Approved: January 30, 1995
Date

MINUTES OF THE HOUSE COMMITTEE ON FINANCIAL INSTITUTIONS AND INSURANCE.

The meeting was called to order by Chairperson Bill Bryant at 3:30 p.m. on January 23, 1995 in Room 527-S of the Capitol.

All members were present except: Representative Sawyer, Excused

Committee staff present: Bill Wolff, Legislative Research Department
Bruce Kinzie, Revisor of Statutes
Nikki Feuerborn, Committee Secretary

Conferees appearing before the committee: Bill Caton, Commissioner of Consumer Credit
Chuck Stones, Kansas Bankers Association
Janet Chubb, Secretary of State's Office
Carol Beard, Secretary of State's Office
Jeff Sonnich, Kansas, Nebraska, Oklahoma League of Savings

Others attending: See attached list

**Hearing on HB 2068-- UCCC, computation of finance charges, term.**
Bill Caton, Commissioner of the Consumer Credit Department, testified as a proponent of the bill which would delete language in the UCCC which refers to the method of computing finance charges on retail sales contracts and consumer loans (Attachment 1). This language should have been deleted in 1993 amendments which instituted the policy of simple interest which is: outstanding principal balance times the interest rate times the actual days since the last payment divided by 365.

There were no opponents and the Hearing was declared closed.

**Hearing on HB 2080--Banks and trust companies, reproduction of records**
Chuck Stones of the Kansas Bankers Association appeared in support of the bill which would allow banks to destroy hard copies of certain documents which they are now required to keep and use read-only imaging technology by allowing such records to be admissible in court (Attachment 2). The documents in question would be internal and regulatory information. This legislation would change the banking code to agree with the general business statutes which were passed in 1994.

There were no opponents and the hearing was declared closed.

**Hearing on HB 2082--UCC financing statement**
Chuck Stones, Kansas Bankers Association, reported that current laws and regulations now require a bank to determine whether a customer is doing business as a partnership or a sole proprietorship (Attachment 3). This bill addresses the filing of UC-1 forms or financing statements with the Secretary of State. These are used to establish the creditor's rights to collateral used in obtaining a loan. Mr. Stones explained the differences involved in filing either sole proprietorship or partnership papers. Borrowers are required to make the determination regarding the type of ownership. Under current law a legal partnerships may exist even though formal partnership papers do not exist such as in the case of a married couple involved in the same business venture. If a court of law should find that a partnership existed when the bank loaned the money as a sole proprietorship, the bank would not be "perfected" on its loan and would have no access to the collateral in the case of default.

This bill would state that "where married debtors are jointly engaged in business and it is unclear whether a partnership exists, the financing statement may be filed in the names of the individual debtors." The legal definition of partnership would remain unchanged.

Janet Chubb of the Secretary of State's Office introduced Carol Beard. Mrs. Beard stated that their office cross-indexes debtor names on all financing statements, except officers of corporations, whether they are partnerships or sole proprietorships (Attachment 4). No procedural change would be required in their office.

Committee discussion included comments regarding problems in forming regulations determining what constitutes a partnership between married persons and requiring them to be registered with the Secretary of State's office.

No opponents appeared and the Hearing was closed.

**Hearing on HB 2089-- Confidentiality of compliance review documents for financial institutions**

Chuck Stones, Director of Research for the Kansas Bankers Association, stated the bill would allow banks and savings and loans to perform self-evaluations through an internal compliance committee (Attachment 5). Corrections could be made to violations without involving regulatory action. The findings of such an internal audit would remain confidential to the institution involved thus allowing them to make corrections. Such findings would not be discoverable or admissible in evidence in any civil action.

Committee members questioned the right of banking institutions to keep confidential problem areas from the public or regulators. Is it good public policy and does it follow the spirit of the law? Is it the intention of the banks to throw up a shield around the internal compliance committee?

Compliance review committees are strictly voluntary and are oftentimes very costly to the banking institutions. If the findings of such a committee could be used against the institution in litigation, there would be no purpose served in making such evaluations. A violation found and corrected internally is far superior to one found by a regulator.

