Approved: March 7, 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 March 6, 1995 in Room 527S of the Capitol.

All members were present except: Representative Tom Sawyer, Excused
Representative Ray Cox, Excused
Representative Gary Merritt, Excused

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

Conferees appearing before the committee: Mr. Jim Maag, Kansas Bankers Association
Ms. Kathy Taylor, Kansas Bankers Association
Mrs. Judi Stork, Office of Bank Commissioner

Others attending: See attached list

3/6

Hearing on SB 249--Bank powers, life insurance policies

Jim Maag, Kansas Bankers Association, stated that the bill would add three amendments to the state banking code as it relates to a state bank's authority to purchase life insurance for its officers and directors and for employee deferred compensation plans (Attachment 1). The amendments would:

1. If the bank has the authority to direct the investment of the policy's cash values, the investments are limited to those assets which may be directly purchased by the bank for its own account.

2. Grandfathers life insurance policies in place before July 1, 1993, which may not meet federal guidelines relating to the projected value of such policies.

3. Removes requirement of a mathematical test (Test B) which attempts to determine the value of the policy at some future date which may be as much as 40 years away.

The Bank Commissioner supports the bill according to Judi Stork, Deputy Commissioner.

Hearing on SB 25--Defining student banks and providing for exemption from banking codes regulation

Judi Stork, Office of the Bank Commissioner, informed the Committee that an exact definition of a student bank is being added as well as an amendment which would exempt student banks from provisions of the banking code and supervision by the Bank Commissioner's Office (Attachment 2). There is currently one bank operating in one high school but there is interest in the development by other schools. Nothing is carried over from one year to another in these banks and any interest paid on accounts and loans is deposited in local banks. The Department of Education intends to implement policies to govern schools with student banks if the legislation passes.

Hearing on SB 23--State banks, same powers as national banks upon order of bank commissioner

Judi Stork, Office of the Bank Commissioner, appeared before the Committee and explained the need for combining sections of the bill dealing with national and state banks competitive equality (Attachment 2). Because of the development of concepts such as statewide branching, interstate banking, and recently enacted Riegle-Neal Interstate bill, the "geography" of banking in Kansas shows very little resemblance to the environment of when the separate subsections were devised. The combinations of these subsections should relieve some confusion created by the existence of two subsections while maintaining the commissioner's ability to protect the competitive equality of all state banks in Kansas by granting to these those powers possessed by national banks. It does not authorize a special order to grant to state banks powers that exceed

those of the national bank.

Hearing on SB 21--Time of payments to the bank commissioner fee fund
Judi Stork, Office of the Bank Commissioner, explained that this bill would allow their office to utilize the March 31 FDIC call report information for calculating their assessment (Attachment 2). The bill would require any institutions registered with the Secretary of State as of a specified date to be assessed fees and, in the case of mergers, consolidations, or purchases and assumptions of assets and liabilities between certain specified dates, they would clarify that the surviving institution will be responsible for payment of the fees on the acquired assets. Last year the Office of the State Banking Commissioner lost $108,000 without these changes.

Representative Dawson moved to pass the bill out favorably. The motion was seconded by Representative Crabb. Motion carried.

Hearing on SB 24--Closed meetings of state banking board
Judi Stork, Office of the Bank Commissioner, said the proposal would add language to specifically allow the board authority to meet in executive session to discuss confidential information (Attachment 2). The board generally holds this authority now.

Hearing on SB 287--Banks and banking; limitations on loans
Kathy Taylor, Kansas Bankers Association, appeared as a proponent of the bill which address the statute which generally establishes a lending limitation to any one bank customer at an amount which does not exceed 15 percent of the bank's capital stock paid in and unimpaired and the unimpaired surplus of the bank (Attachment 3). Certain exceptions are allowed to that limitation allowing the total liability of a borrower to equal but not exceed 25 percent of unimpaired capital and surplus of the bank.

The bill would eliminate the requirement that the total liability of the borrower be secured by the "excess" collateral (collateral required to secure the amount borrowed which exceeds the 15 percent limitation). The bill would require only a portion of the eligibility, the amount which exceeds the original 15 percent limitation, be secured by allowable collateral which includes readily marketable nonperishable grains, seeds, livestock, or by a first lien or liens upon real property. Banks can currently circumvent the law by participatory lending and borrowing. Enactment of the bill may reduce mortgage registrations fees, in cases where real estate is used to collateralize the excess liability, since the borrower will be required to pay fees only on the amount of the loan in excess of the general limitation.

