

Approved: Feb 17, 1999
Date

MINUTES OF THE SENATE COMMITTEE ON FINANCIAL INSTITUTIONS AND INSURANCE .

The meeting was called to order by Chairperson Senator Don Steffes at 9:00 a.m. on February 16, 1999 in Room 529 S of the Capitol.

All members were present except: Senator Sandy Praeger, Excused

Committee staff present: Dr. Bill Wolff, Research
Ken Wilke, Office of Revisor
Nikki Feuerborn, Committee Secretary

Conferees appearing before the committee: David Brant, Acting Commissioner of Consumer Credit
Kathleen Keest, Assistant Attorney General, Iowa
Barkley Clark, Shook, Hardy & Bacon, LLP

Others attending: See Attached

Hearing on SB 301 - Consumer credit, uniform consumer credit code

David Brant, Acting Consumer Credit Commissioner, explained the need to update and strengthen the UCCC through legislation prepared by the Advisory Council, a Drafting Committee, and the agency (Attachment 1). This proposed legislation would enhance the regulatory powers of the agency and add a number of consumer protections to address the abuses of sub-prime of mortgage loans as well as address usury rates, consumer loans, and lender credit cards. He walked the Committee through the affected sections of the bill. None of these changes will affect "rent to own" transactions. A major change would be to lift the interest cap on in-state credit cards so they will be on a competitive basis with those cards coming in from out of state. Interest rates on out of state cards are controlled by the state in which the card originates and many have no limits set on them. Technical cleanup amendments are forthcoming.

Kathleen Keest, Assistant Attorney General from Iowa, was introduced as being a leading expert in consumer credit in the United States. Ms. Keest presented testimony on the search for balance between the need for credit and the huge amount of credit available to consumers (Attachment 2). Much of the credit available at this time is considered "destructive credit" as it has very high interest rates and appeals to over-leveraged households. The deregulation of credit is based upon the theory of letting the market operate automatically but it does not consider the human element—those that are least able to afford high credit are those seeking it. She cited several examples of 60% car loans and 34% home equity loans which have escalated due to fees, origination fees, points, and hidden charges due to predatory lenders in many states. Deregulation is touted to be a way of creating a level playing field for lenders but it does not create a level playing field for lenders and consumers. Federal pre-emption has disallowed states to make protection choices. Ms. Keest expressed concern that aggregate figures for households was 25% leverage twenty years ago and now it is figured at 104%. Major credit problems are occurring due to asset-based lending being made available to those on limited incomes and/or receiving government subsistence. Required underwriting for credit card companies may be a future protective option. Information and education should be made available to all credit consumers at an early age including the privileges and detriments of such credit availability.

Barkley Clark, former KU law professor and member of Shook, Hardy & Bacon, LLP, explained this as being a balanced bill which addresses the concerns of Kansas-based creditors while offering protection for Kansas consumers by increasing the interest rate caps (Attachment 3). There has been no comparable amendment to the UCCC since 1973. He explained the need to lift the caps off in-state issued credit cards so they could compete with states exporting their credit cards to Kansas. If this is not changes, those banks with credit cards will be forced to move out of Kansas in order to do business here. Fees and interest rates which originate in Kansas companies are exportable to all other states and they must be competitive.

The meeting was adjourned at 10:00 a.m. The next meeting is scheduled for February 17.

SENATE FINANCIAL INSTITUTIONS AND INSURANCE
COMMITTEE GUEST LIST

DATE: 2/16/99

NAME	REPRESENTING
<i>Ray Cox</i>	<i>House FI & I</i>
BUD CORANT	KCC
LINDA CULLINAN	INTRUST BANK
Gail Bright	A.G.
STEVE RARRICK	A.G.
Ketty Olson	KBA
Sharon Self	Intrust Bank
Chuck Stones	KBA
Don GACHES	INTRUST BANK
Martha Ann Smith	KMHA
Nancy Ulrich	AG
Terel Wright	Ks Dept of Credit Unions
Sue Schuler	KCUA
Diane Kemar	Intrust Bank
Charity Mason	Intrust Bank
Mark Oungton	Shank, Hardy & Bacon
Barkley Clark	"
SAMANTHA PARKS	CONS. CREDIT COMM'N
DAVID BRANT	SECURITIES COMM.