Jeff Sonnich, Kansas, Nebraska, Oklahoma League of Savings Institutions, stated that it is in the best interest of the institution and public for the institution to be able to review its policies, procedures, and internal controls in an unbiased and straightforward manner without fearing exposure (Attachment 6). Without the protection afforded in the proposed legislature, there is the strong possibility that internal compliance committees could be discontinued which would put directors, officers, and shareholders at financial risk due to penalties imposed for non-compliance.

There were no opponents and the Hearing was closed.

**Action on HB 2069--Banks and trust companies, officers and directors**

This bill amends five sections of the banking code. It deals with the forfeiture of position of officers or directors for charged off or forgiven indebtedness at the bank where they serve in such a position. Other portions of the bill refer to directors owning qualifying shares of stock in the bank, adding "or trust companies" to the current prohibition against an individual who has been convicted of a felony or crime (involving dishonesty or breach of trust) from serving as employee or director, and notification via newspaper of relocation of a bank.

Representative Correll moved to pass the bill favorably. Motion was seconded by Representative Cox. Motion carried.

**Action on HB 2070--Allowing bank commissioner to provide unclaimed property violation information to state treasurer**

Motion carried.Representative Samuelson moved for the favorable passage of the bill. The motion was seconded by Representative Gilbert.

**Action on HB 2073--Banks and trust companies, financial reports**

The Bank Commissioner would have the authority to require certain "call reports" from banks and trust companies and may require their publication in the local newspaper. Each trust company or trust department of a bank would be required to report all assets by December 31 of each year.

Representative Gilbert moved to pass the bill out favorably. Representative Humerickhouse seconded the motion. Motion carried.

Representative Donovan moved for the minutes of the January 18, 1995, meeting to be approved. Representative Wilson seconded the motion. The motion carried.

The meeting was adjourned at 4:45 p.m. The next meeting is scheduled for January 24, 1995.

# HOUSE FINANCIAL INSTITUTIONS AND INSURANCE COMMITTEE GUEST LIST

DATE: 1-23-95

| NAME | REPRESENTING |
|---|---|
| Danielle Noe | KCUA |
| Chuck Stones | KBA |
| Stacey Empson | Hein, Ebert & Weir, Chtd. |
| Carol Beard | Secretary of State |
| Janet Chubb | S.O.S. |
| [signature] | Mid-Am Lumbermens Assn |
| Roger Francke | FFC |
| [signature] | OSBC |
| [signature] | " |
| William Grant Jr. | - OSBC - |
| Pam Somerville | Kansas Auto Dealers Assn |
| John Federico | Pete McGill + Assoc |
| Ben Coates | KPA |
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# KANSAS

Office of CONSUMER CREDIT COMMISSIONER

Bill Graves
*Governor*

Wm. F. Caton
*Commissioner*

## TESTIMONY
## HOUSE BILL 2068
## HOUSE FINANCIAL INSTITUTIONS AND INSURANCE
## JANUARY 23, 1995
## WM. F. CATON

Thank you for the opportunity to present testimony on House Bill 2068. The purpose for introduction of this bill is to delete language in the Kansas Uniform Consumer Credit Code (UCCC) which refers to the method of computing finance charges on retail sales contracts and consumer loans.

During the 1993 Legislature, legislation was passed that discontinued the use of "pre-computed" contracts. Interest on pre-computed contracts was calculated without regard to the date the payment was made; all months had 30 days and the pre-computed amount of interest was added to the principal amount of the loan. If the consumer paid the loan off early, a formula called the "rule of 78ths" was used to refund the unearned interest that was added to the loan. This system of interest computation was obsolete, and although this system was generally fair to the consumer because of "averaging" the interest on payments, it did not reward consumers for early payments nor compensate lenders for late payments. Prepayment early in the contract usually penalized the consumer and some lenders were taking advantage of this by encouraging borrowers to re-write the loan early in its life.