The meeting was adjourned at 5:00 p.m. The next meeting is scheduled for March 7, 1995.

HOUSE FINANCIAL INSTITUTIONS AND INSURANCE COMMITTEE GUEST LIST

DATE: 3-06-95

NAME	REPRESENTING
Kathy Taylor	Kans Bankers Assn
Herb Lamb	"
Chuck Stones	"
D L Mellor	Bank Compensation Strategies

The KANSAS BANKERS ASSOCIATION
A Full Service Banking Association

March 6, 1995

TO: House Committee on Financial Institutions and Insurance
RE: **SB 249** - The purchase of life insurance by banks

Mr. Chairman and Members of the Committee:

Thank you for the opportunity to appear before the committee in support of **SB 249** which amends the state banking code. Specifically it makes three amendments to K.S.A. 9-1101(25) which relate to a state bank's authority to purchase life insurance for its officers and directors and for employee deferred compensation plans.

The first amendment to K.S.A. 9-1101(25) restricts the types of investments which a bank can make for policies where the bank has the authority to direct the investment of the policy's cash values. It states that such investments are limited to those assets which may be directly purchased by the bank for its own account.

The second amendment grandfathers life insurance policies in place before July 1, 1993, which may not meet new federal guidelines relating to the projected value of such policies. These are policies which have been in effect for some time and at the time they were entered into they were meeting state and federal requirements. To be forced to restructure such policies at this time could have very significant financial consequences for the bank from a standpoint of taxes and surrender charges. This is a particular problem for a number of small community banks where these policies are a very key part of retaining qualified management for the bank.

The third amendment removes the requirement of a mathematical test which attempts to determine the value of the policy at some future date which may be as much as four decades away. The test results are virtually meaningless since it is necessary to make assumptions on factors where there is little, if any, consensus. Again this is a particular problem for community banks which have a smaller capital base.

Attached to this testimony is a letter from Kevin Murphy of Bank Compensation Strategies. His company works with community banks in Kansas to create

House FI&I
Attachment 1
March 6, 1995

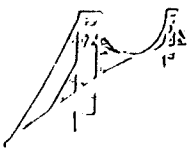
Office of Executive Vice President • 1500 Merchants National Building
Eighth and Jackson • Topeka, Kansas 66612 • (913) 232-3444
FAX (913) 232-3484

retirement plans and benefit plans for bankers. Mr. Murphy also addresses the proposed amendments and requests favorable consideration of **SB 249**.

The KBA has worked closely with the State Banking Department for the past three years in an attempt to resolve this very complex problem which has been exacerbated by the shifting guidelines of federal regulatory agencies. We sincerely hope this amendatory language will finally resolve what has been a highly troublesome impediment to community banks which need the ability to offer attractive benefit plans to qualified employees.

Your favorable consideration of **SB 249** would be greatly appreciated.

James S. Maag
Senior Vice President



BANK
COMPENSATION
STRATEGIES GROUP

February 10, 1995

The Honorable Richard Bond
Chairman
Senate Committee on Financial Institutions and Insurance
The State Senate
State Capital
Topeka, Kansas 66612

Sir:

Bank Compensation Strategies Group is a Minneapolis based company which designs and markets retirement and other benefit plans for bank executives, many of which are informally financed by bank-owned life insurance policies. We have approximately 700 client banks nationwide. Our firm is endorsed by the Kansas Bankers Association, the American Bankers Association and 39 other state bankers associations. We believe that affordable benefit plans enhance the ability of community banks to attract and retain competent managers which is critical to their continued success and viability.

We have had the opportunity to review the proposed amendments to K.S.A. 9-1101(25) as set forth in Senate Bill No. 249.

The proposed amendments would grandfather life insurance policies in place before July 1, 1993; strike the language contained in subsection (vii) of K.S.A. 9-1101(25); and where a bank has the authority to direct the investment of policy cash values, limit the investments to only those assets that may be directly purchased by the bank for its own account.

