Approved 2/19/92
Date

MINUTES OF THE SENATE COMMITTEE ON FINANCIAL INSTITUTIONS AND INSURANCE.

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

9:13 a.m./p.m. on Tuesday, February 18, 1992 in room 529-S of the Capitol.

All members were present except:

Committee staff present:

Fred Carman, Revisor
Bill Wolff, Research
June Kossover, Secretary

Conferees appearing before the committee:

Stan Lind, Kansas Association of Financial Services
Jim Maag, Kansas Bankers Association
Brad Bergman, Johnson County National Bank
Kathy Stover, Attorney, Kansas Banking Department
Dick Brock, State Insurance Department

The committee was called to order by Chairman Bond at 9:13 a.m.

Stan Lind, Kansas Association of Financial Services, appeared before the committee to request introduction of a bill which would permit annual or other periodic fees payable in advance on open-end line of credit consumer loan contracts. (Attachment #1.) A motion was made by Senator Salisbury and seconded by Senator Strick to introduce this bill. The motion carried.

The Chairman opened hearings on **SB 510**, concerning certain investments by banks and trust companies. Jim Maag, Kansas Bankers Association, advised the committee that the State Affairs Committee of the KBA requested introduction of this bill which would enable Trust Divisions to invest their fiduciary assets in mutual funds.

Brad Bergman, Johnson County National Bank, appeared before the committee to testify in favor of **SB 510**. The intent of the bill is to provide trust services in an economical manner to Kansas consumers by allowing a trust department to use a mutual fund for which it is also the investment adviser in its trust accounts. (Attachment #2.) In response to Senator Ward's question, Mr. Bergman explained that currently banks can pool money to maximize the return on investments, but this bill would also allow them to have more than one bank in the pool.

Chairman Bond noted that, under current law, banks are not able to invest in their own fund pools for their cash management customers.

Kathy Stover, Attorney and Trust Examiner with the Kansas Banking Department, appeared before the committee in opposition to **SB 510**. (Attachment #3.) Ms. Stover suggested that section (a) of the bill should be stricken entirely as the word "substantially" in line 23 makes the bill objectionable and opens up the opportunity for higher risk investments. Ms. Stover also stated that the Bank Commissioner's office does not understand the need for the bill since banks can collect fees under current law. Chairman Bond requested Ms. Stover and Mr. Bergman to confer to decide if the bill is really necessary and, if so, to develop language that is acceptable to the Bank Commissioner's office. Chairman Bond noted that the committee would be disinclined to pass a bill that the Bank Commissioner objects to. Chairman Bond then declared the hearing on **SB 510** closed.

Unless specifically noted, the individual remarks recorded herein have not been transcribed verbatim. Individual remarks as reported herein have not been submitted to the individuals appearing before the committee for editing or corrections.

CONTINUATION SHEET

MINUTES OF THE SENATE COMMITTEE ON FINANCIAL INSTITUTIONS AND INSURANCE,

room 529-S Statehouse, at 9:13 a.m./p.m. on Tuesday, February 18, 1992.

The Chairman reopened the hearing on **SB 561**, relating to small employers group coverage, by asking for further amendments to the bill. None were forthcoming. Senator Kerr made a motion to move **SB 561** favorably as amended. The motion was seconded by Senator Salisbury.

At Chairman Bond's request, Dick Brock of the State Insurance Department clarified some of the language contained in the bill. A substitute motion was made by Senator Yost and seconded by Senator Parrish to further amend the bill on page 10, line 7, to read, "30% per year for the first three years." The motion carried.

Following discussion regarding the reinsurance mechanism and the mandate exemption contained in the bill, Chairman Bond asked, if the bill passes, when the product would be available. Mr. Brock replied that the rating restrictions would take effect on January 1, 1993, with the product to be available May 1, 1993.

Senator Kerr then moved to pass **SB 561** favorably as amended. The motion was seconded by Senator Salisbury. The motion carried.

Senator Strick moved, seconded by Senator Moran, to approve the minutes of the meeting of February 13 as submitted. The motion carried.

The committee adjourned at 10:03 a.m.

