

MINUTES OF THE HOUSE FINANCIAL INSTITUTIONS.

The meeting was called to order by Chairperson at Ray Cox on February 16, 2000 in Room 527-S of the Capitol.

All members were present except: Representative Cindy Empson  
Representative Carlos Mayans

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

Conferees appearing before the committee: Chuck Stones, Kansas Bankers Association  
Steve Rarrick, Office of the Attorney General  
Ernest Pogge, AARP

Others attending: See attached

Chairman Cox said the committee would take final action on **HB 2675 - UCCC, manufactured homes.**

Representative Grant made a motion to adopt the amendments to HB 2675. Representative Vickrey seconded the motion. The motion carried.

Representative Vickrey made a motion to pass HB 2675 out favorably as amended. Representative Burroughs seconded the motion. The motion carried.

Chairman Cox said the committee would take final action on **HB 2753 - Banks and trust companies, list of stockholders.**

Representative Burroughs had a question on **HB 2753**. He said that line 19 said "president or cashier of every bank and every trust company." He said there is a wide gap of responsibility between a president and a cashier. He asked about having it read "designated employee." Judi Stork, Office of the State Bank Commissioner, said really what they're looking for, when they say president or cashier, is whoever fills it out in the bank. They don't really care who fills it out, they are just checking that it is attested to or signed by those parties. They want to know that a responsible party in the bank has looked it over.

Chairman Cox reminded the committee that there was an amendment presented for **HB 2753** which read "except that the names and addresses of all stockholders owning less than 5% of the capital stock of such bank shall be confidential and shall not be subject to disclosure under the provisions of the open records act."

Representative Dreher made a motion to adopt the amendment to HB 2753. Representative Merrick seconded the motion. The motion carried.

Representative Grant made a motion to move HB 2753 out favorably as amended. Representative Minor seconded the motion. The motion carried.

Chairman Cox opened the hearing on: **HB 2825 - Consumer protection, prohibiting obtaining or submitting check without consent.**

**Neutral:**

**Chuck Stones**, Kansas Bankers Association, provided written information on how drafts, checks and negotiable instruments work at banks. The bank has a responsibility to pay only those items which are "properly payable." Normally, the item has to be properly authorized to be properly payable. On a check, it's your signature. When it's a draft, there is no signature and drafts can come in many forms. Many times it looks exactly like a check and even has a customers' name printed on it. How the draft is authorized, is the critical issue here. Often, an authorization is secured by the customer signing a form up-front saying it's alright to deduct certain items from an account. The form is filed at the bank. What's happened in telemarketing activities, a lot of times, is they will call a customer and ask for their authorization to purchase certain items. That's where it gets sticky. If a customer gives their account number and in their head they

## CONTINUATION SHEET

FINANCIAL INSTITUTION, Room 527-S Statehouse, at 3:30 p.m. on February 16, 2000.

know they're buying something, that is deemed to be authorization. What is happening with a few telemarketers is they will ask for your account number to verify that you're won a prize. In the customer's mind, even though they are giving their account number, they are not giving authorization. It's sticky for the bank. If it pays an unauthorized draft and the customer comes back and says I didn't authorize this, the bank's on the hook. It must credit the customers account back. It's the bank's final responsibility to determined whether the draft is authorized or not. Bank's have done a lot of things, mostly internally, to deal with this. For example, sometimes drafts over a certain amount are kicked out to be handled manually. He referred to the new FTC rule. (**Attachment 1**)

### **Proponents:**

**Representative Gerry Ray** said she couldn't believe it when she learned, last year, that withdrawals could be taken from your account without your consent. She introduced **Steve Rarrick**, Office of the Attorney General, who said he was approached last year by a couple of groups, primarily the AARP, because they were very concerned about their constituents. The AG's office receives complaints on a regular basis from consumers whose accounts have been accessed without their authorization. There are numerous deceptive means that companies use to convince people to give their checking account number over the phone. Now the internet is a new means to do so. His office regularly cautions people, to not give out their checking account number, in their consumer education pieces. Most banks don't have the time to screen for unauthorized withdrawals: often banks pay them. Then it becomes the burden of the consumer to review their statement. There are certain rules about when they must notify the bank or they will suffer the loss. It also puts banks in a bad position. The language of the bill may not yet be exact or perfect. It has been brought to his attention that perhaps the phrase "negotiable paper" might be better phrased "negotiable instrument." His office believes the bill will get banks out of a "catch 22" situation. There are federal rules with regards to getting either written or oral verification or subsequent written verification. Unfortunately, the kind of businesses that do not follow the guidelines aren't around when his office is called in to take action. The AG's office supports **HB 2825** and is open to amendments to it. (**Attachment 2**)

