

Approved: January 27, 1999  
Date

## MINUTES OF THE HOUSE COMMITTEE ON FINANCIAL INSTITUTIONS.

The meeting was called to order by Chairperson Representative Ray Cox at 3:30 p.m. on January 20, 1999 in Room 527-S of the Capitol.

All members were present except: Representative Cindy Empson - Excused  
Representative Henry Helgersen - Excused

Committee staff present: Dr. Bill Wolff, Legislative Research  
Bruce Kinzie, Office of Revisor  
Maggie Breen, Committee Secretary

Conferees appearing before the committee: Judi Stork, Acting Bank Commissioner, Office of State Bank Commissioner

Others attending: (See Attached)

Chairman Cox welcomed the members to the committee noting that there were many new members this year. He stated that it looked like it was going to be a light year and the committee would not meet when there were no bills to process.

**Judi Stork**, Acting Bank Commissioner, Office of State Banking Commissioner, gave an overview of the Banking Department and the condition of Kansas banking (**Attachment 1**). The agency employs about 70 people, 20 of them in the main office in Topeka, and 50 located throughout Kansas in 7 different field offices. They regulate 282 state chartered banks, 11 trust companies, 68 trust departments located in banks, 19 money transmitter companies, and about 490 mortgage businesses. They examine the banks and trust companies, jointly with the FDIC and Federal Reserve, once every 18 month period. The institutions are given a CAMELS rating. The examiners assess the condition of the Capital, Assets, Management, Earnings, Liquidity, and Sensitivity to Market Risk. All of the components are rated on a scale of 1 to 5 with 1 being the best. They are then given an overall rating, which is disclosed to the bank. Of the 282 banks, 277 are rated 1 or 2. In comparison, in 1989 there were 407 institutions and there were 122 "problem banks" with ratings of 3, 4 or 5.

Overall the condition of Kansas banks is good. There has been some minor deterioration in loan portfolios due to low grain and cattle prices. An exceptional harvest did offset this in some banks. While the asset quality of some banks has worsened, the overall conditions of most banks remains extremely healthy.

**Dr. Bill Wolff** gave an overview of two Interim committee reports:

1. Study The Reorganization of State Regulatory Supervision of the Executive Branch Applicable to Financial Institutions (**Attachment 2**).

The committee was looking at a way to restructure the Bank Department, the Credit Union Department, the Consumer Credit Commissioner's Office and the Securities Commissioner's Office, perhaps into one umbrella agency where all would be housed and regulated. The first part of the report contains the historical background of legislative activity regarding governmental regulation of these kinds of departments. The second part discusses what the committee did and identifies those that the committee heard from. It involved conversations with banking interests, both from the commissioner's side and from the bankers side; conversations with the Credit Union Administrator and the league; conversations with the securities people, especially with John Cleland of SBL, a noted authority on securities transactions. Having heard all of these people, the committee looked at structures from other states. They are included in the report. Probably Kansas is in the minority of states that have a single regulator for each entity. Over time many states have put regulation under an umbrella agency. The committee decided it was premature to set about creating such an umbrella agency. The committee emphasized the point that the regulatory agencies should exist and function for the public benefit. They are to ensure that the institutions are operated safely and soundly and that consumer interests are protected. Their primary responsibility should not be to benefit the group or

CONTINUATION SHEET

MINUTES OF THE HOUSE FINANCIAL INSTITUTIONS, Room 527-S Statehouse, at 3:30 p.m. on January 20, 1999.

profession that they regulate. Operating from that principle, they addressed the following areas:

- The head of each financial regulatory agency should be a full-time employee in the unclassified civil service.
- The head of each financial regulatory agency should be prohibited from actively engaging in the industry being regulated during the term of the appointment.
- The statutory qualifications for service as a financial regulator should be broad enough to create a pool of candidates eligible to serve as the agency head.

These are the topics of conversation in the Senate this week

Dr. Wolff proceeded with the second report:

2. State Taxation of Banks (**Attachment 3**).

Shirley Sicilian, Department of Revenue, was the primary conferee, the banking industry also submitted testimony. The conclusions and recommendations were very short. The Committee recognizes that comparison of the taxation of financial institutions between states is difficult because of the variance of tax structures used by the states. Nevertheless, the Committee concludes that Kansas financial institutions are not unduly taxed based on the most meaningful comparisons that the Committee had. The Committee recognized the need for continued diligence on the subject but makes no recommendations on this study. There was some comment that the report needs to be sent to the appropriate standing committee, which would probably mean the Tax Committee.

The meeting adjourned at 4:03 p.m.

The next meeting is scheduled for Wednesday, January 27, 1999.



STATE OF KANSAS  
BILL GRAVES  
GOVERNOR

Judi M. Stork  
Acting Bank Commissioner

Kevin C. Glendening  
Assistant Deputy Commissioner



Sonya L. Allen  
General Counsel

Louise A. Monell  
Administrative Officer

OFFICE OF THE  
STATE BANK COMMISSIONER

HOUSE COMMITTEE ON FINANCIAL INSTITUTIONS

January 20, 1999

Mr. Chairman and Members of the Committee:

My name is Judi Stork. I am the Acting Bank Commissioner for the State of Kansas and have served in that role since the resignation of Newton Male on November 30<sup>th</sup>. I have been with the Office of the State Bank Commissioner (OSBC) for 19½ years and have held the position of Deputy Commissioner since 1991.

I was pleased to be asked to speak before this committee concerning the banking department and the condition of Kansas banking. Over the years, our agency has enjoyed a good working relationship with this committee. I am committed to ensure this relationship continues to be one of open communication. The job of the Office of the State Bank Commissioner is to regulate the state banks of Kansas to ensure they are safe and sound institutions where Kansas consumers can deposit their funds. We have a staff of 70 people who share this belief and work hard every day to carry out this goal.

