

MINUTES OF THE HOUSE FINANCIAL INSTITUTIONS.

The meeting was called to order by Chairperson Ray Cox at 3:30 p.m. on February 19, 2001 in Room 514-S of the Capitol.

All members were present except: Representative Jene Vickrey - Excused

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

Conferees appearing before the committee: Matthew Goddard, Heartland Community Bankers Assn.
George Barbee, Kansas Association of Financial Services
Kathy Olsen, Kansas Bankers Association
Paul Davis, Kansas Bar Association
Melissa Walker, Kansas Association of Mortgage Brokers
Kevin Glendening, Office of the State Bank Commissioner
Bruce Morgan, Banking Board Member
Franklin Nelson, State Bank Commissioner
Karen France, Kansas Association of Realtors
David Brant, Securities Commissioner

Others attending: See Attached

Chairman Cox opened the continuation of the hearing on - HB 2254 Enacting the California credit score disclosure act.

Opponents:

Matthew Goddard, Heartland Community Bankers Association, said his organization has serious concerns and opposition regarding HB 2254. They have three main concerns regarding the bill. First, it would put a state law in place of a federal law, the Fair Credit Reporting Act, which they believe is working right now. The law requires that consumers who are turned down for credit be given a copy of the credit report plus other information. A second reason is that congress is looking at federal regulation. There is no reason for Kansas to take an action ahead of the Feds. The third reason is that status quo and companies in the market place are already taking care of this. A final troubling aspect of the bill is that it requires everyone involved with the loan to get a copy of the credit score. This is not necessary. If it were, the federal government would have required it long ago. He urged the committee not to take action on the bill. (Attachment 1)

George Barbee, representing Kansas Association of Financial Services, which is made up of consumer credit lending companies, said he agreed with the previous conferee's comments. You can get a free credit report, which is more comprehensive than a credit score, if you have been declined credit. The same credit report is available to all consumers for \$8. If we already have access to credit reports, we do not need another statute to place a burden on the system. The fair thing to do is to wait and see what happens with this legislation in California, when it becomes effective in July of 2001. (Attachment 2)

Chairman Cox closed the hearing on HB 2254 and opened the hearing on HB 2465 - Prudent investor act.

Proponents:

Kathy Olsen, Kansas Bankers Association, covered testimony prepared by Daryl Craft of their Trust Division. Last session the legislature replaced an earlier version of the Uniform Prudent Investor Act and placed it in a different location, from the original Act, in the Kansas Statutes Annotated. HB 2465 corrects a number of references to the old location and replaces one paragraph that was left out of the Act last session. This paragraph concerns the written directions of a grantor and clarifies the ability of the trustee to follow these written instructions. (Attachment 3)

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Paul Davis, Kansas Bar Association, spoke in favor of **HB 2465**. It has been a cooperative effort on the part of Kansas Bar Association, Kansas Bankers Association, and the Kansas Trial Lawyers Association. He requested favorable consideration of the bill. (**Attachment 4**)

Chairman Cox closed the hearing on **HB 2465** and opened the hearing on **HB 2481 - Kansas mortgage business act; regulation of**.

Proponents:

Melissa Walker, Kansas Association of Mortgage Brokers, said that **HB 2481** is crucial to the mortgage industry. They believe that it is very important for mortgage representatives, that have dealings with the general public, to be not only licensed but also to have required continuing education. This increases professionalism throughout the industry, will get rid of the bad apples, and insures that only qualified professionals are dealings with the public. (**Attachment 5**)

Chairman Cox asked if the bill required the out-of-state brokers to have an office, i.e. a physical presence, in the state of Kansas. Melissa said it was her understanding that they would have to have a larger bond if they do not.