GUEST LIST

SENATE

COMMITTEE: FINANCIAL INSTITUTIONS AND INSURANCE DATE: 2/18/92

NAME	ADDRESS	ORGANIZATION
Jim Maag	Topeka	KBA
Gary Robbins	Topeka	KS Opt Assn
Chuck Stones	"	KBA
Judi Stork	"	KS Banking Dept.
Kathy Stover	Topeka	KS Banking Dept
James A Dabney	Fairway	J.C.Bk.
Kathy Olsen	KS Bankers Assoc	→ Topeka
Bill Sneed	Topeka	NIAA
Stan Lind	KS. Assn. of Financial Services	K.C. Ks.
Cheryl Dillard	Overland Park	Kaiser Permanente
William Yoder		Legis.
TOM PALACE	TOPEKA	SLSI
JEFF SONNICH	TOPEKA	KNLSI
Roland Smith	Wichita	WIBA
Bruce Ratzlaff		INTERN Moran
LISA Getz	WICHITA	KS ASSO FOR SMALL BUSINESS
Meyer L. Goldman	Kansas City	Humana Prime Health
Bill Pitsenberger	Topeka	Blue Cross
Dave Hanson	Topeka	KS LIFE Assoc

KANSAS COMMENT, 1973

See the comment to 16a-2-202. The actual rate ceilings for lender credit card transactions are set forth in 16a-2-401.

Law Review and Bar Journal References:

"The New Kansas Consumer Legislation," Barkley Clark, 42 J.B.A.K. 147, 194 (1973).

16a-2-403. Prohibiting surcharge on credit cards. No seller or lessor in any sales or lease transaction or any company issuing credit cards may impose a surcharge on a holder who elects to use a credit card in lieu of payment by cash, check or similar means. A surcharge is any additional amount imposed at the time of the sales or lease transaction by the merchant, seller or lessor that increases the charge to the buyer or lessee for the privilege of using a credit card.

History: L. 1986, ch. 90, § 2; July 1.

Attorney General's Opinions:

Disclosure; discounts for cash purchases. 86-115.

Part 5

CONSUMER CREDIT TRANSACTIONS; OTHER CHARGES AND MODIFICATIONS

16a-2-501. (UCCC) Additional charges. (1) In addition to the finance charge permitted by the parts of this article on maximum finance charges for consumer credit sales and consumer loans (parts 2 and 4), a creditor may contract for and receive the following additional charges in connection with a consumer credit transaction:

(a) Official fees and taxes;

(b) charges for insurance as described in subsection (2);

(c) annual fees payable in advance or monthly fees, delinquency charges, insufficient check charges as provided in paragraph (e) of this subsection, over-limit fees and cash advance fees, for the privilege of using a lender credit card which entitles the user to purchase goods or services from at least 100 persons not related to the issuer of the lender credit card, under an arrangement pursuant to which the debts resulting from the purchases are payable to the issuer;

annual or other periodic fees payable in advance on open-end line of credit consumer loan contracts, or

(d) charges for other benefits, including insurance, conferred on the consumer, if the benefits are of value to the consumer and if the charges are reasonable in relation to the benefits, are of a type which is not for credit,

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Attachment #1

SENATE BILL 510

Senate Bill 510 is necessary to provide high quality trust investment services to Kansas banks and their customers. Bank trust departments have historically relied upon the usage of common trust funds and pooled income funds as the preferred method for managing trust assets that in an individual account were not large enough to be properly diversified. In addition, it was deemed that a pool of trust account dollars could receive economies of scale through reduced trading costs, greater ease in monitoring securities, etc. However, there are some disadvantages to the usage of common trust funds and pool funds. First, they may only be used for trustee accounts and not for management agency accounts and custodial accounts. Second, each bank wishing to participate in such a fund must create its own set of funds, and they may not share them with other institutions. Third, advertisement of the investment performance in common funds is not allowed under current regulation, so it is difficult for consumers to be aware of differences in bank trust department management performance.

In order to overcome these difficulties, most large banks have created a mutual fund family as an alternative to its common funds. Trust accounts are not charged any additional fees, nor are management fees taken in the mutual fund for trust account, so for a trust customer it works very much like a common trust fund. However, the three limitations mentioned above are all overcome using mutual funds. The Office of the Comptroller of the Currency has taken the position, however, that usage of the mutual fund by the bank trust department that manages the fund can be a conflict of interest unless state law rules otherwise. The trust department cannot make additional fees through the usage of the mutual fund, but even still, it has ruled there is a conflict unless local statute allows it. For this reason, the ABA has sponsored model legislation which has been enacted in many states, including Illinois, Maryland, Nevada, Tennessee, Oklahoma, Missouri, and Colorado. This legislation simply allows a trust department to use a mutual fund for which it is also the investment adviser in its trust accounts. This should provide access to better money management for all trust departments and their customers in the state of Kansas. In other words, if a bank were interested in finding professional management for its agency and custody accounts, or allow other banks to participate in a fund that provides for that, it would be able to do so. The consumer thus has better information to make an enlightened decision and professional money management is available on a wide-spread basis to other trust departments that would wish to participate.