The agency was first formed in 1891 to oversee the numerous private banks then in existence in Kansas. Today, the OSBC regulates 282 state chartered banks, 11 trust companies, 68 trust departments in state banks, 19 money transmitter companies, and 490 mortgage businesses. We have seven field offices located throughout the state with our largest offices in Overland Park, Wichita, and Topeka, and our smallest in Dodge City. We have made a few personnel changes in the Topeka office since the last legislative session by shifting the work duties our staff performs. We now have two individuals who work full time handling the Information Management area for the department, and one individual who directs our training and handles public relations. We also have one staff member who is now devoted full time to the Mortgage Business area. In addition, we maintain a review examination staff, a legal department with two attorneys, a budget/personnel officer, and a support staff of four individuals.

*House Financial Institutions*  
*1-20-99*  
*Attachment 1*



It is our statutory duty to examine banks and trust companies once every 18 month period. We accomplish compliance with this statute by doing alternating and/or joint examinations with the Federal Reserve Bank and the Federal Deposit Insurance Corporation. Examiners review all aspects of our institutions and provide a written report to our office. The report is reviewed by staff and forwarded to me for final review and signature. The report is then transmitted back to the bank or trust company. A rating is assigned to each of our banks and trust companies known as a CAMELS rating. We assess the condition of the **C**apital, **A**ssets, **M**anagement, **E**arnings, **L**iquidity, and **S**ensitivity to Market Risk of each bank. We then rate each component on a scale of one to five, with a one rating being the best and a five being the worst. The CAMELS rating is disclosed to each bank in their examination report. Our office also reviews and approves various applications. We have a nine member banking board - six bankers, three public interest members - which meets monthly in our office. They review and approve new charters, branches, name changes, relocations, etc. The commissioner approves mergers, acquisitions, trust powers, etc.

The condition of banking in Kansas and in the United States continues to remain strong. The FDIC reported in their third quarter 1998 *PROFILE* that earnings for commercial banks in the third quarter totalled \$15 billion. This earnings figure is down by \$1.1 billion from the June 30, 1998 data. The return on assets for commercial banks also fell from 1.25% to 1.15% between June 30 and September 30, 1998. The earnings decline was caused by weaknesses in overseas operations, and the greatest drag on industry earnings came from banks' trading activities. Nationally, asset quality remained largely healthy. Equity capital increased during the quarter by \$11.4 billion up to \$457.4 billion. This represents a capital to assets ratio for banks of 8.68%. The number of institutions nationwide declined by 73 institutions in the third quarter of 1998. The number of "problem" banks rose from 64 to 70 with total assets of \$5.4 billion.

In Kansas, September 30, 1998 data shows 398 commercial banks with total assets of \$32.6 billion. Total capital in Kansas banks equaled \$3.3 billion with an equity capital to assets ratio of 10.04%. The banks' return on assets ratio equaled 1.31%, which is down from the Kansas ratio noted for June 30, 1998 of 1.36%. The categories of *provisions to the banks' loan loss accounts* and *net charge-offs in loans* show little change from the figures represented for year end 1997 and 1996. Currently there are 282 state chartered banks with 277 falling in the 1 and 2 CAMELS rated category. These Kansas banks have showed some minor deterioration in their loan portfolios due to low grain and cattle prices, but an exceptional harvest in portions of the state helped to offset that deterioration for some banks. While the asset quality of some banks has worsened, the overall condition of most banks remains extremely healthy.

Something you might find of interest, which was included in the FDIC *PROFILE*, relates to the percent of Kansas branch deposits held by out of state organizations. Based on branch ownership as of 9-30-98 and deposits figures of June 30, 1998, 29.4% of Kansas deposits are held by out of state organizations. Arizona and Rhode Island have the highest percentages of out of state holding of their deposits with 95.6% and 86.9%, respectively. North Carolina, Alabama, and Maine are the only states with single digit percentages of 1.7%, 6.8%, and 9.6%, respectively.

Another fact I thought to be of interest --- for the first time in a long time, the number of state chartered banks nationwide has shown a net increase. As of September 30, 1998, states regulated 6,951 banks versus the end total for 1997 of 6,876. This shows the value banks and bankers are finding with a state charter.

Finally, I want to share with you some of the current issues the staff of the OSBC is working on. We are spending a considerable amount of time and devotion of resources to improving the information systems within our office. First, we use a system called ALERT which allows our examiners to download directly to their computers, the information contained within a bank's computer system regarding all pertinent loan data. The download of this information saves a considerable amount of our time. It automatically prepares our line sheets which are used to review loans. We are also using a system called ED (Examination Documentation). ED is divided into modules associated with various areas of the bank ... loans, securities, management, internal controls, earnings, liquidity, etc. It provides for uniformity throughout our field offices and with the Federal Reserve Bank and the FDIC. The final piece of our technology puzzle is the implementation of GENESYS (General Examination System). We will start to utilize GENESYS during the second quarter of this year. It will assist examiners in the completion of safety and soundness examinations. The FDIC, Federal Reserve Bank, and 33 other states have or will implement this system. It first rolled out in October of 1998. All three products are utilized together to decrease repetitive steps and to fully computerize the examination process. Our agency is also in the process of converting our storage method for examination reports, correspondence, etc., by scanning the information and burning it onto CDs. This will allow for easier access of our records. We also continue to work on updating, changing, and improving our home page on the Internet. It is approximately 50% complete.

Thank you for the opportunity to share with you information about the Office of the State Bank Commissioner, and about the condition of Kansas banking. I look forward to working with all of you during this legislative session.

# SPECIAL COMMITTEE ON FINANCIAL INSTITUTIONS AND INSURANCE

## STUDY THE REORGANIZATION OF STATE REGULATORY SUPERVISION OF THE EXECUTIVE BRANCH APPLICABLE TO FINANCIAL INSTITUTIONS

### CONCLUSIONS AND RECOMMENDATIONS

The Special Committee on Financial Institutions and Insurance does not recommend reorganizing the financial institutions regulatory agencies at this time. Nevertheless, there are issues related to financial regulatory agencies that should be addressed by the 1999 Legislature, including agency heads as full-time employees; prohibiting agency heads from engaging in the industry being regulated; and broader qualifications for holding office. Additionally, the Special Committee supports the concept of consolidation of the Office of the Consumer Credit Commissioner with the Office of Bank Commissioner, and the creation of a gubernatorial task force to continue the study of reorganizing the financial institution regulatory agencies.