**Ernest Pogge**, AARP, said he expresses the views of 340,000 members in the state of Kansas. They are in support of **HB 2825**. Telemarketing fraud victimizes people of all ages, ethnic groups, educational backgrounds and income levels. Unfortunately, unscrupulous telemarketers often target older Americans. Congress passed the Telemarketing Fraud Prevention Act early in 1998. However, it addresses only certain deceptive and abusive practices. Many known abuses are still permissible. States such as Kentucky, Montana, Vermont, and Arkansas have addressed the access to bank account concerns. AARP supports access to consumers' bank, savings, trust, stock or bond accounts by a telephone solicitor only after receipt of written consent by the consumer. (**Attachment 3**)

Chairman Cox asked Steve Rarrick why the wording was changed to "negotiable instrument" in the amendment. Mr. Rarrick said he thought it was because it was the term used in the statute. The Chairman asked KBA if there was any feedback. Kathy Olsen said negotiable instrument is a term defined in the UCC.

A question-answer period followed. Particular areas of concern were: 1) situations where the amount of an authorized withdrawal would change due to the addition of a service or coverage and 2) the possibility of hurting honest business people.

There was a suggestion to grandfather existing businesses so that written authorization would be required from this day forward. Mr. Rarrick said that could be done or language could be added to the section which would basically allow ongoing business relationships to have one authorization that can be amended orally between the consumer and the merchant.

Chairman Cox closed the hearing on **HB 2825**.

Representative Sharp made a motion to approve the minutes for February 9<sup>th</sup> as written. Representative Vickrey seconded the motion. The motion carried.

The meeting adjourned at 4:17 p.m. The next meeting is scheduled for February 21, 2000.

# HOUSE FINANCIAL INSTITUTIONS COMMITTEE GUEST LIST

DATE: February 16, 2000

NAME	REPRESENTING
KEITH R LANDIS	CHRISTIAN SCIENCE COMMITTEES ON PUBLICATION FOR KANSAS
BILL EGGERS	AARP
DON QUINN	AARP - MANSB-JOHNSON CITY.
DARRELL DONAHUE	AARP - BSRS
DIK LAVERENTZ	AARP
Shelley Nelson	AARP
Bill Sneed	CONSECO FIN CORP
Ernest C. Fogge	AARP
DEAN GILSTRAP	AARP
Elaine Gilstrap	AARP - SLC.com.
William Liffen	AARP - SLC.com
Tim McConville	Federico Consulting
Kathleen Olson	KFA
Rep Gerry Ray	Legis
Matt Gaddard	HCBA
J. TED WALTERS	AARP/KRTA
Wm Bill Crosby	AARP SLO
Donna L. Gracie	AARP SLC
Vera Spencer	AARP SLC

John D. Linger  
Lauri Jones

DMA  
AARP SLC

HOUSE FINANCIAL INSTITUTIONS COMMITTEE GUEST LIST

Cont.

DATE: February 16, 2000

NAME	REPRESENTING
Mike Recht	AT&T
Eloise Lynch	AARP
Maven Turner	AARP

## UNAUTHORIZED PAPER DRAFTS

### ■ Need for "Authorization"

Under the Uniform Commercial Code, banks have a responsibility to pay only those items which are "**properly payable**." To be properly payable, an item must be **authorized** by the account holder. An account holder "authorizes" payment of a regular bank check by **signing** that check. But a "draft" is not signed by the account holder. A draft is an order (to the bank) by a third person to pay the third person with funds from the account holder's account. Like checks, the draft is properly payable only if payment is authorized by the account holder, but since the draft is not signed, it is difficult to determine whether these paper drafts have actually been authorized.

### ■ Telemarketing Problems

Paper drafts are commonly used by insurance companies and utility companies; these insurance/utility drafts are typically authorized by the account holder and rarely create a problem for the bank. Most problems relating to unauthorized paper drafts arise out of **telemarketing** practices. Telemarketing companies market products over the telephone, and have, in some instances, presented unauthorized drafts. Not all telemarketing is inappropriate; most telemarketing companies—annoying as they may be—are reputable companies who properly use the telephone to generate legitimate sales. But a few telemarketers have used information received over the phone to prepare unauthorized paper drafts. For example, an unscrupulous telemarketer might ask a bank customer to give his/her checking account number (or bank routing number) so that the telemarketer can "verify" that the customer has won a prize. Once the telemarketer has those numbers (and there are numerous schemes enabling the telemarketer to obtain that information), he/she can use them to prepare an unauthorized draft against the customer's account. These drafts look just like a check, except the customer's **actual signature** is **missing**. In some cases, the customer's name is printed in the signature space; other drafts contain a notation claiming that the "signature" is authorized.