We believe that grandfathering existing policies is warranted because restructuring existing policies to meet new guidelines often requires the withdrawal of cash from a policy, which may result in adverse tax consequences or surrender charges to the bank which owns the policy. This amendment will enable banks which have owned life insurance policies for many years to avoid additional costs and taxes and we support the change.

As contained in the current law, subsection (vii) applies when life insurance is purchased for the purpose of providing deferred compensation and benefit plans and reads as follows:

> "the present value of the projected cash flow from the policy must not substantially exceed the present value of the projected cost of the deferred compensation or benefit program liabilities"

The current language requires that a mathematical test be prepared when a bank purchases a life insurance policy in connection with compensation or benefit plans. Compliance with this provision requires that financial projections be made far into the future (30 to 40 years is not uncommon) which are then converted back to current dollars by way of present value calculations. In order to perform the calculations, assumptions must be made concerning interest rates, insurance mortality costs, tax rates and life expectancy of plan participants. The calculations are very sensitive to minor

3600 West 80th Street, Suite 200
Minneapolis, MN 55431
(612) 893-6767 · Fax: (612) 893-6797

changes in assumptions and there is no consensus concerning the reasonableness of assumptions used in these computations. Also, many insurance vendors are unable or unwilling to unbundle the costs and income components of their policies and provide the information needed to make the calculations. Our experience with the tests required by this subsection is that they are needlessly complex, not well understood by bankers, bank regulatory officials and insurance providers, and we believe that the test results have little or no economic significance. The test requirements are a significant burden to community banks and we support the elimination of this portion of the law.

The third element of the proposed amendment would add language to K.S.A. 9-1101(25) which would, in the situation where a bank has the authority to direct the investment of the life insurance policy cash values, limit the types of investments to those which may be directly purchased by the bank for its own account. There are a myriad of life insurance products available in the marketplace today, including variable life insurance policies, where the policy owner selects where the policy cash values are to be invested. Several options are typically available, including money market funds, bond funds and common stock funds. With this type of life insurance policy, the policy owner bears all of the investment risks associated with fluctuations in the value of the policy cash values. While these types of policies are suitable and appropriate in many circumstances, both state legislatures and the U.S. Congress have enacted laws which generally prohibit commercial banks from investing in corporate equity instruments and common stocks. The proposed amendment would prohibit a state bank from making an investment through the purchase of a life insurance policy that it would be prohibited from making directly. We believe that the addition of this provision is appropriate.

In summary, we believe that the proposed amendments would be beneficial to the banking industry, without any adverse effect on bank soundness or solvency.

We appreciate the opportunity to submit comments.

Thank you in advance for your consideration.

Very truly yours,

Kevin M. Murphy
Vice President of Compliance

STATE OF KANSAS
BILL GRAVES
GOVERNOR

Frank D. Dunnick
Bank Commissioner

Judi M. Stork
Deputy Commissioner

Kevin C. Glendening
Assistant Deputy Commissioner

William D. Grant, Jr.
General Counsel

Ruth E. Glover
Administrative Officer

OFFICE OF THE
STATE BANK COMMISSIONER

HOUSE COMMITTEE ON FINANCIAL INSTITUTIONS AND INSURANCE

MARCH 6, 1995

Mr. Chairman and Members of the Committee:

My name is Judi Stork. I am the Deputy Commissioner and I am here today on behalf of Commissioner Dunnick and the Office of the State Bank Commissioner to testify on behalf of four Senate Bills.

Senate Bill 25 amends K.S.A. 9-701 and K.S.A. 9-702. This proposal adds a definition of student bank to K.S.A. 9-701, found on page three, line four of the bill. The amendment to K.S.A. 9-702 exempts student banks from what is considered to be the "business of banking" and therefore from the provisions of the banking code.

Currently we have one high school bank that has been operating approximately 70 years. The bank is well run and has never been chartered, supervised or examined by our office. During my tenure in the OSBC I have received a handful of inquiries as to whether other schools could pursue such banking operations as part of a money and banking class. Currently we have one school in Olathe that has put their "student bank" on hold pending the outcome of this legislation. We have discussed this matter with the State Department of Education and they intend to implement policies to govern schools with "student banks" if this legislation is passed.