### BACKGROUND

The last years of the 1960s and the early years of the 1970s were times of executive branch reform in states across the country. The need for reform seemed obvious to nearly all major interest groups. In Kansas, Governor Robert Docking persistently called for constitutional revision and executive reorganization. Those calls were heard by the Legislature as it convened for its 63rd session in January 1970.

The theme of my legislative recommendations in 1967, 1968, 1969 and 1970 was reform. The theme of my message to this 1971 legislature again is reform. We can improve; we can do better.

—Governor Robert Docking

Message of Robert B. Docking to the Kansas Legislature, January 20, 1971

### **The Kansas Commission on Executive Reorganization**

H.B. 2031 enacted in the 1970 Session of the Legislature created the Kansas Commission on Executive Reorganization. The

Commission was instructed to conduct a comprehensive study of the executive branch of government and make recommendations concerning the efficient operation of government and to report those findings to the Governor and the 1971 Session of the Legislature.

The preface to the report of the Commission stated that the purpose and intent of the Commission was to do an efficiency study, but to propose a plan "of reorganization to provide a base from which efficiencies and economies could be achieved." The report suggested two further considerations: reorganization should be politically responsible and responsive to the people; and the new structure "should perform with maximum effectiveness, efficiency and economy the jobs assigned to it." In response to the question, "Why reorganization?" the Commission concluded that: "By grouping agencies together it should be possible to share facilities and services and minimize duplication of effort. Why, for example, is it necessary for every licensing agency to maintain its own staff to perform clerical tasks

which a single staff could perform for all of them?"

The Commission recommended a cabinet system of government for Kansas consisting of eight cabinet departments, among which was a Department of Regulatory Agencies. The Department was proposed to include state agencies whose functions were primarily regulatory in nature and would consist of the following: Division of Banking; Corporation Commission; Division of Consumer Credit; Division of Credit Unions; Division of Professional Licensing; Division of Savings and Loan; and Division of Securities. The Commission findings and recommendations were submitted to the Governor and to the 1971 Session of the Legislature.

Four reorganization bills were introduced to create the Department of Revenue, the Department of Regulatory Agencies, the Department of Administration, and the Department of Transportation. None of the measures were enacted in 1971. The Department of Revenue and the Department of Administration were reorganized by action of the 1972 Legislature. Legislation proposing the Department of Transportation was enacted in 1975. The idea of a Department of Regulatory Agencies died in Committee in 1971.

### Sunset

By 1976, the Legislature was looking in a different direction to find efficiencies and accountability

Under Proposal No. 62, the Special Committee on Ways and Means was directed to conduct "an examination of the 'Sunset' concept, by which executive agencies and programs are automatically terminated unless specifically reauthorized by legislative action at periodic intervals."

*Report on Kansas Legislative Studies to the 1977 Legislature*

in state government—the Kansas Sunset Law. That law provided a framework for periodic legislative reviews of pre-selected state agencies and set them for automatic termination unless the Legislature passed a bill reestablishing them. In the year preceding the

sunset year, agencies were subjected to a "sunset audit" conducted by the Division of Legislative Post Audit with the report of the Audit staff presented to the Legislative Post Audit Committee and to the Legislature. All agencies included in the 1971 reorganization measure were subject to the 1978 Kansas Sunset Law, including the financial departments, boards, and agency heads which were targeted for sunset on July 1, 1980.

### Sunset Audit Report—Financial Regulatory Agencies.

The more important concern in evaluating regulatory activity under the Kansas Sunset Law, however, is whether regulation meets the needs of the public, not the needs of the institutions.

Sunset Audit Report  
Financial Regulatory Agencies  
Financial Regulatory Boards, 1979

The sunset audit of these agencies and boards addressed two main questions: Should state regulation of banks, savings and loan associations, credit unions, and consumer credit granters be continued?

Or, as an alternative to re-establishing the agencies and boards in their present form, should they be consolidated? More than 150 pages of the report are filled with the responses to these questions, first by the auditors and secondly by agency representatives.

In summary, the Legislative Division of Post Audit concluded that state regulation of the banking industry, the savings and loan industry, the credit union industry, and the consumer credit industry should be re-established. Having made that finding, the auditors recommended that the regulatory activity of the agencies and boards be consolidated into a single agency and board under a single commissioner responsible for all four types of financial institutions. The report stated that, compared with other states, Kansas was the only one with four independent financial regulatory agencies and boards. Every other state had at least some degree of consolidation, and many were completely consolidated. The report noted that the experience of the other states indicates consolidation helps to make regulation more consistent and uniform, and it



does so more efficiently and economically than decentralized regulation. In addition, and perhaps most importantly, the Post Audit report made the point that, by moving regulation away from the individual types of financial institutions, consolidation provides greater assurance that regulation is in the public's interest, not the industry's.

In reality, the Sunset Audit provided the Legislature an alternative to consolidation; namely, continuation of the agencies with certain modifications intended to improve performance. In the 1979 interim, the Special Committee on Governmental Organization was directed to conduct: "an assessment of the desirability of combining the functions of the several state agencies engaged in the regulation of financial institutions . . . into a single state agency." (See the *Report on Kansas Legislative Interim Studies to the 1980 Legislature*, Proposal No. 20, pp. 430-434.)

In addition, by moving regulation away from the individual types of financial institutions, consolidation provides greater assurance that regulation is in the public's interest, not the industry's.

The Special Committee heard the testimony of the Legislative Post Auditor favoring the consolidation of the financial regulatory agencies, as well as the opposing point of view from the regulators and the representatives of the industry. Based on its hearings, the Special Committee recommended to the 1980 Legislature that no consolidation in this area be undertaken at the time and that all of the existing boards and agencies be re-established until July 1, 1986, the maximum term permitted under the Kansas Sunset Law.

