the April projection "optimistic.")

Thus Mr. LeBow hasn't been able to achieve the hoped-for cash-flow boost, despite replacing 75% of management, firing and retiring 2,800 employees, selling most of Western Union's telecommunications assets and cutting $134 million in annual operating costs. Last November, the company put up its first distress signal: Directors omitted preferred dividend payments—on securities issued just a year earlier.

Interest Rises

By June, the sorry state of the business caused interest on the junk bonds to be reset to 19¼% from 16½%, increasing the company's annual interest payments by $13.8 million. Terms required interest be reset to give them a market value of 101% of their principal amount. After the reset, the bonds held at a price of 92 to 93, but they started plunging soon afterwards, weakening with the rest of the junk market this fall. Yesterday they closed at 62½.

Mr. LeBow has continued tinkering with the package of notes he hopes to swap for the junk bonds. But if it isn't attractive enough and bondholders won't exchange, Western Union will be forced to start repurchasing the bonds in $100 million chunks sometime next year. So, "if this current exchange doesn't go through, clearly there will have to be a son-of-exchange offer," says Mr. Paperin.

And now, the company says it is looking at alternatives to an exchange offer because of the turmoil in the junk-bond market and the long time the Securities and Exchange Commission has taken to review its proposed swap.

Mr. LeBow and his group say Western Union isn't close to a bankruptcy filing. At the moment, Brooke Partners' investment in Western Union's preferred shares and some junk bonds is worth less than it cost ($46 million), and Mr. LeBow concedes that "those were dumb investments." But he says he never expected a quick payout.

"I don't think Western Union is distressed, though people disagree with that," Mr. LeBow declares. "Obviously we are disappointed about the decline in telex, but everything else, including the management team, is working well."

Cash on Hand

The company expects to end the year with $70 million in cash, although net fixed charges of $95 million this year will exceed operating cash flow by $15 million to $20 million. Mr. Anderson says he expects the decline in telex revenue to be made up by revenue from the electronic mail service, called EasyLink, and other business services by the third quarter of next year, with operating earnings in his division hitting bottom in this year's third quarter.

Meantime, Mr. Amman has a new destiny for Western Union: financial services for the 25% of U.S. households that don't have checking accounts. The company currently moves about $3 billion a year through its money-transfer network, mostly from poor and lower-middle-class neighborhoods. Despite the financial distresses of the past five years, people still entrust the company with their cash, says Mr. Amman, although those money transfers aren't insured. Western Union recently bought National Payments Network, which collects bills for utilities from people who pay in person.

Western Union isn't the only one to think of these opportunities, of course. It is up against AT&T, MCI Communications Corp. and US Sprint Communications Co. in electronic mail, and must compete with American Express in money transfer. And Western Union in the past, under different management, has sketched itself a new destiny only to be outdone by sudden changes in technology and competition.

Still, Mr. LeBow professes great faith in Western Union. Turning it around, he says, will just take a bit longer, perhaps until 1993. "If telex had held to our original assumptions," says Mr. Amman, "the turnaround of this company would have been a slam dunk. But the game only runs out when you run out of money."

1-3

Western Union is basically insolvent. (See, The Wall Street Journal, October 13, 1989). They had an operating loss of $15 to $20 million dollars last year. Western Union moves approximately $3 billion dollars a year through its money transfer network. It takes about 15 minutes to 2 hours for a wire transfer.

If Western Union went bankrupt, there would be Kansas citizens that would have money in transit that would be lost because thereis no bond posted to cover the money transfers.

Therefore, this bill deletes the telegraph exemption from the licensing requirements and will require all telegraph companies to post a bond as security for the wire transfers.

House Bill 2995

This bill amends K.S.A. 9-1602 which allows the State Bank Commissioner discretion in granting trust authority to a bank. This statute has no provision for the revocation of trust authority.

The amendments give the State Bank Commissioner the authority to revoke a bank's permit to operate a trust department only upon finding the bank is failing to adhere to sound fiduciary practices. The proposed language provides any bank, subject to revocation, the right to a hearing pursuant to the Kansas Administrative Procedures Act.

Attachment 2
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