Before I introduced the 1993 legislation, I asked the consumer credit industry to provide me with reasons that pre-computed contracts should continue to be used, and they had no valid reasons. It was the position of this office that the UCCC needed to be updated to disallow pre-computed contracts. The computation of "simple interest" is not complicated and can be computed quickly on a $5 calculator (or even a pencil and paper by most 6th graders). The simple interest formula is: outstanding principal balance times the interest rate times the actual days since the last payment divided by 365. It is absolutely fair to both the borrower and the lender.

The language this bill eliminates should have been deleted in the 1993 amendments, but was inadvertently overlooked. This language is contradictory and needs to be removed. Please consider favorable action on House Bill 2068.

JAYHAWK TOWER, 700 S.W. JACKSON, SUITE 1001 / TOPEKA, KANSAS 66603 / (913) 296-3151

Attachment 1
1-23-95

# The Kansas Bankers Association

800 SW Jackson, Suite 1500
Topeka, KS 66612
913-232-3444 FAX 913-232-3484

1-23-95

TO: House Financial Institutions and Insurance Committee

FROM: Chuck Stones, Director of Research

RE: HB 2080

Mr. Chairman and Members of the Committee,

The Kansas Bankers Association appreciates the opportunity to appear today in support of HB 2080.

State law requires that banks retain certain records for periods of time prescribed by the Bank Commissioner. The retention of these records has been made more cost-efficient with technological advances. HB 2080 would allow banks to use read-only imaging technology by allowing such records to be admissible in court.

Attached is a memo from Bill Grant, General Counsel for the State Banking Department that outlines the reasoning for HB 2080. In essence the memo states that while K.S.A. 9-1130 would allow banks to use read-only imaging, technically a bank could not because such records are not admissible by banks in a court of law. Last year, K.S.A. 60-469 was changed to allow the admissibility of business records using such technology. However, the banking code allows for a specific type of imaging and therefore takes precedent over the general business statute.

We are therefore requesting this change in the banking code which mirrors KSA 60-469 to enable banks to utilize current cost saving technology.

Thank you for your attention and we urge your favorable action.

House FI&I
Attachment 2
1-23-95

# Office of the State Bank Commission
# Memorandum

**EXHIBIT J**

Date: October 4, 1994

From: William Grant
General Counsel

RE: **Record Storage by Electronic Means**

**THIS MEMO SUPERSEDES THE PREVIOUS MEMO OF AUGUST 31, 1994, RELATING TO OPTICAL DISK STORAGE OF RECORDS CONTAINED IN THE RECENT ALL BANK MAILING. THE PREVIOUS MEMO SHOULD BE DESTROYED.**

K.S.A. 9-1130 provides in general that a bank or trust company must retain records for periods prescribed by the commissioner. These periods have been more definitively defined by promulgation of K.A.R. 17-15-1 and amendments thereto. With regard to the utilization of optical disk storage of records, 9-1130(f) expressly provides "...any bank or trust company may cause any, or all, of its records ... to be photographed or otherwise reproduced to permanent form." This language is interpreted to mean that maintenance of bank records by use of electronic means is acceptable so long as the technology is of the "read-only" variety. (Read-only, as used in this memo, means that once a record is placed on the system the information is static and the image can not be altered.)

A related question involves the courtroom admissibility of records stored and document images retrieved from an electronic storage system. While K.S.A. 9-1121 provides for the admissibility of "microphotographed" reproductions, the department has taken the position that the specific reference to a particular method of recordation would infer the non-admissibility of records stored by alternative means. This conclusion has been weakened by amendment last session of K.S.A. 60-469 to provide for the admissibility of copies of certain business records retrieved from "read-only" optical systems. (1994 Session Laws, ch. 60, section 1.)

An important consideration which must be reviewed is the fact that the new admissibility provision relating to optical disk recordation contained in 60-469 is a general civil procedure provision while the more restrictive provision of 9-1121 is found in the Kansas Banking Code and relates specifically to records maintained by banks, trust companies, and savings and loans. The general rule of statutory construction in Kansas relating to the interaction between general and specific statutes is that general and specific statutes should be read together and harmonized whenever possible, but to the extent conflict exists, the specific statute will control unless it appears the legislature intended to make the general statute controlling. State v. Edwards 252 Kan. 860 (1993).