Acting in 1980, the Legislature took up recommendations of the Special Committee on Governmental Organization and:

- continued the Bank Commissioner and the Banking Department until 1986, but took no action to extend the Banking Board thereby sending it into the statutory one-year wind-

- down period;
- continued the Savings and Loan Commissioner and the Savings and Loan Department to 1986;
- continued the Credit Union Administrator and the Credit Union Council to 1986, but took no action to continue the Credit Union Department thereby sending it into the statutory one-year wind-down period;
- directed that the Credit Union Administrator be appointed by the Governor (previous appointment was by the Credit Union Council) for a four-year term and that the appointee have at least three years of experience in the management of a credit union;
- continued the office of the Consumer Credit Commissioner to 1986, but made the appointment of the Commissioner subject to Senate confirmation and established a four-year term of office;
- took no action to continue the Council of Advisors on Consumer Credit thereby sending it into the statutory one-year wind-down period; and
- took no action to consolidate the financial regulatory agencies.

In the 1981 Session, S.B. 107 completed the work begun under the Sunset Law by continuing the Banking Board to 1986 and subjecting its members to confirmation by the Senate and by continuing the Credit Union Department to 1986 as well.

S.B. 107, while a vehicle to continue the Banking Board and the Credit Union Department, also amended significantly the Kansas Sunset Law itself. Particularly, the Legislature removed from the provisions of the new Kansas Sunset Law 20 fee agencies, including the Banking Board, Department and Commissioner; the Savings and Loan Board, Department and Commissioner; the Credit Union Council, Department and Administrator; and the Consumer Credit Commissioner. The effect of the amendment was to remove these agencies from any scheduled legislative oversight.

Curiously, the Special Committee on Governmental Organization, in its 1979 report to the

1980 Legislature, thought the subject of consolidation should be studied further and went so far as to suggest that the Division of Post Audit gather information to supplement its original report and that the Legislature return to the subject in the 1980 interim period. No supplemental information was gathered and no committee undertaking in 1980.

While there was unanimous opposition to the creation of a financial institutions regulatory agency at the time of the Post Audit study, Stanley L. Lind, the representative for the Kansas Association of Finance Companies (now the Kansas Association of Financial Services), reacted as an individual to the request of the Legislative Post Auditor for a response to the report on the office of Consumer Credit Commissioner and Council of Advisors on Consumer Credit. He offered a recommendation, "should the Legislature decide to merge the departments," that, in brief, would have created a governing board to regulate financial service agencies much as the Board of Regents governs higher educational institutions in the state. (See Chart 4.)

### Then and Now

At the time of the Post Audit study (1979), there were 464 banks chartered by the Bank Commissioner and the Banking Board; 53 savings and loan associations chartered by the Savings and Loan Commissioner; 190 credit unions chartered by the Credit Union Administrator; 369 licensed supervised lenders; 18 investment certificate companies; and 5,711 retail companies granting credit supervised by the Consumer Credit Commissioner. With the exception of the activities regulated by the Consumer Credit Commission, most of those numbers have been significantly reduced. Currently, there are 283 state-chartered banks; no state-chartered savings and loan associations; 120 state-chartered credit unions; 720 licensed supervised lenders; no investment certificate companies; and 5,897 retail credit grantors.

	1979	1998
Banks	464	283
Savings and Loan Associations	53	0
Credit Unions	190	120
Licensed Supervised Lenders	369	720
Investment Certificate Companies	18	0
Retail Credit Grantors	5,711	5,897

The decline in the number of banks is attributable to the insolvencies of the 1980s and the nationwide merger and acquisition activities of the 1990s. The savings and loan debacle of the 1980s touched the industry in every state reducing the number of offices and charters, and federal bail-out legislation made it more attractive to hold a federal charter. The result in Kansas was the demise of the state charter with only two in existence in 1993 when the Legislature shifted regulation of state-chartered institutions to the Bank Commissioner. While banks and savings and loan insolvencies captured headlines in the 1980s, credit unions, too, had their financial troubles. Unlike those other institutions, however, credit union insolvencies generally were handled quietly through administrator-arranged mergers with other institutions.

Growth in the consumer credit arena is mostly accounted for by the increased numbers of mortgage brokers located outside of the state but licensed in Kansas to solicit second mortgage real estate loans. The Bank Commissioner, charged in 1996 with the registration of persons conducting mortgage business, also has witnessed a growth in registrants which now total more than 450 entities. Most of the registrants are out-of-state companies seeking to do second mortgage real estate transactions in Kansas.

## CURRENT KANSAS REGULATORY STRUCTURES

### Banks

**Regulatory Model.** The stand alone, single agency regulatory model followed by Kansas is not unique to this state. Twelve states have the independent agency model. Thirty-eight states



follow different structure patterns with two styles being predominant: a small umbrella agency which includes only financial services entities comprised mostly of banks, savings and loan associations, credit unions, and consumer credit regulators and a larger umbrella agency sheltering financial service agencies and other regulatory agencies commonly referred to in this state as fee agencies.

**Supervisor.** The head of the banking agency, whether freestanding or under an umbrella structure, is appointed by the governor in 40 states. Among the remaining states, the supervisor is appointed by the umbrella department head, a corporation commission, or, as in the sole case of Florida, elected. In 17 states the supervisor serves a statutory term with the length of appointments ranging from four to six years. In 29 states, the supervisor serves at the pleasure of the governor.

Nearly every state has established requirements for the supervisor. Eighteen states require practical banking experience with three or five years being the most common. Nearly the same number of states, 17, have no requirements for the supervisory position. Kansas is somewhat unique in this category as the state seems to be alone in its restriction of executive experience to that gained in a state-chartered bank. Kansas also may be nearly the only state with a supervisor who is an active banker.

**Boards.** To assist the supervisors, most states (30) have in place either an advisory or policymaking board. In 26 of those states, the board members are appointed by the governor and serve for terms ranging from two to six years. Sixteen of the boards have policymaking authority while 12 are simply advisory. In Kansas, the nine-member Banking Board is appointed by the Governor to three-year terms, subject to Senate confirmation. The Board approves applications for bank and trust company charters and for relocation of a bank or trust company. The Board also approves proposed rules and regulations prior to their adoption by the Commissioner.