Senate Bill 23 proposes amendment of K.S.A. 9-1715, commonly known as the "wild-card" statute. The current provisions of the statute were implemented to protect the competitive equality of state and national banks operating in Kansas. The statute allows the state bank commissioner to issue special orders authorizing state banks to engage in any activity that is permitted for national banks by federal authority. The proposed amendments contained in Senate Bill 23 are designed to modernize the statute in two ways.

First, the substantive portions of the current subsections (a) and (b) have been combined into a single section as proposed subsection (a) of the bill. The original version of the statute was passed in 1967, and consisted only of a portion of what is now subsection (a). The original 1967 enactment was based on the concept of preserving competitive equality among banks but only provided authority to issue a special order that applied to a specific bank. Consequently, if national banks in Kansas were authorized to engage in a particular activity each state bank which faced unfair competition in their community would be required to request a special order and a special order for each state bank would be necessary to provide parity.

House F.I.I.
Attachment 2
3-6-95

This approach may have been practical in 1967, when most banks' trade territories were relatively compact, resulting in fewer competitive relationships between state and national banks. However, as banking evolved in Kansas, and the reach of banking operations broadened, an activity of a single national bank may have created the need for several special orders to preserve parity for surrounding state banks. In 1975, the legislature added current subsection (b) which allows the issuance of a special order of general application to provide statewide parity to all state chartered banks in Kansas.

Senate Bill 23 proposes to combine these two sections. Because of the development of concepts such as statewide branching, interstate banking, and the recently enacted Riegle-Neal Interstate bill, the "geography" of banking in Kansas shows very little resemblance to the environment of 1975, when the separate subsections of K.S.A. 9-1715 were devised. The need for a special order that applies to only one state bank in a particular community is almost inconceivable and the utility of separate subsections has diminished. In fact, the existence of the two similar provisions has created some confusion on the part of the public and the banking community regarding their distinct meanings. Therefore, the proposed language has been combined in broad terms to allow either a general or specific special order, preserving the availability of both types of orders. This should relieve some confusion created by the existence of two subsections while maintaining the commissioner's ability to protect the competitive equality of all state banks in Kansas.

The second substantive change contained in Senate Bill 23 involves the repeal of the current subsection (d). Subsection (d) is an antiquated provision that prevents a special order from providing parity to our state banks on the issue of branching. This provision was added to K.S.A. 9-1715 in 1975 at a time when Kansas did not allow bank branches. During the several years prior to 1975, there had been rigorous debate in Kansas over the acceptability of branching in our state and to that point full-fledged branches continued to be illegal. From 1975 until today, we have seen branches become commonplace on a statewide basis.

Additionally, until recently, the states have enjoyed nearly universal federal deference to state laws on branching. Historically, national banks could only branch to the same extent as state banks in their state because of the McFadden Act. This federal provision provided parity in branching similar to the parity provided by K.S.A. 9-1715 in all other areas of state vs. national bank competition. However, we now face enactment of the Riegle-Neal act and the many uncertainties it presents. In fact, Riegle-Neal contains language that expressly authorizes national banks to engage in some "branching activity," through agency agreements, absolutely without regard to state law. Fortunately, this new national bank branching authority does not become effective until September of 1995 so that we have the opportunity to seek parity from the legislature on this particular issue. Also, while it has not yet occurred in Kansas, other states have seen the OCC interpret existing laws to allow them to simply ignore the state's law and the McFadden Act on issues of national bank branching. These represent clear examples of the federal government's move away from deference to state laws on matters relating to national bank branching.

Because subsection (d) was enacted at a time when the acceptability of any type branching was far less settled than it is today, it is obsolete in terms of its original purpose. Additionally, in light of the uncertainty presented by the federal government's steady move toward abolishing the states' rights to determine the type of branching which occurs within their borders, as evidenced by passage of the Riegle-Neal bill and the OCC's creative indifference to state law, keeping subsection (d) would remove a great deal of the statute's utility in light of its purpose, "parity."