Because of the apparent conflict between the statutes and the lack of any review by a court on the effect of the new general civil procedure provision on the existing specific banking code language, every institution should consult with bank counsel prior to destroying any records it intends to maintain by electronic means, to assess the need for retention of the items in a form suitable for use during possible litigation.

Finally, paper files and information, or hard copies of the files produced by the electronic storage technology, must be available on an expedient basis for review by this department's examination staff. While CRT's or other electronic technology may occasionally be utilized by the examiners, the majority of the file reviews will continue to be accomplished by reference to paper copies. The availability of terminals or readers alone will not be sufficient to meet this requirement at this time.

2-2

# The Kansas Bankers Association

800 SW Jackson, Suite 1500
Topeka, KS 66612
913-232-3444 FAX 913-232-3484

1-23-95

TO: House Financial Institutions and Insurance Committee

FROM: Chuck Stones, Director of Research

RE: HB 2082

Mr. Chairman and Members of the Committee:

The Kansas Bankers Association appreciates the opportunity to appear before you in support of HB 2082.

It is not always easy to determine whether a small business is a partnership or a sole-proprietorship. For many years, the banking industry didn't worry much about this distinction. It never seemed to matter how an account or loan was documented for this purpose. But current laws and regulations now require a bank to determine whether a customer is doing business as a partnership of a sole proprietorship.

The KBA formed a taskforce to study this problem over the summer. The taskforce identified many areas of banking where this situation might potentially be problem. Most of these situations had solutions that were administrative in nature. It did recommend that we seek a legislative remedy to the problem addressed in HB 2082.

HB 2082 addresses the filing of UCC-1 forms or financing statements with the Secretary of State. UCC-1 forms are filed to establish the creditors rights to collateral used in obtaining a loan. A lender is said to be "perfected" if the UCC-1 is filed correctly. If a business is a partnership, the UCC-1 must be filed in the name of the partnership and the partnership's Employee Identification Number. But if the business is a sole proprietorship, the UCC-1 must be filed in the name of the sole proprietor and his or her Social Security Number. A bank must rely on the borrower(s) to make a determination as to the nature of the business. The banker is not to be expected to sort through a couple's business affairs to make this determination. Once the borrower(s) has decided upon a appropriate business structure, the banker can accept their decision as appropriate and document the loan accordingly.

This is where the potential problem arises. Under Kansas law, a partnership is statutorily defined as an association of two or more persons to carry on as co-owners of a business for profit. Under this definition, a legal partnership may exist even though formal partnership papers do not exist. Our concern is that the potential exists for a bank to have filed a UCC-1 for a business loan as a sole proprietorship based on their customers determination. Later, in a court of law, the business could be found to meet the legal definition of a partnership. This would cause the bank to be found to be "not perfected" on its loan. In this situation, even though the bank did everything right, based on information given it by its customer, it could lose its right to the collateral it used to make the loan.

HB 2082 merely says that "where married debtors are jointly engaged in business and it is unclear whether a partnership exists, the financing statement may be filed in the names of the individual debtors. This change only affects the filing of the financing statement. It does NOT change the legal definition of a partnership.

Thank you for your consideration and I urge your favorable action.

House FI & I
Attachment 3
1-23-95

Ron Thornburgh
Secretary of State


2nd Floor, State Capitol
300 S.W. 10th Ave.
Topeka, KS 66612-1594
(913) 296-2236

# STATE OF KANSAS

TESTIMONY -- HB 2082
Financial Institutions and Insurance
Office of the Secretary of State
January 23, 1995

My name is Janet Chubb, Assistant Secretary of State. With me today is Carol Beard, Deputy Assistant Secretary of State, Uniform Commercial Code Division. Carol has supervised the day-to-day activities of the division for 20 years, and she is prepared to provide further detail to the committee about secretary of state procedures if it would be helpful.

The proposed amendment does not affect the Secretary of State's office. It would not require procedural changes or increase costs.