**Miscellaneous.** The Kansas Bank Commis-

sioner, as do most other states' banking supervisors, regulates the activities of independent trust companies (43 states) and money transmitters (32 states), and registers persons conducting mortgage business (25 states). The agency has a staff of 72 persons and an approved FY 1998 budget of \$3.7 million.

## Credit Unions

**Regulatory Model.** The Kansas Credit Union Department is an autonomous or independent agency of state government. Its independence as an agency is unique to this state, Alabama, Georgia, and Texas. In all other states, the regulation of state-chartered credit unions is the responsibility of another entity whether that be the banking department, a small financial services agency, or as part of a larger umbrella regulatory scheme.

**Supervisor.** In 12 states, including Kansas, the supervisor of the agency is appointed by the governor. The remaining supervisors are appointed by the head of the umbrella agency in which the supervisor is housed, in a few instances, with the approval of the governor. Apparently, Delaware, South Carolina, South Dakota, Wyoming, and Nevada have no credit union department. Generally, the credit union supervisor functioning in an umbrella agency is not an independent decision-maker. Rather, the supervisors' decisions are subject to approval by the appointing authorities.

More than half of the states (25) establish minimum qualifications for the credit union supervisor. The usual prerequisite for service includes some experience in a credit union or other financial institution. Nineteen states have no minimum requirement to be the credit union supervisor. The Kansas Administrator, appointed by the Governor to a four-year term subject to Senate confirmation, must have three years' actual experience in the operation and management of a credit union.

**Boards/Council.** Twenty-one states have advisory bodies. The governor is the appointing authority in 17 of the states while the umbrella agency heads appoint the remainder. None of the

bodies are policymaking; however, several (ten) hear appeals from administrative decisions. In Kansas, the seven-member Credit Union Council is appointed by the Governor for a term of three years and serves in an advisory capacity to the Credit Union Administrator.

**Miscellaneous.** The agency has a staff of 12 persons and an approved FY 1998 budget of \$0.7 million.

### Consumer Credit Commissioner

**Regulatory Model.** The primary regulator for consumer credit transaction—sales, loans, and leases for personal, family, or household purposes—is the Consumer Credit Commissioner. The independent regulatory office of the Commissioner is a model shared by only five other states. Those states, like Kansas, administer the Uniform Consumer Credit Code and share a common statutory framework for their regulatory functions. In most states, the regulation of consumer credit transactions is assigned to a division within an umbrella agency. Generally, the assignment is to the banking regulator (29 states).

**Supervisor.** Since the regulation of consumer credit transactions is usually a function of the head of another financial services regulatory body, the supervisor is the agency head. In Kansas, the Consumer Credit Commissioner is appointed by the Governor, subject to confirmation by the Senate, and serves at the pleasure of the Governor. The appointee to the position is to have three years' actual practical experience in the operation and management of a consumer loan company.

**Board/Council of Advisors.** Adoption of the Uniform Consumer Credit Code in 1973 brought into existence a Council of Advisors on Consumer Credit. While that Council met as prescribed in the early years of the Code, it ultimately fell into disuse and, in 1981, the statute creating the Council was repealed.

**Miscellaneous.** The agency has a staff of seven persons and an approved FY 1998 budget of

\$0.4 million.

### Securities Commissioner

**Regulatory Model.** The independent securities regulatory body in Kansas stands in stark contrast to regulation in other states. From the inception of securities regulation in 1911 until 1935, the Bank Commissioner was responsible for the activities of investment companies and speculative securities. From 1935 to 1957, the securities statutes were administered by the Corporation Commission. In 1957, the regulator of securities became the Securities Commissioner, appointed by the Corporation Commission and housed within the Commission structure. In 1970, the Legislative Council studied the need to create a three-person securities commission appointed by the Governor and headed by a director appointed by the Commission; however, no action was recommended to change the regulatory structure. Underlying the committee's inaction was the awareness that the Kansas Commission on Executive Reorganization was deliberating a thorough reorganization of the executive branch of Kansas government. The Commission in its 1971 report concluded that regulation of securities was "of sufficient importance to deserve separate divisional status" within the Department of Regulatory Agencies. In 1982, the Legislature established the Office of Securities Commissioner as an independent state agency and abolished the existing office within the Corporation Commission.

In most states, the regulation of securities is handled through a division of a larger umbrella structure. For example, in 12 states, the agency regulating banking activities also supervises securities. In other states, the activity is housed in the office of the secretary of state, and in still others, within the corporation commission.

**Supervisor.** As is clear from the above discussion, the supervision of securities activities in the state has changed over time, *i.e.*, from the Bank Commissioner, to the Corporation Commission, to the Securities Commissioner. Current law provides for a Securities Commissioner to be appointed by the Governor and subject to Senate

confirmation. The Commissioner is to have "special training and qualifications" in order to serve.

**Boards.** While the Legislature and other interested parties, from time to time, have thought it useful to have more than one person making decisions about securities regulation, no statutory advisory or policymaking board exists to assist the Commissioner. Commissioners have used their executive authority to appoint advisory groups for advice and counsel.

**Miscellaneous.** The agency has a staff of 26 persons and an FY 1998 approved budget of \$1.7 million.

#### OTHER STATES' REGULATORY STRUCTURE

The Kansas Commission on Executive Reorganization was aware at the time of its study that other states also were looking at reorganization and that some had initiated the action. Wisconsin, for example, was in the process of implementing a broad reorganization of that state's governmental structure. Correspondence with the then Secretary of the Wisconsin Department of Administration in 1970, indicated to the Commission that the process would be lengthy. He noted that "A reorganization effort as comprehensive as the one we have undertaken takes many years to implement." Indeed, while much of the original reorganization plan was implemented early on in Wisconsin, the reorganization of the financial services agencies was undertaken in 1995 through the biennial budget process and dubbed "Streamlining State Government." The most recent reorganization legislation passed after several earlier attempts by the governor to pass reorganization legislation had failed.