The largest and swiftest changes facing the banking industry center on branching. There will be many debates on these issues and our office intends to continue to remain neutral on structure issues such as opt in/opt out. However, we are not neutral on the issue of maintaining the competitive equality that is so important to our current dual banking system. Luckily, time was on the side of Kansas state chartered banks with respect to the agency provisions of the Riegle-Neal Act. The Kansas legislature has the opportunity to explore the issue of "agency," and to provide the needed statutory parity, before this branching authority becomes effective for the national banks in Kansas. However, the timing of federal action may not always be so fortunate, and the uncertainty presented by Riegle-Neal and the federal government's continued move toward disregarding state laws and the McFadden Act, create a need for the commissioner to have the ability to react quickly to allow Kansas state banks the same authority as granted to national banks.

It is important to note that the proposed amendments continue to be based solely on the original purpose encompassed by the 1967 version of K.S.A. 9-1715; parity and competitive equality between state and national banks. The proposed language of Senate Bill 23, as did the original statute, only allows the commissioner to grant to state banks those powers possessed by the national banks. It does not authorize a special order that grants to state banks powers that exceed those of the national banks.

Senate Bill 21, amends K.S.A. 9-1703, a statute that governs how banks and trust companies are assessed. There are three substantive changes made to this statute via this proposal. First, beginning on line 26, we are asking to utilize the March 31 **FDIC** call report information for calculating our assessment. Currently, the Office of the State Bank Commissioner (OSBC) receives call report data in paper form. The FDIC receives the same paper data and inputs such into a data base which is accessible to our agency through a computer network. Because such data is much more readily usable via the computer, the paper copies kept in our office are seldom used. The quarterly FDIC information is downloaded into our assessment calculation and the annual bank assessments are calculated via computer. We have been utilizing this process for approximately four to five years.

The second substantive change can be found on page two, beginning on line 12. This amendment adds language to establish a specific cutoff date for bank existence for paying an annual assessment. If the banks are in existence as of June 30 and December 31, one-half of their assessment is due and payable for the respective half of the coming year. Because of the numerous mergers that are occurring in the banking industry, this amendment is necessary to provide financial institutions with a clear notice of what dates must be met for filing their merger documents, with the Secretary of State's office, to avoid assessment fees for the coming year. Additionally, for budgetary purpose for the OSBC, we have relied on assessments from banks who are operating as state chartered institutions only to find out later they have merged into a national association and refuse to pay any assessment.

The third substantive change can be found at the top of page three under new subsection (e). This amendment concerns assessments when a state chartered bank merges with and into another state chartered bank. If this occurs between March 31 (the date on which our assessments are based) and June 30 (the dates the banks are assessed), the assessment of those banks merged out of existence are lost, even though the assets remain in the state chartered system. An example may illustrate this best. We have two state chartered banks--Bank ABC with $20,000,000 in assets and Bank XYZ with $30,000,000 in assets. Both of these institutions exist on March 31. On May 25 these institutions merge and only ABC bank remains. On June 30, ABC is a state chartered bank with $50,000,000 in assets; however, the statute requires us to assess ABC based on their March 31 assets of $20,000,000. XYZ is no longer in existence therefore we can not assess them. The $30,000,000 in assets are still in the state chartered system, however, there are no provisions allowing us to assess ABC for those $30,000,000 in assets. The new language in subsection (e) will allow us to correct that problem.

Senate Bill 24 amends K.S.A. 74-3006 concerning state banking board meetings. This proposal adds language to specifically allow the board authority to meet in executive session to discuss confidential information. While the board already possesses this general authority under K.S.A. 75-4319, the addition of the proposed language to the banking board statute clarifies any questions or concerns that may be raised.

The KANSAS BANKERS ASSOCIATION
A Full Service Banking Association

March 6, 1995

To: House Committee on Financial Institutions and Insurance

From: Kathy Taylor, Kansas Bankers Association

Re: SB 287: Lending Limits and Cross Collateralization

Mr. Chairman and Members of the Committee:

Thank you for the opportunity to appear before the Committee in support of SB 287. This bill amends KSA 9-1104, which is the statute that sets forth the limitations on the amount of debt that one borrower can have to one bank (lending limits). This limitation is expressed as a percentage of "capital". (Defined as capital stock paid in and unimpaired, and the unimpaired surplus fund of the bank.)

The statute sets forth the general rule that a borrower's total liability may not exceed 15% of "capital". There are also several exceptions to this general rule, i.e., limited circumstances where the borrower's liability could exceed the general 15% rule.