### ■ Bank Liability

If the customer gives the telemarketer his/her account number and **understands** that the number will be used to draft funds out of the customer's checking account, the draft is indeed "authorized" and is properly payable. But if the customer gives the number for some other reason (like verifying a prize) and **does not understand** that the number will be used to debit funds from his/her account, the resulting draft is "unauthorized" and is not properly payable. If the bank pays an unauthorized (not properly payable) draft and the customer complains, the bank will be required to **re-credit the customer's account** and take the loss. The draft **cannot be returned** to prior banks because determining whether a draft is "authorized" is the responsibility of the bank on which the draft is drawn.

### ■ Avoiding Losses

Bankers should be aware of the risks associated with unauthorized paper drafts, but this is not to say that all drafts must be individually scrutinized and dishonored. In fact, common sense would suggest that most drafts should be paid without question. It is not likely, for example, that a draft presented by Blue Cross Blue Shield (or a utility company) is unauthorized. But drafts presented by **unfamiliar businesses** should be closely **scrutinized**. Where the bank finds an unsigned draft presented by an unfamiliar payee, it should consider **contacting the account holder** to determine whether the draft is authorized. If it is not authorized, the draft must be returned through the check-collection system by the bank's midnight deadline.

■ **Practical Considerations**

As indicated above, a bank can avoid liability by verifying customer authorization on suspicious drafts. In many cases, however, it is *more practical to simply pay* every draft without question and re-credit the customer's account in the event a draft turns out to be unauthorized. Similarly, a bank could choose to pay smaller drafts without question, but *verify authorization on larger items*. Under these policies, the bank simply accepts the fact that it might unknowingly pay a few unauthorized drafts for which it will be liable. This can be a legitimate business decision in which bank management concludes that the cost of a few unauthorized drafts will be less than the cost of routinely verifying customer authorization. Banks with these "just-pay-it" policies consider unauthorized-draft losses part of the cost of doing business.

■ **Educating Customers**

Perhaps the best way to control unauthorized-draft losses is to *educate bank customers*. Bankers might consider using *statement stuffers* to warn of possible telemarketing fraud. Likewise, banks can work with the *local newspaper* to alert the public about telemarketing problems. And since telemarketing fraud is often aimed at the elderly, banks may want to consider a short *seminar or "town meeting"* to discuss the matter with its older customers. Customers should be advised to never give any account information to anyone over the telephone. Once customers understand this "rule," unauthorized-draft problems will significantly diminish. Also be aware that Bankers Systems sells a pre-printed *brochure* which advises bank customers of telemarketing scams.

■ **New FTC Rule**

In September 1994, Congress passed the Telemarketing and Consumer Fraud and Abuse Prevention Act which directs the Federal Trade Commission (FTC) to issue rules prohibiting deceptive telemarketing practices (15 U.S.C. §6102). Pursuant to this Act, the FTC originally proposed a rule that would have required telemarketers to obtain *written* authorization before issuing a draft against a consumer's account. That requirement was ultimately deleted, however, and the final rule simply prohibits a telemarketer from issuing a draft without "express verifiable information." An authorization is "verifiable" if it is:

- In writing;
- Tape recorded and made available to the consumer's bank upon request; or
- Confirmed by a writing sent to the consumer prior to submitting the check for payment.

While not fool proof, this relatively new regulation may be successful in limiting the number of unauthorized telemarketing drafts.

■ **Other Common Draft Situations**

While most paper drafts will be drawn by utility companies, insurance companies and telemarketers, there are some other situations in which paper drafts will commonly be drawn against a customer's account. One company, for example, is advertising a new "*checks-by-fax*" system (CHAX). This system, being marketed to businesses, would apparently enable the business's customer to make payment by faxing (instead of mailing) a check. It is unclear how this system works, but it is likely that the company uses the faxed check as an "authorization," then issues its own paper draft against it's customer's account. Other types of paper draft situations might include drafts issued by *collection agencies* to obtain payment from a debtor's account; and drafts drawn by *casinos* to cover a person's gambling expenses.

■ **Different Rule for EFT's**

Finally, note that a payor bank will be liable for an unauthorized debit only if the debit arises as a result of a *paper draft*. If an electronic funds transfer (*EFT*) *debit is unauthorized*, special NACHA rules put the liability squarely on the *originating bank* (and not the account holder's bank).