Kevin Glendening, Deputy Bank Commissioner, said the bill represents somewhat of a shift in the way they propose to license mortgage lenders and brokers. There are lots of amendments in the bill which can be grouped into three categories. The first issue is, due to low start-up costs, there are a large number of companies engage in the business and they cover a sizable range in ability and experience levels. The bill would authorize his agency to establish continuing education and testing requirements for individuals engaged in mortgaged brokering. The second broad category is the change to the current bonding structure for in-state companies. The change eliminates several alternatives which have been underused and difficult to enforce. The third issue pertains to the establishment of what could be described as a laundry list of prohibited business practices, as well as additional clarification on advertising and related matters. They generally deal with possible deceptive and/or predatory types of activities. The bill also extends the existing criminal penalties to the entire act and makes the prohibited activities subject to criminal as well as administrative action. He believes **HB 2481** will enhance the protection afforded consumers. Kevin pointed out that starting on page 10, line 27 of the bill the numerical numbering of the subsets should be changed to alphabetical numbering. (**Attachment 6**)

Chairman Cox closed the hearing on **HB 2481** and opened the hearing on **HB 2482 - Powers and duties of the state banking board and bank commissioner**.

Dr. Wolf gave a summary of the bill. He stated that for the last couple of years there have been an issue coming from the Senate to the House that talked about the functions of the commissioner and the functions of the board. Last year there was a bill which was going to transfer some of the functions or responsibilities to the place that was most appropriate for each of the two entities. In the past year the board has gone back and gone over the issues and **HB 2482** is the work product of the activity. A number of things that are currently delegated to the State Banking Board are now being transferred to the Commissioner. He reviewed the changes which included: changing a bank's name; reducing the capital stock of a bank; issuance of preferred stock; reducing the surplus of a bank; establishing a subsidiary and investing money in that subsidiary; approval and authorization to hold life insurance policies on officers and employees; doing away with pledged shares for qualifying directors; ability of bank to issue capital notes and debentures; and approval of branches of eligible banks. The Commissioner would have authority to grant a bank branch office, but the banking board would hear any appeals. The Commissioner has authority, in the case of a problem bank to create special deputies and to assign those persons to those banks to stay there until relieved by the Commissioner. This authority has been with the State Banking Board. The Commissioner has been given the authority to establishing emergency charters in those locations where they are needed. The result, of this change of responsibility, is that the Board will review what it believes it ought to be involved with, as it relates to decisions being made in the Banking Department, and the Bank Commissioner will be delegated those areas where they believe the Commissioner should have sole authority to act. All this pertains to policy decisions for the committed to decide. There are also some changes which simply clean up language. He pointed out

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MINUTES OF THE HOUSE FINANCIAL INSTITUTIONS at on February 19, 2001 in Room 514-S of the Capitol.

a printers error on line 32. The word "provided" should not be there.

Proponents:

Bruce Morgan, Banker and Banking Board Member, said there are 271 banks in the state regulated by the banking department. They last came to the committee in March 1999 regarding this matter. Since then, the Banking Board adopted a mission statement and reviewed all the laws relating to duties of the State Banking Board against the mission statement. The bill shifts a number of the duties from the Banking Board to the Bank Commissioner that are administrative in nature and do not involve policy decisions that require review by the nine member Banking Board. These are things that affect the Commissioners' job and the Banking Board believes the changes will improve the efficiency of the Office of the State Bank Commissioner and streamline the regulatory process of the State Banking Department. Administrative decisions can be made on an expatiated basis similar to what national banks, that are regulate by the office of Comptroller of Currency, now enjoy. The Banking Board compared the parallel laws and regulations that the OCC or Federal Reserve have the national banks go through. The bill strengthens the Office of State Bank Commissioner, preserves the policy and advisory role of the State Banking Board on issues of importance and is in the public's interest. **(Attachment 7)**

Franklin W. Nelson, State Bank Commissioner, said the Banking Board and his office followed the suggestions of the House FI and Senate FI & I Committees last year that they review the Banking Board powers and the statutes that are obsolete and outdated. Since that time, the board, with the aid of his office, has been reviewing the statutes and powers. The Banking Board members were very thorough in their review. The product contained in this bill is the cumulation of 10 to 12 months of comprehensive discussions. He complimented the nine member Banking Board for a job well done. He strongly supports **HB 2482** and requests the favorable consideration of the committee. **(Attachment 8)**

Chairman Cox closed the hearing on **HB 2482**.