Matt Goddard

HCBA



KANSAS

Bill Graves
Governor

OFFICE OF CONSUMER CREDIT COMMISSIONER

David R. Brant
Acting
Commissioner

TESTIMONY REGARDING SENATE BILL No. 301

Amendments to the Consumer Credit Code

Financial Institutions and Insurance Committee Kansas Senate

Mr. Chairman and members of the committee, thank you for this opportunity to testify regarding Senate Bill No. 301.

The Kansas Consumer Credit Code, originally adopted by Kansas in 1973, needs to be updated and strengthened to enhance consumer protection. In the past year, I have assembled an Advisory Council to advise and assist the agency and a Drafting Committee to work on this proposed legislation. Attached for your information are the names of the individuals serving on these two groups.

Senate Bill No. 301 updates the Code in a number of areas, enhances the regulatory powers of the agency, and adds a number of consumer protections to address the abuses of sub-prime mortgage loans. The bill also contains a number of provisions concerning usury rates, consumer loans, and lender credit cards. This bill has been drafted as a **collaborative** effort.

The following is a brief summary of a number of provisions in Senate Bill No. 301:

- Section 1 Requires a county appraiser's estimate or an appraisal for second mortgage loans and certain first mortgage loans. Further requires that consumers be notified of the availability of credit counseling for mortgage loans which have a LTV ratio in excess of 100%.
- Sections 2 Prohibits false, misleading, or deceptive advertising in mortgage loan solicitations.
and 3 The drafting of this provision is based on a Michigan statute.
- Section 4 Requires a creditor to "wet fund" a loan and disburse the proceeds upon consummation. Definitions of "consummation" and "disbursement of proceeds" are being added in Section 8.
- Section 5 Amends 16-207 and proposes to lift the usury cap on first mortgage loans (see attached chart).
- Section 7 Amends 16-1-201 and deletes in line 20 the condition of "face to face" solicitation to expand the coverage of the Code to loans offered by mail, telephone, or internet.
- Section 8 Adds and amends various definitions contained in 16-1-301 including "appraised value", "first mortgage code rate", "loan-to-value ratio", and "prepaid finance charge".

- lenders license*
- Section 12 Changes licensing standards to repeal the current financial test of “business assets of \$25,000” and now require a surety bond of \$100,000. *1st change since 1973*
- Section 13 Strengthens the administrator’s powers to deny or revoke a lender’s license.
- Section 14 Amends 16a-2-401 to preserve the current 18% usury cap on second mortgage loans and lift the usury cap on consumer loans and in-state credit cards (see attached chart).
- Raises the current limit on up-front lender origination fees for Code mortgage loans from 3% to 5% and imposes a new limit of 10% on all prepaid finance charges which would now include mortgage broker fees. *Prohibits refinancing for 12 months.*
- Limits prepaid finance charges on refinancing loans within 12 months now allow only lender origination fees on the “new money” portion and not on the amount refinanced.
- Section 15 Amends the finance charges allowed in 16a-2-402 on open-end credit and credit cards.
- Section 17 Rewords 16a-2-404 which authorizes pay-day loans and allowable finance charges.
- Sections 18 and 19 Amends the charges allowed in 16a-2-501 and 2-502 for lender credit cards. *charges allowed for in-state credit cards*
- Section 24 Strengthens the criminal sanctions for violations of the Code.
- Section 25 Enhances the agency’s examination authority.
- Section 27 Enhances the agency’s investigation powers and grants authority to issue subpoenas.
- Authorizes the administrator to conduct exams on out-of-state locations rather than at the lender’s discretion.
- Section 28 Empowers the administrator to censure and impose fines, to issue cease and desist orders, and to impose administrative sanctions after an opportunity for a hearing.
- Section 30 Expands the notification requirements to those “who take assignments” in addition to the originating lenders.