In Washington, the Department of Financial Institutions came into existence in the fall of 1993. The Department exercises oversight of banks, savings and loan associations, trust companies, credit unions, consumer loan companies, and check cashiers and sellers. Additionally, the agency licenses securities brokers, franchisers, mortgage brokers, and escrow agents and compa-

nies. A study group that recommended creation of the unified department noted that legislation proposing the change should embody, among others, the following principles:

- the new department should first and foremost be organized and provided sufficient resources to protect the safety and soundness of state-chartered institutions and the rights and interests of consumers and the general public;
- the structure of the new department should provide access for all types of institutions to the decision-makers who regulate them; and
- the regulatory and policymaking processes of the new department should protect the integrity of each type of institution (this includes providing regulation which is sensitive to the competitive pressures of the market, which is sensitive to the differences among institutions, and which is representative of the diverse constituencies making up the department).

While Wisconsin and Washington represent relatively recent reorganizations, other states have a much longer history of regulation of financial services providers under an umbrella agency. The following represents a sampling of those other state structures.

**Idaho.** The Department of Finance was created in 1905 and is headed by a Director who is appointed by the governor. The Director must have five years' practical experience in the banking business or have served for a like period in the Banking Division of the Department. No one may serve as Director who is the owner of or has a financial interest in any bank or insurance corporation subject to supervision by the Department. The Director heads the agency comprised of five divisions: administration, financial institutions, Idaho Credit Code, securities, and mortgages.

**Indiana.** The Department of Financial Institutions was created in 1933 to supervise banks, trust companies, savings and loan associations, credit unions, and finance companies. The policymaking body of the Department is a bipar-

tisan board appointed by the governor composed of seven members: two with executive level banking experience, two with executive level savings and loan experience, one with experience at the executive level of a licensed lender, one with executive level credit union experience, and two appointed with due regard for fair representation of the consumer, agricultural, industrial, and commercial interests of the state. The Department is divided into six divisions: banks and trust companies, building and loan associations, credit unions, nondepository institutions, administration, and legal.

**Kentucky.** The Department of Financial Institutions was created incrementally beginning with bank regulation, adding savings and loan associations in 1918, and credit unions in 1922. Regulation of securities was added in 1932. The whole agency was recodified in 1984 to expand the Department's scope of activities to include mortgage loans and loan brokers. The agency is headed by a Commissioner appointed by the governor who is assisted by an advisory board. The Department is organized into three functional divisions—financial institutions, securities, and administrative services.

**Connecticut.** The Department of Banking administers the state's banking and credit union laws, laws regarding securities, and consumer credit laws. The Bank Commissioner is appointed by the governor and oversees an agency with six divisions: bank examination, consumer credit, credit union, government relations and communications, legal, and securities and business investments.

**Pennsylvania.** The Department of Banking is organized into four bureaus: examinations, supervision and enforcement, licensing and consumer compliance, and administration. The Department also has a legal division and a personnel services division. The agency is headed by the Secretary of Banking who is appointed by the governor, with the advice and consent of the Senate, and serves a four-year term.

**Iowa.** The Iowa Department of Commerce is an example of a large umbrella agency. The Department is organized into seven divisions: administrative services, alcoholic beverages, banking, credit unions, insurance (the Insurance Commissioner also administers the securities laws), professional licensing, and utilities. The Department is administered by the Director who is appointed by the governor. (The model parallels closely the structure proposed by the Kansas Commission on Executive Reorganization.)

**Nebraska.** The Department of Banking and Finance is comprised of the Financial Institutions Division and the Bureau of Securities. The Division of Financial Institutions monitors and regulates banks, credit unions, building and loan associations, industrial loan and investment companies, and trust companies. The Department is headed by a Director with the Division and Bureau headed by Assistant Directors.

**Colorado.** The Department of Regulatory Agencies is another example of a large umbrella regulatory model. The Department is headed by an Executive Director who is appointed by the governor and, who in turn, appoints most of the division directors (not insurance or public utilities). The Director's responsibilities are both policy and administrative, *i.e.*, he insures that the Department runs smoothly and in accordance with applicable state laws and that the various boards and programs have the resources necessary to accomplish their tasks. In addition to the office of the Executive Director, there is an office of certification, an office of policy and research, a division of banking, a division of civil rights, office of consumer counsel, division of financial services, division of insurance, public utilities commission, division of real estate, division of registrations (occupational and professional licensing boards), and the division of securities. Again, this large umbrella concept approaches the regulatory agency structure envisioned by the Kansas Commission on Executive Reorganization.



As the Committee embarked on its interim activities, it was mindful of a final comment from the original Kansas Commission on Executive Reorganization report. The Commission had solicited comments

"... agencies in a regulatory department must retain their identity. They cannot become one big department ruled by one 'Super Board' or commission . . . ."  
-Lyle Lindesmith

from the first Executive Director of the umbrella agency in Colorado. Mr. Lindesmith noted that the Colorado Legislature "directed that the department head confine his activities to management functions not related to the technical aspects of the work of the boards and commissions" and, with the backing of the Legislature, "we gradually but firmly began to form a workable federation of agencies."

#### COMMITTEE ACTIVITY

The Special Committee on Financial Institutions and Insurance spent two and one-half days in hearings on the reorganization study. Additional time was spent in discussion sorting out the issues and arriving at conclusions and recommendations.

In the course of its study, the Committee heard the agency heads of the current administrative structure, including the Securities and Consumer Credit Commissioner, the Bank Commissioner, and the Credit Union Administrator. A member of the Credit Union Council also presented comments. Representatives of the regulated industries making presentations included the Kansas Bankers Association, the Community Bankers Association of Kansas, the Kansas Credit Union Association, and the Kansas Association of Financial Services. Mr. John Cleland, Security Benefit Group, Inc., commented on the interrelatedness of the financial marketplace and continual blurring of roles and positions of the players in that marketplace. Dan Stanley, Secretary of Administration, made preliminary comments for the executive branch. Finally, the Committee held a telephone conference with Richard Dean,

Secretary of the Department of Financial Institutions, State of Wisconsin.