Chairman Cox asked **Karen France** if she had any comments to make regarding **HB 2254**. Karen said she knew the committee had a lot to deal with before the turn around deadline and suggested that perhaps the committee would ask for an interim study on the issue of credit scores. This would give the opportunity for information to be gathered from California. Chairman Cox said he wasn't sure there would be enough time to gather much data since the law didn't take effect until July. Karen suggested perhaps some sort of monitoring function be done if there is an interim committee on another matter.

Chairman Cox asked Commissioner Brant to tell the committee what was on his mind regarding **HB 2243 - Regulating securities, powers of the commissioner**.

David Brant, Securities Commissioner, said he was prepared to strip the provisions in **HB 2243** that deal with variable annuities and variable products, if the committee would consider that favorably. He submitted a handout listing amendments which would accomplish this. The handout also listed two minor technical amendments and the adding of language to provide a five year sunset on the propose investor education fund. The five year sunset provision was suggested by a legislator. **(Attachment 9)** He also submitted a copy of an article in the Wall Street Journal regarding switching of variable annuities. **(Attachment 10)**

Chairman Cox said the committee would now work some bills.

HB 2243

Representative Tomlinson moved to amend **HB 2243** along the outline submitted by Commissioner Brant.

Representative Dreher seconded the motion. The motion carried.

Representative Tomlinson moved to recommend **HB 2243** as amended marked favorable for passage. Representative Dreher seconded the motion.

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Representative Grant made a substitute motion to table **HB 2243**. Representative Boston seconded the motion. The motion carried on a hand count of eight yeas.

HB 2254

Representative Burroughs made a motion to study the results of the California legislation in an interim committee. Either one set up for the specific purpose or attached to another interim committee.

Representative Tomlinson said everything could be accomplished without putting it in the form of a motion. He suggested the committee not take any action.

Representative Burroughs withdrew his motion.

HB 2465

Representative Tomlinson made a motion that the committee recommend **HB 2465** marked favorable for passage. Representative Sharp seconded the motion. The motion carried.

HB 2481

Bruce Kinzie stated that besides the amendment to renumber subsets starting on page 10, the word "and" needed to be deleted on page 8, line 16.

Representative Burroughs made a motion to amend **HB 2481** as stated by Bruce. Representative McCreary seconded. The motion carried.

Representative Grant made a motion that **HB 2481** be passed favorably as amended. Representative Dreher seconded the motion. The motion carried.

HB 2482

Representative Minor made a motion to pass **HB 2482** marked favorable. Representative Sharp seconded the motion. The motion carried.

HB 2193 - Payday loans, limitations on number of loans to same borrowers

Representative Burroughs made a motion to remove all amendments made by the House Committee of the Whole and restore the bill to its original state. Representative Gatewood seconded the motion. The motion carried.

Representative Burroughs made a motion to pass **HB 2193** out favorable for passage as further amended. Representative Tomlinson seconded the motion. The motion carried.

The meeting adjourned at 4:40 p.m.

The date of the next meeting will be determined later.

HOUSE FINANCIAL INSTITUTIONS COMMITTEE GUEST LIST

DATE: February 19, 2001 Pg 1 of 2

NAME	REPRESENTING
Paul Davis	KS Bar Assn.
Matt Goddard	HCB A
Mike Stewart	Trans Union
Dan Murphy	TRANS Union
Robert Myer	Secretary of State
Erik Sartorius	K.C. Regional Assoc. of Realtors
Wanda Lee Smith	KMHA
Rick Friedstrom	KAIFA
Ame Spiess	KAIFA
George Barber	KAFS
Kevin Glendening	BANK Commissioner Office
Melissa Walker	Kansas Assoc. of Mtg. Brokers
LARRY MAGILL	KAIA
Chuck Stokes	KBA
BRUCE B. MORGAN	STATE BANKING BOARD
Jane Bateman	State Banking Board
HARRY HOWELL	KANSAS ASS. OF MORTGAGE BROKERS
Delia L. Emerson	KS. ACB / Credit Bureau of Topeka
Julie Numrick	federico Consulting

To: House Financial Institutions Committee

From: Matthew Goddard
Heartland Community Bankers Association

Date: February 19, 2001

Re: House Bill No. 2254

The Heartland Community Bankers Association appreciates the opportunity to share our concerns with House Bill 2254 to the House Committee on Financial Institutions.