- cleanup

In addition, we are working a number of amendments to the bill, including restrictions on balloon payments and negative amortization, which will be submitted for the committee’s consideration in the coming days.

Thank you for your consideration.

OFFICE OF CONSUMER CREDIT COMMISSIONER

1998-99 Advisory Council

David Brant
Acting Commissioner

Sonya Allen
Office of the Bank Commissioner

Pat Bolan
American General Finance Inc.

Jerel Wright
Credit Union Administrator

George Barbee
Kansas Association of Financial Services

Robert Elliott
(Former Consumer Credit Commissioner)

Barkley Clark
Mark Ovington
Mark Hargrave
Shook, Hardy & Bacon L.L.P.

Senator Donald Biggs
Senate Financial Institutions and Insurance
Committee

Anne Lolley
Kansas Bankers Association

Representative Ray Cox
House Financial Institutions Committee

SueAnn Schultz
Insurance Management Associates

Other Participants

Robert Trigg, Financial Examiner
Jo Anne Minihan, Financial Examiner
Debbie Richardson, Public Service
Administrator
Office of Consumer Credit Commissioner

William G. Wolff
Legislative Research Department

Guen Easley
Nancy Ulrich
Assistant Attorneys General

David Lord
Office of the Securities Commissioner

Marc Hamann
Division of the Budget

OFFICE OF CONSUMER CREDIT COMMISSIONER

1998-99 UCCC Drafting Committee

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Acting Commissioner

Greg Taylor
Household Financial

SueAnn Schultz
Insurance Management Associates

Terri Thomas
Housing and Consumer Credit Counseling

Sonya Allen
Kevin Glendening
Office of the Bank Commissioner

Steve Rarrick
Jim Welch
Assistant Attorneys General

Robert Trigg, Financial Examiner
Jo Anne Minihan, Financial Examiner
Samantha Parks, Law Clerk
Office of Consumer Credit Commissioner

David Lord
Office of the Securities Commissioner

Barkley Clark
Mark Ovington
Mark Hargrave
Shook, Hardy & Bacon L.L.P.

Professor Keith Meyer
University of Kansas School of Law

Professor Steve Ramirez
Washburn University School of Law

USURY RATES FOR CONSUMER CREDIT TRANSACTIONS

SB 301

	Example Lenders	Current Usury Rate	Proposed Usury Rate	Authority	Year Effective
In state credit cards (Open End)	Intrust	18%	No limit	K.S.A. 16a-2-402	1974
Out of state credit cards (Open End)	Visa Mastercard	No limit	No limit	National Bank Importation Act 12 USCA 385	1980
Retail sales (Open end)	Ed Marlings Best Buy	No limit	No limit	K.S.A. 16a-2-202	1997
Retail sales (Closed end)	Ed Marlings Best Buy	No limit	No limit	K.S.A. 16a-2-201	1997
Consumer loans (Open end)	Household American General	18%	No limit	K.S.A. 16a-2-402	1974
Consumer loans (Closed end)	Household American General	18%	No limit	K.S.A. 16a-2-401	1995
Auto Retail Sales (Closed end)	Auto Dealers GMAC; Ford	No limit	No limit	K.S.A. 16a-2-201	1997
1st Mortgage (Fixed rate)	Capitol Federal	1½% over FreddieMac (8.21 for February)	No limit	K.S.A. 16-207(b)	1983
2nd Mortgage (Fixed rate)	FirstPlus The Money Store	18%	18%	K.S.A. 16a-2-401	1995
1st & 2nd Mortgages (Variable rate)	AAA Mortgage	No limit	No limit	K.S.A. 16-207(h)	1983
1st & 2nd Mortgage (Balloon payment)	Nationwide	No limit	No limit	K.S.A. 16-207(h)	1983
Rent To Own	Rent-a-Center Rent-All	No limit	No limit	Not regulated Except contract terms	N/A
Pay Day Loans (\$100 for 16 days)	QuikCash Mister Money	342% (\$15 charge)	342% (\$15 charge)	K.S.A. 16a-2-404	1993