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Attachment #2

Senate Committee on Financial Institutions and Insurance
Senate Bill 510: An Act concerning investments by banks and trust companies
February 18, 1991

Good morning Mr. Chairman and members of the Committee:

My name is Kathy Stover, and I am an attorney and trust examiner with the Kansas Banking Department. I am here today on behalf of Commissioner Frank Dunnick to oppose the adoption of Senate Bill 510.

The bill affects the types of investments permitted by fiduciaries who manage financial assets on behalf of another. As you are aware, the term "fiduciary" carries significant responsibilities under the law, since fiduciaries are held to a higher standard than ordinary investment advisors, pursuant to K.S.A. 17-5004.

This bill permits Kansas banks and trust companies to invest fiduciary assets in open and closed-end mutual funds. At the present time, there are no statutory limitations which restrict such investments under either state or federal law. Banks and trust companies can invest trust assets over which they exercise investment discretion in any mutual fund. However, the bill does attempt to alter fiduciary law in two important ways, which I would suggest are contrary to acceptable standards of fiduciary law.

First, let me address section (a) of the bill. It permits banks and trust companies to invest in closed and open end mutual funds "so long as the portfolio of such investment company or investment trust consists substantially in investments not prohibited by the governing instrument." This language appears to suggest that, even if a trust agreement specifically prohibited an investment, the bank or trust company could purchase that investment, as long as a majority of the investments in that portfolio were not prohibited.

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Attachment #3

To illustrate, let's assume a trust customer signs a fiduciary contract with a bank, but the agreement prohibits any investment in "junk bonds." Under this bill, the bank would have the right to invest the customer's funds in junk bonds, even though he had instructed otherwise, as long as the portfolio isn't substantially invested in junk bonds. In effect, the bill provides the bank with legislative authority to breach the trust, by investing in items specifically prohibited by the governing instrument.

Trust customers in the State of Kansas have the right to restrict fiduciary investments, and financial institutions should not have the ability to legally breach these contractual agreements. If the bank or trust company does not wish to invest the trust according to the customer's wishes, it should not accept the trust instrument.

The second problem with the bill is contained in Section (b). The Office of the Comptroller of the Currency (OCC) has ruled it is a conflict of interest if a bank invests fiduciary assets in a mutual fund for which it acts as an investment advisor and receives fees for that service. The basis of the OCC's reasoning is this: A trustee owes a duty to beneficiaries to administer the affairs of the trust solely in the interest of beneficiaries, and to refrain from placing itself in a position where other interests may conflict with the interests of beneficiaries. Thus, banks and trust companies who place trust funds under their management should not place themselves in a position where they would benefit from violating a duty of loyalty to the beneficiaries. [See Scott on Trusts, Vol. IIA, Section 170 (Duty of Loyalty)].

A conflict of interest arises when a trustee's duty to make investment decisions exclusively upon the best interests of trust customers is compromised or clouded by a financial reward, such as a fee, which provides a direct financial benefit to the bank.

Here's what the OCC says:

> A conflict of interest arises when... the bank may be tempted to invest discretionary funds in mutual funds in order to provide the minimum investment necessary to warrant the mutual fund's establishment and maintenance and thereby receive an advisory fee with respect to non-discretionary funds. Moreover, a bank may be influenced to invest discretionary funds as a means of maintaining a contractual arrangement to act as investment advisor. A bank may also be tempted to make or maintain trust investments in the fund under adverse conditions, for example, to provide liquidity to honor redemption requests from non-discretionary customers. (OCC Trust Interpretative Letter No. 558, April 3, 1991.)

This bill does not address any of these potential conflicts.

Under the bill, the bank or trust company can receive a direct financial benefit from serving as both the trustee and investment advisor of the same fiduciary assets. We believe this financial interest clouds the judgment of the financial institution to invest all fiduciary assets in the best interests of the trust customer, and not the financial institution. We suggest that if the bank wishes to receive fees both as an investment advisor and trustee, this arrangement should be lawfully authorized by the terms of the instrument creating the trust relationship, or by court order.

According to our research, not a single state has adopted this bill in its present form. Those states which have partially adopted the language contained in this bill have required the fiduciary to fully disclose all fees to trust customers, based on the premise that the self-dealing and conflicts

of interest aspects of the transaction necessitate full disclosure. Fiduciary principles do not permit "secret" or "hidden" fees, since liability for such action may ensue.

We believe trust customers have the right to know the full amount of fees and expenses charged by the bank or trust company and/or its affiliates, and that failure to provide such information is a breach of the bank's fiduciary duty.

In conclusion, S.B. 510 is a bill which establishes an unsound precedent fiduciary law, both in terms of its ability to breach an existing trust agreement, and the conflict of interest which arises concerning fiduciary fees.