House Bill 2254 is based on legislation, Senate Bill 1607, passed last September in California. The bill creates a new state regulatory scheme for the use of consumer credit scores by consumer credit reporting agencies and lenders. A credit score is calculated by applying information in a consumer's credit report to a statistical program that awards points to a consumer. The number representing the credit score is applied to a scale to determine whether or not the applicant qualifies for credit. A credit score is the most objective way to evaluate a loan applicant's credit worthiness.

In short, HB 2254 requires credit reporting agencies to make credit scores available to the public. The agency is authorized to charge a fee not to exceed \$8 for providing the credit score and associated information. Lenders who use a score are required to provide disclosures regarding credit scores to the loan applicant.

HCBA does not feel it is necessary for Kansas to legislate in an area already effectively governed by a uniform federal law. The Fair Credit Reporting Act (FCRA) already protects consumer interests when lenders use information provided by a consumer reporting agency. Senator Charles Schumer of New York introduced credit score disclosure legislation late last year and is expected to do so again in the 107th Congress. In addition, the private sector is already in the process of making credit scores available to consumers. These facts would seem to indicate that HB 2254 is simply unnecessary. The passage of legislation on the state level could in fact create a different regulatory environment in Kansas than that found in neighboring states.

The Fair Credit Reporting Act requires that if a user of a consumer credit report takes any type of adverse action based, at least in part, on the information contained in a credit report, the user is required to notify the consumer. The notification may be done in writing, orally or electronically and must include the following:

- the name, address and telephone number of the credit reporting agency that provided the report
- a statement that the credit reporting agency did not make the adver

to explain why the decision was made

- a statement setting forth the consumer's right to obtain a free copy of their credit report if the consumer requests the report within 60 days
- a statement explaining the consumer's right to dispute directly with the CRA the accuracy or completeness of any information in their credit report

Most institutions combine adverse action notifications required by FCRA and Regulation B, the rule implementing the Equal Credit Opportunity Act, on one disclosure form. A sample disclosure for loan denials based on a credit score is attached to this testimony. The model disclosure was written by the Federal Reserve. Please note that it includes why the credit score was insufficient. That information is much more important to a consumer than a number representing a credit score.

When a customer exercises their rights under FCRA, the credit report they receive includes all of the information that goes into their credit score. In some cases, the credit score is a part of the credit report. In response to the California law that HB 2254 is based on, the national credit reporting agencies are developing websites that, for a nominal fee as allowed in the law, will provide consumers with their credit score. Existing law and the marketplace are already making credit report and credit score information available to consumers.

In addition to questioning the overall need for the bill, HCBA specifically objects to Section 6. As the bill is drafted, Section 6 requires a lender who uses a credit score to provide disclosures regarding credit scores to the loan applicant. The threshold for the disclosures is the simple use of a credit score. In some cases, lenders receive a consumer credit score as part of selling a loan on the secondary market or securing private mortgage insurance, but the actual credit decision is made independent of any score. However, because a credit score is still involved with the loan, the threshold is crossed and the lender must begin providing disclosures.

HCBA would suggest that if the Committee intends to recommend the bill favorable for passage, then the responsibilities for lenders should be amended to have the same trigger as under FCRA, denial of an application for credit. The bill also should not require disclosures because of a credit score if that credit score is not actually the basis for the credit decision.

The Heartland Community Bankers Association appreciates the consideration of our concerns by the House Financial Institutions Committee.

Thank you.

Date _____

Dear Applicant:

Thank you for your recent application for _____.
We regret that we are unable to approve your request.

Your application was processed by a credit scoring system that assigns a numerical value to the various items of information we consider in evaluating an application. These numerical values are based upon the results of analyses of repayment histories of large numbers of customers.