*disclosure
(key)*

*5-1
Ex
Rates should
remain*

1-5



Department of Justice

CONSUMER CREDIT: REGULATORY CHALLENGES & THE SEARCH FOR BALANCE¹

I. THE SEARCH FOR BALANCE: Benefits and Problems in a Deregulatory, Growth-Oriented Environment

A. Janus-faced: Record Credit Outstanding/ Record Debt Levels

- Growth in both "productive credit" & "destructive debt;" failure by all concerned to keep the distinction in mind.
- Fuels growth in the economy; fuels growth in personal bankruptcies and raises specter of greater problems for over-leveraged households during economic downturn.

B. Janus-faced: Increased Market Segmentation

- Proponents: Niche markets increase access to credit
- Critics: "Financial apartheid" locks low-income, unsophisticated, and, too typically, minority consumers into high-cost (and too often low-value, overpriced) providers - *subprime market.*

C. Growing Consensus That There Are Abuses in the Marketplace Which Must Be Addressed

- There are necessary preconditions for an effective market to work; the necessary preconditions are missing in some sectors of the consumer credit marketplace. The problem is greatest in the subprime market.

Unequal information; unequal sophistication; unequal bargaining power; absence of meaningful choice -- which are typical in consumer credit -- is why

¹ Kathleen Keest; Assistant Attorney General, Deputy Administrator, Iowa Consumer Credit Code. The opinions expressed here are those of the author, and do not necessarily represent those of the Attorney General nor of the Office of the Attorney General.

consumer credit has historically been treated differently by the law than commercial credit, where the parties are more on a level playing field. These characteristics are present in most consumer credit transactions -- and are more pronounced in the subprime markets.

The resultant "opportunistic pricing," rather than "risk-based" pricing is the reason deregulated states have seen such creatures as 60% auto loans (or 80+% effective auto financing which is not disclosed as such) and 30% mortgages.

The line between "opportunistic pricing" and "risk-based pricing" is not yet an empirical one; but the market segmentation means that those least able to afford it pay most across the spectrum of financial services -- from check cashing to small loans (the 300-400% "payday" loans) to retail installment credit (the triple-digit rent-to-own); to overpriced automobiles where the pricing is driven by hidden costs of expensive financing; to high-cost (and sometimes "equity-skimming" mortgage loans). The degree of opportunistic pricing is limited in a regulated environment; unlimited in a deregulated environment. The result has been an increase in litigation to challenge such practices under fairness-based legal doctrine such as "unfair and deceptive acts and practices," "unconscionability" and various misrepresentation and fraud-based theories.

- See list of resources for some of the literature on the topic of "predatory" lending practices and problems in the "fringe banking" (or subprime) market.

II. *DIFFUSE ACCOUNTABILITY -- Who's In Charge?*

States must grapple with limits on their capacity to respond to the needs of the citizens of their states, because the scope of federal preemption is eroding their authority.

- The full scope is uncertain, with some federal regulators (and the industry) pushing the envelope. The rules are enormously complex, which creates problems in use of courts to interpret the complicated web of statutes and regulations. Congress has repeatedly expressed concern that federal regulators have been "inappropriately aggressive" in interpreting federal law to allow preemption of state law, but has been politically unwilling to draw bright lines in legislation.

- As the issue is too complex -- and the direct causal impact on constituents too hard to trace and articulate -- the states have not been vocal in expressing to Congress the need for democratic accountability. The result has been that, quite silently, the voting consumers in some states are being disenfranchised as to these very real pocketbook issues. They are disenfranchised because federal law permits the industry to force the states and the consumers in those states to ignore their own enactments, using instead the enactments of other states in

which they cannot vote. (It is a fundamentally anti-democratic process, because it doesn't substitute federal law for state law, rather the federal law permits the substitution of other states' laws.) The result in the states has been a "race to the bottom."