HB 2082 amends K.S.A. 84-9-402 by clarifying the requirements of partnerships and sole proprietors. The Secretary of State's office cross-indexes debtor names on all financing statements, except officers of corporations. However, debtor names are not entered by status -- e.g. sole proprietor, partnership, corporation or individual. When it is unknown whether a partnership exists, the individual's name may be entered as the debtor on a financing statement. With this amendment, if the debtor files as a sole proprietor and provides an SSN, the interest of the creditor (bank) would be perfected in the event of a subsequent bankruptcy and a legal determination that a partnership exists.

The second part of the amendment to H.B. 2082 (Sec. 1, (9) ), merely rewords the present statute. The amendment requires no procedural change for our office.

The Secretary of State supports HB 2082. Thank you.

J. D. J.
Attachment 4

1-23-95

**Corporations** (913) 296-4564
FAX (913) 296-4570

**Elections** (913) 296-4561
**Administration** (913) 296-2236
FAX (913) 291-3051

**UCC** (913) 296-3650
FAX (913) 296-3659

# KANSAS BANK FACTS

** Kansas ranks 6th in the nation in the number of chartered banks with 447. Only Texas, Illinois, Minnesota, Iowa, and Missouri currently have more charters.

** There is at least one chartered bank in every Kansas county except Wallace County. 10 counties have only one chartered bank while Johnson County has the most with 26.

** Kansas law has allowed multi-bank holding companies since 1985. There are currently 33 multi-bank holding companies in Kansas which control 85 Kansas banks. Southeast Bancshares of Chanute have the most affiliatebanks with 6.

** Interstate banking for Kansas began on July 1, 1992. To this date seven Missouri bank holding companies have purchased 35 Kansas banks with $4.16 billion in assets. Five Nebraska holding companies have purchased eight Kansas banks with total assets of $362.4 million.

** Three Kansas bank holding companies have purchased 23 banks and S&Ls in Oklahoma and Missouri with total assets of $2.85 billion.

** Statewide branching has been allowed in Kansas since 1987. Currently 155 Kansas banks operate one or more out-of-town branch offices. There are over 350 out-of-town branch offices currently operating throughout the state. There are branch offices are located in nearly 250 different communities.

** Kansas banks have total assets of $30.45 billion. Bank IV is the largest bank with $5.37 billion in assets and the Farmers State Bank of Simpson is the smallest with $2.03 million in assets. While the average asset size for Kansas banks is $66.2 million the median asset size is less than $32 million. Nearly 70% of all Kansas banks have $50 million or less in assets.

** There are currently banking facilities in 443 Kansas towns. Over 70% of all chartered banks in Kansas are located in towns of less than 5,000 population. 20% of all chartered banks are located in towns of less than 500. The smallest town in the state with a charterd bank is Cedar Point (population 39)

** Kansas banks employ more than 14,000 people. Nearly 80% of the banks have fewer than 25 employees and over 25% of all Kansas banks have fewer than 10 employees.

# The Kansas Bankers Association

800 SW Jackson, Suite 1500
Topeka, KS 66612
913-232-3444 FAX 913-232-3484

1-23-95

TO: House Financial Institutions and Insurance Committee

FROM: Chuck Stones, Director of Research

RE: HB 2089

Mr. Chairman and Members of the Committee:

The Kansas Bankers Association appreciates the opportunity to appear before you in support of HB 2089.

**What is it?**

HB 2089 would allow banks and S & L's to perform candid self-evaluations in order to have an effective compliance program. It will ensure the confidentiality of records and files of a "Compliance Review Committee." This Compliance Review Committee functions to evaluate and improve loan underwriting standards, asset quality, financial reporting to federal and state regulatory agencies, and compliance with federal or state statutory or regulatory requirements. The task of these compliance programs is to review internal activities, to identify weaknesses in procedures and policies, and to discover violations of law. It is our belief that a fine-tuned compliance program is highly desirable by all parties involved, bankers, bank regulators, and consumers. It can correct practices that, if otherwise left unaddressed, could result in a citation by a regulator of the violation of law. A violation found and corrected internally is far superior to one found by a regulator.

**What does it do?**

HB 2089 allows banks and S & L's to internally determine if they are in compliance with a variety of laws and regulations without the fear that those same internal documents will later be used against them in a court of law. It states "Compliance review documents are confidential and are not discoverable or admissible in evidence in any civil action arising out of matters evaluated by the compliance review committee"...