Each of the regulators presented a brief background statement about themselves and then provided considerable detail regarding the history and activities of their various departments. In general, they told the Committee that each of their agencies functions well as currently structured and that the industries they regulate also are doing well under their supervision.

David Brant, serving as both the Securities Commissioner and as Acting Consumer Credit Commissioner, provided extended comments on the role of each of his agencies in consumer protection and consumer education. The increased popularity of and demand for home equity loans has increased the number of second mortgage entities in the marketplace, many of them operating from locations outside of Kansas. The nature of the second mortgage market and the manner in which solicitations for business is being conducted requires full time vigilance of the industry by the regulator and a greater emphasis on educating Kansas consumers. Regardless of what might come of the study on reorganizing the financial regulatory structure, he indicated that he would be making recommendations to the 1999 Legislature to address the issues arising from the second mortgage industry.

On the subject of reorganization, Commissioner Brant said he had no opposition to an umbrella-type regulatory system, if the Securities and Consumer Credit divisions were treated equitably with other included entities and were allowed to set their own regulatory agendas specific to their areas. He indicated that such a system might allow a full-time investment education counselor for the Securities and Consumer Credit divisions. Also, advanced information technology experts could be available to work with all financial regulatory divisions if they were housed in the same location. Mr. Brant cautioned the Committee against combining the responsibilities of the bank and securities regulators as each agency requires its own expertise and autonomy.

Jerel Wright, the Credit Union Administrator,

commented regarding reorganization that the functions of the various departments or divisions be respected and the overall agency head be unbiased in the administration of the umbrella agency.

W. Newton Male, Bank Commissioner, emphasized that the current regulatory structure worked well and did not need to be fixed. He suggested, however, adding the regulation of consumer credit to the responsibilities of the Bank Commissioner. Since Mr. Male is the only regulator of a financial institution in Kansas who also is an active participant in that industry, the Committee briefly explored with him the issue of a conflict of interest or the perception of a conflict that might impact his decision-making responsibilities.

Representatives of the entities regulated reported satisfaction with the current regulatory structure. The spokesperson for credit union interests commented that the industry had no opposition to looking at restructuring supervision at the state level, but would be opposed to a structure which had credit unions reporting to a banking department. Bankers seemed somewhat skeptical of the need for change, particularly if change is proposed just for the sake of change, or if the banks are singled out for the most regulatory change. Those regulated under the Uniform Consumer Credit Code also expressed satisfaction with the status quo and suggested the Committee take action since there is such a potential for significant changes in the financial marketplace stemming from actions at the federal level. Should the Committee make some proposal for change, he requested that consumer credit remain under the auspices of an independent enforcer of the Uniform Consumer Credit Code.

John Cleland, Chief Investment Strategist for Security Benefit Group, provided the Committee with a global view of what has happened over the last years as individual assets and pension funds have moved to the mutual funds industry. Having completed his review, he saw no indication in the marketplace of a reversal of this movement. On the contrary, he commented that the Committee represented a step in the right direction for

Kansas as, at some point, there needs to be a regulatory focus in this state that recognizes the blending of activities among banks, securities agents and brokers, and insurers. In the future, he said, it will be difficult to have an isolated regulatory oversight responsibility for one type of financial service when that service is impacted by the actions and activities of other financial service providers. In summary, Mr. Cleland observed that the world continues to change and those in a position to do so must prepare Kansas for those changes, as opposed to sitting back in support of the status quo. He advised that, in preparing for these future changes, the main focus should be to provide flexibility for the market and protection to the consumer.

Mr. Stanley reminded the Committee of Governor Graves' commitment to "customer service" and suggested that citizen and consumer input be included in the Committee's decision-making process as the "people" are the true consumers of the regulatory service, not the entities being regulated. He encouraged the Committee to examine reorganization carefully, quantifying the costs of the current system, and modeling the costs of the proposed structure. If the result of the examination suggests that the customer will significantly benefit, then that would be a good reason to proceed.

Finally, the Committee closed its hearings on the reorganization issue with a conversation with Richard Dean, the first Secretary of the newly created Department of Financial Institutions in the State of Wisconsin. At the outset, Mr. Dean emphasized to the Committee that support for the reorganization in Wisconsin came from the top down—from the governor through the appropriations process. He acknowledged that support for the idea came from the fact that 37 other states already supervised their financial regulatory agencies under the umbrella concept. The driving force for the restructuring came from the need to find savings throughout state government to fund the return of tax dollars to the citizens of the state. He reported that the banking interest group in the state was supportive of the governor's proposal, but the savings and loan and credit union industries had to be persuaded to



come aboard, which they did having won certain concessions in the structure and operation of the new department.

Mr. Dean admitted that such reorganization projects take time to work out as there are the many details and competing and conflicting interests involved in such an adventure. Nevertheless, having accomplished the goal of bringing banks, savings and loan associations, credit unions, consumer credit licensees, and securities interests into one department, the rewards have been as anticipated. All of the financial regulators are conveniently located, have the most modern information technology, and are poised to deal with the types of financial businesses they will be regulating in the future. On this latter point, he said the one thing proponents kept presenting to the Legislature was the need to be prepared for change in the financial services marketplace. Consumers, too, have benefitted from the reorganization, he said, as they now have one-stop shopping via consumer education, consistent regulation, improved turn around times, and a customer service center to assist customers with any question from mortgage banking to securities. Since saving money was a primary reason for the reorganization, approximately \$1.3 million has been saved annually.

#### CONCLUSIONS AND RECOMMENDATIONS

The Special Committee on Financial Institutions and Insurance concludes that reorganizing the financial institutions regulatory agencies is premature at this time. Nevertheless, there are issues related to financial regulatory agencies that should be addressed by the 1999 Legislature. In that regard, the Committee affirms that regulatory agencies exist and function for the public benefit, which in the case of financial regulatory agencies, is the assurance that institutions are operated safely and soundly and that consumer interests are protected. Building on that premise,

the Committee recommends the following proposals be developed and acted upon by the 1999 Legislature:

- The head of each financial regulatory agency should be a full-time employee in the unclassified civil service.
- The head of each financial regulatory agency should be prohibited from actively engaging in the industry being regulated during the term of the appointment.
- The statutory qualifications for service as a financial regulator should be broad enough to create a pool of candidates eligible to serve as the agency head, *e.g.*, the qualifications for Bank Commissioner could be expanded to include service as an examiner or as an officer in a federally chartered bank.