- States are left with the growing concerns about problems in the marketplace on the one hand, and restricted ability to address those problems. Nonetheless, the geographic patterns as to where the greatest problems occur suggest that one of the determining factors is the regulatory environment in the state. States which recognize that the role of government is to provide a balancing of interests have had fewer problems than states which do not. (Other factors include the literacy and educational level of the state's citizens; and economic factors such as highly appreciated real estate values.)

- Kansas, having opted-out of the federal preemption on first liens on mortgages, is one state which is better able to address abuses in the non-purchase money mortgage lending area.²

III. Targetted Protections in the Bill

Some of the proposals provide common-sensical guidelines which should not need legislation, but apparently do, such as the statutory provision telling creditors that a year has 365-days, and that they should not use accounting tricks that permit them to collect 5 extra days' interest a year.

But more significantly, the proposal takes steps to curb some of the abuses in the home-equity lending market that have plagued elderly, minority, and unsophisticated homeowners. While applying the interest rate cap to only second mortgages, instead of all non-purchase money mortgages, does open the door for some abuses which have occurred in other states,³ it is one of the best protections for those transactions which it covers.

By limiting the amount of prepaid finance charges which can be imposed within 12-month periods, it also imposes some restraint on one of the most frequently used tools of "equity skimmers" -- flipping.

² Kansas was one of 16 jurisdictions that "opted-out" of the federal law preempting state usury caps on first liens in the Depository Institutions Deregulation and Monetary Control Act of 1980 (DIDA). (The majority of the UCCC states opted-out.)

³ In Pennsylvania, which did not opt-out, and therefore had deregulated first lien mortgages, a "used car mortgage company" required first liens to secure its used car loans so that it could charge upwards of 30% on \$3000 used Buicks. The result was that 19-year olds buying their first cheap used car would have to ask their grandmothers to co-sign -- putting their grandmother's home on the line when the car broke down and the 19-year old stopped paying.

**A FEW RESOURCES ON PROBLEMS
IN THE CONSUMER CREDIT MARKET PLACE**

"Equity-Skimming" and Home-Equity Secured Lending

Congressional Hearings:

Hearing, *Equity Predators: Stripping, Flipping and Packing Their Way to Profits*, U.S. Senate Select Committee on Aging, (March 16, 1998).

Problems in Community Development Banking, Mortgage Lending Discrimination, Reverse Redlining, and Home Equity Lending, Hearings Before the Senate Comm. on Banking, Housing and Urban Affairs, 103d Cong. 1st Sess. (Feb. 3, 17, 24, 1993)

Hearing on S. 924 Home Ownership and Equity Protection Act, before the Senate Banking Committee, 103d Cong., 1st Sess. (May 19, 1993).

The Home Equity Protection Act of 1993, Hearings on H.R. 3153 Before the Subcommittee on Consumer Credit and Insurance of the House Committee on Banking, Finance and Urban Affairs, 103d Cong. 2d Sess. (March 22, 1994).

Government & Quasi-Governmental Reports:

Federal Reserve Board and Department of Housing and Urban Development, *Joint Report to Congress Concerning Reform to the Truth in Lending Act and the Real Estate Settlement Procedures Act* (July 1998) (Chap. 6, "The Need for Additional Substantive Consumer Protection.").

Freddie Mac, *Opening Doors: Serving More of America's Families* (August 14, 1998) (examining subprime mortgage market, and Freddie Mac's proposal to utilize secondary market to ease the problems created by the segmentation into prime and subprime markets: notes that as many as 30% of the subprime mortgage borrowers could be eligible for prime market; and finds that implementation of their risk-based pricing could reduce current subprime customers' costs by \$120/per month.)