**Why is it needed?**

We believe that for a bank to be more effective and a better service to its community it needs the ability to fully evaluate its compliance with all laws and regulations. It must be free to review its own performance without fear that its own analysis of what occurred and resulting dialogue as to the remedy will be used against it in legal proceedings. Under current law, an institution's criticism of its own practices can and is used against the institution in the litigation process.

The fact that these records and documents can be used against them causes the bank to either not perform the compliance review or hinders their ability to be totally candid in the evaluation and resulting recommendations for remedy.

House FI&I
Attachment 5
1-23-95

**What is included and not included.**

The bill is very specific. Only "Compliance Review Documents" ( as defined ) prepared by the "Compliance Review Committee" ( as defined ) are protected.

The bill is very clear (Subsection d and e, Pg. 2, lines 2-9 ) that it does not apply to any information required by statute or rules and regulation, and that is not to be construed to limit the discoverability or admissibility in any civil action of any documents that are not compliance review documents. This would include documents used in the lending process, such as underwriting, credit scoring, and appraisal documents.

In conclusion, we feel everybody involved will benefit from HB 2089. The bank will benefit because it can perform effective internal compliance reviews without fear that those review documents will be used against them in legal proceedings. The bank regulators will benefit by the knowledge that banks will be able to perform such reviews and have the ability to internally determine their compliance with laws and regulations. Consumers will benefit by their bank having the ability to better determine whether or not it complies with the many laws and regulations that apply to banks. As a result they will be better protected from becoming a non-intended victim of the bank's non-compliance. The consumer also benefits by the enhanced safety and soundness of their bank and the banking system if banks can candidly self evaluates for compliance.

Thank you for your attention and we urge your favorable support.

Kansas-
Nebraska-
Oklahoma
League of
Savings
Institutions

Jeffrey D. Sonnich, Vice-President

700 S. Kansas Ave., Suite 512
Topeka, Kansas 66603
(913) 232-8215

January 23, 1995

TO: House Committee on Financial Institutions and Insurance
FROM: Jeffrey Sonnich, Vice President
RE: HB 2089; Confidentiality of Compliance Review Documents

Mr. Chairman. Members of the Committee. The Kansas-Nebraska-Oklahoma League of Savings Institutions appreciates the opportunity to appear before the House Committee on Financial Institutions and Insurance in support of HB 2089.

It is a fact of life that financial institutions spend millions on compliance activities. Why? Because the penalties imposed for non-compliance are so severe, that without a comprehensive strategy the institution would be putting it's board of directors, officers, and shareholders at financial risk. Therefore, it is in the best interests of the institution to be able to review its policies, procedures, and internal controls in an unbiased and straightforward manner. It involves an honest look at whether the institution is meeting all statutory and regulatory requirements.

The problem we see is that the process of self-evaluation is like a "two-edged" sword. If an institution takes a hard look at its control procedures and documents a problem area, it has the opportunity to put in place corrective measures...thereby reducing potential risks. However, under current law these same documents may be subpoenaed and may become admissible in evidence in civil actions against the institution....thereby increasing potential risks. This puts the institution in the unfortunate position of having to weigh the benefits against the risks in every aspect of compliance review.

HB 2089 provides banks and savings institutions with a small margin of protection when performing compliance reviews. By preventing documents prepared by a "compliance review committee" from being admissible in civil actions, an institution is more likely to perform meaningful reviews of it's policies and procedures. I hope you would agree that the public is better served if potential problems are discovered and corrected, rather than ignored because the risks of knowing are too high.

In conclusion we feel that this bill will provide the best solution to an ever increasing area of concern for financial institutions. It does not limit the discoverability or admissibility in any civil action of any documents that are not compliance review documents. It's value is that it reduces an institution's overall exposure, so they are more able and willing to make meaningful self evaluations. We respectfully request your favorable support

Jeffrey D. Sonnich
Vice President

JDS:cip

House Fin. & Ins.
Attachment 6
1-23-95