The amendments which we have proposed deal with two of these lending limit exceptions. There is an exception where the loan is secured by grain, seed or livestock (KSA 9-1104 (a)(3)), and there is an exception where the loan is secured by a first lien on real estate (KSA 9-1104 (a)(5)).

Before a bank is allowed to exceed the general 15% limitation, that bank must meet certain requirements regarding (a) the value of the collateral and (b) the documentation of the loan.

For example, if a bank had loaned up to 15% of its "capital" on a customer, according to current law, the customer could obtain up to 10% additional borrowings if the loan was secured by grain, seed, or livestock. But before the bank would be allowed to loan any additional amounts, it would have to make certain (a) that the value of the grain, seed, and livestock had a market value of at least 115% of the excess liability, and (b) that the excess collateral secured the **total** liability of the borrower as evidenced by the loan documentation. This last requirement is what we refer to as "**cross-collateralization**".

House FI & I
Attachment 3
3-6-95

Office of Executive Vice President • 1500 Merchants National Building
Eighth and Jackson • Topeka, Kansas 66612 • (913) 232-3444
FAX (913) 232-3484

The same is true if the bank wanted to exceed the 15% limitation on a customer by securing the excess liability with real estate. In that case, before the bank would be allowed to loan any additional amounts, it would have to make certain (a) that the appraised value of the real estate was at least twice the amount of the excess liability, and (b) that the real estate secured the **total** liability of the borrower as evidenced by the loan documentation.

The amendments which have been proposed address only the second requirement - the "cross collateralization" requirement. We have attempted to eliminate the requirement that the "excess" collateral secure the **total** amount of the liability to that borrower. The new language would specify that the collateral would only have to secure the excess liability, and not the entire amount of debt to that borrower. These amendments are found on page 2, lines 17-20, and on page 3, lines 12-14.

Bankers are very frustrated by the potential for being caught out of compliance with this technicality of the law, especially when there is seemingly no benefit to the borrower in requiring the collateral to secure the entire debt.

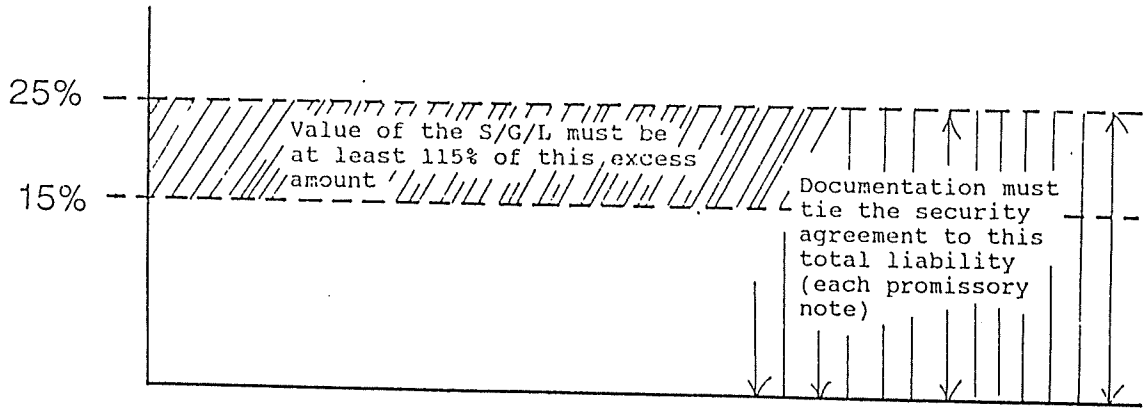
In fact, in the case of real estate, the borrower is required to pay mortgage registration fees on the *amount that is secured by the mortgage*. Because of the cross collateralization requirement, that amount is the **total** liability of the borrower. By eliminating this requirement, it will be clear that the borrower will only have to pay mortgage registration fees on the amount of the loan in excess of the general limitation.

This collateralization requirement brings no advantage to the borrower, and is unnecessarily burdensome on the banks. Therefore it should not be a required practice.

The other amendments found on page 2, lines 25-29 and on page 3, lines 16-21 are clarifying amendments. This subject matter is currently covered by one long sentence, and these amendments break it up into two sentences that read much easier.

Thank you for your consideration of this matter and I urge your favorable action on SB 287.

A. Grain, Seed and Livestock



B. Real Estate