Other:

AARP, *Predatory Financial Practices: How Can Consumers Be Protected?* AARP Public Policy Institute, (Winter, 1998).

Consumers' Union, *Dirty Deeds: Abuses and Fraudulent Practices in California's Home Equity Market* (Oct., 1995); updated *The Hard Sell: Combating Home Equity Lending*

Fraud in California," (Consumers Union West Coast Regional Office, July, 1998).

Fringe Banking Market Generally

"Poverty, Inc." Consumer Reports, p. 29, July, 1998

Michael Hudson, *"Merchants of Misery"* (Common Courage Press 1995)

Consumers Federation of America, *A Report on the Payday Loan Industry*, November 1998)

Consumers Federation of American, *The High Cost of 'Banking' at the Corner Check Cashier: Check Cashing Outlet Fees and Payday Loans*, (August, 1997)

Many newspaper articles around the country have addressed the problems in the subprime financial services markets, as have national programs such as PrimeTime Live, 20/20 and Dateline.

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MEMORANDUM

TO: SENATE COMMITTEE ON FINANCIAL INSTITUTIONS AND INSURANCE

FROM: BARKLEY CLARK

DATE: FEBRUARY 16, 1999

RE: SENATE BILL NO. 301

Senate Bill No. 301 is a balanced bill which addresses the legitimate concerns of Kansas-based creditors while at the same time offering greater protection for Kansas consumers. Here are some of the bill's highlights:

- **Elimination of Usury Limits for all Loans other than fixed-rate ^{18%^{1/2}} Second Mortgage Loans and Payday Loans**, thus giving Kansas-based creditors the same interest rate pricing options available to many out-of-state creditors who can "export" their home state's interest rate laws (which often have no usury caps whatsoever). The bill also eliminates the current illogical distinction between credit sales (which have no usury limits) and loans (which have some usury caps). Importantly, the current 18% usury cap will remain for fixed-rate second mortgage loans.
- **Eliminating some Fee Restrictions on Credit Cards and other Open-end Loans**, thus giving Kansas-based creditors the same fee pricing options available to many out-of-state lenders due to their exportation powers (as with interest rates above).
- **Strengthening Licensing and Enforcement Powers over Supervised Lenders**, thus giving the Consumer Credit Commissioner greater authority to regulate lenders making loans to Kansas consumers. The bill also better regulates "deceptive" advertisements by lenders regarding the availability of loans at certain interest rates. Significantly, the bill requires that licensees post a \$100,000 surety bond, as opposed to the current ineffective \$25,000 in "business assets" requirement.
- **Requiring Appraisals and Disclosures for High Loan-to-Value Mortgages**, thus giving Kansas consumers more information about the dangers of high loan-to-value mortgages, and helping to regulate the secondary market for so-called "125 mortgages" (where the loan-to-value ratio, based on an appraisal, may in fact exceed 125%). - requires appraisals; consumer education; credit counseling.
- **New (tougher-than-federal-law) Regulations on Balloon Payments and Negative Amortizations of Mortgage Loans**, which prohibit balloon payments and negative amortizations for various mortgage loans.
- **New Limits on Prepaid Finance Charges**, which cap the total amount of prepaid finance charges (including mortgage broker fees) to 10% of the amount financed. As a further restriction, the bill caps the amount of prepaid finance charges payable to the lender to 5% of the amount financed. This is a major improvement over current law, which does not directly cap the amount of broker fees and "buy-down" interest rate points and closing costs which may be charged to the consumer up front.
- **Restrictions on "Loan-Flipping,"** which restrict the amount of up-front fees that a lender can collect on a loan that is being refinanced with the same lender or a related lender within 12 months. This is also a big improvement over current law, where creditors can charge up-front fees over and over again, by continuing to induce consumers to refinance.
- **High Interest Rate or Loan-to-Value First Mortgages Now Subject to the Code**, thus giving consumers under some first mortgage loans the same default and cure rights that other borrowers under the code enjoy.