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CARLA J. STOVALL  
ATTORNEY GENERAL

State of Kansas

## Office of the Attorney General

### CONSUMER PROTECTION/ANTITRUST DIVISION

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Testimony of  
Steve Rarrick, Deputy Attorney General  
Consumer Protection Division  
Office of Attorney General Carla J. Stovall  
Before the House Financial Institutions Committee  
RE: HB 2825  
February 16, 2000

Chairperson Cox and Members of the Committee:

Thank you for the opportunity to appear on behalf of Attorney General Carla J. Stovall today in regard to HB 2825. My name is Steve Rarrick and I am the Deputy Attorney General for Consumer Protection.

HB 2825 would prohibit suppliers from obtaining or submitting for payment a check, draft, or other form of negotiable paper, drawn on a consumer's checking, savings or bankcard account without the express written authorization of the consumer. Many people are surprised when they learn that money can be removed from your checking account without your signature.

Our office has received complaints and inquiries from consumers who have (1) had money taken from their bank account without their knowledge or (2) inadvertently given their bank account number to a supplier and become worried the supplier could illegally access their account. This scenario is most prevalent in transactions involving telemarketing. Unscrupulous telemarketers will, after a convincing sales pitch, convince consumers to provide their checking account number. Then, with or without the consent of the consumer, the telemarketer will submit a demand for payment to the bank.

Once the money has been paid out by the financial institution, it is extremely difficult to get it back. Unlike credit cards, checking accounts do not have protections such as an expiration date to verify possession of the card and, more importantly, a process for the consumer to contest payment of the bill. The money is simply gone from your account.

Kansas banks often find themselves caught between their customer who denies authorizing payment, and the supplier requesting payment. It's usually a no-win situation for banks. If they pay the amount submitted, their customer is unhappy and may sue and/or take their business elsewhere. If they deny payment, the supplier sues for payment. I believe that his bill will resolve this dilemma. It is my understanding that the Kansas Bankers Association is taking no position on this bill.

*House Financial Institutions*  
*2-16-00*  
*Attachment 2*



A representative of the Kansas Bankers Association has indicated the term "negotiable paper" may need to be changed to "negotiable instrument."

On behalf of Attorney General Stovall, I urge you to recommend passage of HB 2825. I would be happy to answer questions of the Chair or any member of the Committee.



# *in Kansas*

February 17, 2000

Good afternoon Representative Cox and Members of the House Committee on Financial Institutions. My name is Ernest Pogge. I am a volunteer member of our AARP Kansas State Legislative Committee and Chair of our Capital City Task Force (CCTF). We represent the views of our more than 340,000 members in the state of Kansas. Thank you for this opportunity to express our views in support of House Bill 2825.

Telemarketing fraud victimizes people of all ages, ethnic groups, educational backgrounds and income levels. Unfortunately, unscrupulous telemarketers often target older Americans.

In response to the growing problem of telemarketing fraud, Congress passed the Telemarketing Fraud Prevention Act early in 1998. This Act addresses some of the jurisdictional problems involved in combating telemarketing fraud originating from locations outside US borders. The new law, coupled with the Telemarketing and Consumer Fraud and Abuse Prevention Act enacted in August 1994 and the Federal Trade Commission's 1995 Telemarketing Sales Rule, provides more tools for both law enforcement and consumers to use in reducing telemarketing abuses. State attorneys general are allowed to enforce the Rule in federal court, which will permit them to seek remedies against telemarketing fraud nationwide, instead of having to prosecute violations state-by-state.

However, the Telemarketing Sales Rule addresses only certain deceptive and abusive practices. Many known abuses are still permissible. States such as KY, MT, VT and AR have addressed the access to bank accounts concern. *State legislation is needed.*

AARP supports access to consumers' bank, savings, trust, stock or bond accounts by a telephone solicitor only after receipt of written consent by the consumer. Consumers need the opportunity to make a decision without the undue pressure of the telemarketer on the telephone. This can only be accomplished when consumers have time to consider all the information and make a voluntary, informed choice.

Fraudulent telemarketers use verbal authorization to access the consumer's account before the consumer has the opportunity to adequately consider the high pressure telephone sale. The FTC Rule permits access to consumer accounts with "verifiable authorization". One form of verifiable authorization includes verbal consent from consumers that is supposed to be tape recorded by the telemarketer. The telemarketer must maintain the tape and

upon request from the consumer's bank make the tape available. However, banks are under no obligation to request the tape prior to making payment to the telemarketer. Once the bank makes payment to a fraudulent telemarketer, the consumer's money is lost.

Therefore, AARP only supports written authorization. Thank you for this opportunity to express our views.

Ernest Pogge  
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