Additionally, the Special Committee supports the concept of consolidating the Office of the Consumer Credit Commissioner with the Office of the Bank Commissioner. If such a consolidation were to take place, the governing board (Banking Board) should be restructured to obtain needed expertise and balance of representation due to the assumption of consumer credit regulatory responsibility. Further, consideration should be given to creating the position of Deputy Commissioner for Consumer Credit. The Deputy should have experience in the consumer credit business.

Finally, while creation of an umbrella regulatory agency for financial institutions is not recommended at this time, the Committee suggests that the executive branch continue and extend the study begun by the Committee. Particularly, the Committee recommends that a gubernatorial task force be created to determine, among other things, what efficiencies might result from consolidation of regulatory agencies.

# SPECIAL COMMITTEE ON FINANCIAL INSTITUTIONS AND INSURANCE

## STATE TAXATION OF BANKS

### CONCLUSIONS AND RECOMMENDATIONS

The Committee recommends that the issue of privilege tax rates be referred to the appropriate legislative committees for further consideration during the 1999 Session.

### BACKGROUND

On October 2, 1995, State Bank Commissioner Frank Dunnick issued an order, pursuant to his "wild card" authority in K.S.A. 9-1715, which permitted state banks the authority to form investment subsidiaries and for those subsidiaries to hold federal securities of the parent bank. Federal banks already had this authority. State and federal banks in 1995 began to form these subsidiaries.

Such subsidiaries can shelter bank income because they are subject to corporation income tax, and federal securities income is exempt from state corporation income tax. Such income when earned by the banks is subject to the bank privilege tax, which is measured by income, including federal securities income.

In November 1997, the consensus revenue estimating group recognized a fall off in the financial privilege tax and significantly reduced its estimate of the tax, citing the creation of bank subsidiaries. In May 1998, the estimate was increased by \$15.5 million, following the passage of S.B. 6, discussed below.

S.B. 6 required that banks and their subsidiaries file a consolidated or combined return, thus restoring the federal securities income to the tax base. The bill also reduced the financial institution privilege tax rate by approximately one-

third.

### COMMITTEE ACTIVITIES

The Committee devoted parts of two meetings to the topic, totaling more than a day. The Committee heard testimony from the Department of Revenue, the Kansas Bankers Association, the Heartland Community Bankers Association, and the Kansas Association of Community Bankers. The Committee staff also submitted information in response to requests of members.

Staff prepared information showing when subsidiaries were formed. The Committee reviewed the "wild card" order and the letters notifying the Legislature of the order. Staff also presented data comparing banks in the United States, Kansas, Colorado, Nebraska, Missouri, and Oklahoma. The data included net income, total assets, total deposits, return on assets, and return on equity for all commercial banks. The Committee also reviewed the estimates of the Consensus Revenue Estimating Group for the financial institutions privilege tax for fiscal years 1994 through 1999.

A representative of the Department of Revenue presented a substantial study of bank taxes. The presentation began with a summary of how the privilege tax works and a comparison of that tax to the corporation income tax. The privilege

tax is a tax on the privilege of engaging in the banking business in Kansas, measured by the income of the bank. Because of this structure, the state is not directly taxing federal securities income and the measure of income may include the income from federal securities. By contrast, the corporation income tax is a tax upon the income of corporations doing business in Kansas, and the measure of income used for this tax excludes income from federal securities. Other differences, such as in the rates, were reviewed.

The recent history of the tax also was reviewed. In November of 1998, the estimate for FY 1998 was reduced from \$38 million to \$20 million, an \$18 million decrease. The Department then presented four studies suggesting that if all banks made full use of investment subsidiaries the privilege tax would be reduced by 60 to 80 percent.

The Department also described the apportionment of multistate bank income to Kansas. In brief, the apportionment is based on factors of property, payroll, and receipts. It was noted that prior to interstate banking no apportionment was needed since all banks were operated entirely within Kansas.

Next, the tax burden on banks was compared for banks in Kansas, Colorado, Missouri, Nebraska, and Oklahoma. Based on state taxes, Missouri had the highest tax burden, followed by Kansas. When adjusted for the 1998 rate decrease, Kansas drops to fourth place. When federal and state tax burdens are compared, Kansas was the lowest.

The study explained the significant differences in the state taxing schemes. Kansas, for example, imposes a privilege tax, Colorado uses its corporation income tax. Missouri has a complex structure employing a two-part bank franchise tax and its corporation income tax. Nebraska imposes a deposits tax, and Oklahoma

imposes a franchise tax and its corporation income tax.

The final analysis of the Department showed the distinctions between the corporation income tax structure and the financial institutions privilege tax structure. The analysis focused on the treatment of income from federal securities and the rate structure.

The representatives of the banking industry maintained that financial institutions taxes had been high in Kansas relative to neighboring states, opposed raising the rates, and noted that because of volatility in the financial industry, it was difficult to draw conclusions from the actual taxes collected in any year. Among the events cited to support this point was the assessment of savings and loans in the fall of 1996 which cost the State of Kansas a minimum of \$2 million in privilege tax. Also, some concern was expressed that the multistate apportionment formula must operate even-handedly so as to offer no clear advantage to in-state or multistate branch banks.

#### CONCLUSIONS AND RECOMMENDATIONS

The Committee recognizes that comparison of the taxation of financial institutions between states is difficult because of the variety of tax structures used by the states. Nevertheless, the Committee concludes that Kansas financial institutions are not unduly taxed based on the most meaningful comparisons. Recognizing that estimated privilege tax revenues for FY 1999 were reduced by approximately \$12.5 million or about 33 percent, the Committee recommends that the issue of privilege tax rates be referred to the appropriate legislative committees for further consideration during the 1999 Session. The Committee recognizes a need for continued diligence to the subject. The Committee makes no recommendation on this study.