The information you provided in your application did not score a sufficient number of points for approval of the application. The reasons why you did not score well compared to other applicants were:

- * Insufficient bank references
- * Type of occupation
- * Insufficient credit experience

In evaluating your application the consumer reporting agency listed below provided us with information that in whole or in part influenced our decision. The reporting agency played no part in our decision other than providing us with credit information about you. Under the Fair Credit Reporting Act, you have a right to know the information provided to us. It can be obtained by contacting: [name, address, and telephone number of the consumer reporting agency].

If you have any questions regarding this letter, you should contact us at

Creditor's Name: _____

Address: _____

Telephone: _____

Sincerely,

NOTICE: The federal Equal Credit Opportunity Act prohibits creditors from discriminating against credit applicants on the basis of race, color, religion, national origin, sex, marital status, age (with certain limited exceptions); because all or part of the applicant's income derives from any public assistance program; or because the applicant has in good faith exercised any right under the Consumer Credit Protection Act. The federal agency that administers compliance with this law concerning this creditor is (name and address as specified by the appropriate agency listed in Appendix A).

Kansas Association of Financial Services

George Barbee, Executive Director

300 SW Eighth Street, Third Floor

Topeka, KS 66603-3912

785/233-4512

Fax: 785/233-2206

Statement to:

House Committee on Financial Institutions

House Bill 2254

Wednesday, February 14, 2001

Mr. Chairman and members of the Committee, my name is George Barbee, representing the Kansas Association of Financial Services. KAFS is made up of consumer credit lending companies such as American General, Household Finance, Wells Fargo / Norwest and Citi Corp Finance. I appear today on their behalf to oppose HB 2254.

You have heard substantial information regarding this California proposal to provide free credit scoring reports to consumers in Kansas. We were surprised at the introduction of the bill because it is widely known that some companies that participate in the lending industry are already developing systems for free credit scoring reports as a service to the consumer.

In fact, consumers are now able to obtain free credit reports. If you have been declined credit, not just on mortgage loans, but any loan denied because of an adverse credit report, you may request a free report. Or, if you want a report, you may pay \$8.00 and receive a report.

I believe government should do for the people what they cannot do for themselves. If consumers already have access to credit reports, we do not need another statute to place a burden on the system.

Indeed, government has already done it for us. The Federal Fair Credit Reporting Act has several provisions regarding this issue, as does the Kansas Fair Credit Reporting Act. HB 2254 under Section 1(d)(1)(Page 1, Line 37) "The CRA shall disclose the recipients of any consumer credit report on the consumer that the CRA has furnished:

(A) For employment purposes within the two-year period preceding the request,

(B) For any other purpose within the 12-month period preceding the request."

The Kansas Fair Credit Act has similar language and KSA 50-708(a)(3)(A) and the same language in the Federal Fair Credit Reporting Act in 609(a)(3)(A). Do Kansans need HB 2254? It appears not.

House Bill 2254 is a reflection of a California law passed last year, but the California law does not take effect until July of 2001. It seems to me it would be prudent to take no action on HB 2254, step back, take a deep breath, and see what problems California may encounter with this law and then revisit it at some later date.

Thank you for the opportunity to speak on this issue. I would be glad to stand for questions now or later.



Security for Generations

Company

An Independent Trust

Testimony for the
House Financial Institutions Committee
February 14, 2001

House Bill 2465

On behalf of the Kansas Bankers Association Trust Division, thank you, ladies and gentlemen of the committee, for allowing me to present this testimony on HB 2465. My name is Daryl Craft, and I am the legislative chairman for the Trust Division. A prior commitment prevents me from being present for this committee hearing.

Last session, the legislature passed and the governor signed what is known as the Uniform Prudent Investor Act. The legislation replaced an earlier version of the Act, and was placed in a different location from the original Act in the Kansas Statutes Annotated.

This bill has been introduced to correct a number of references to the old location, plus replace one paragraph that was left out of the Act last session. It also moves several statutes relating to investments into Chapter 58. The bill was prepared at the request of the Revisor, and had input from the Kansas Banking Department, the Kansas Bar Association and the Kansas Bankers Association Trust Division.

We urge you to vote in favor of this bill.



**KANSAS BAR
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**LEGISLATIVE TESTIMONY
HOUSE BILL 2465**

FEBRUARY 14, 2001

TO: CHAIRMAN RAY COX AND MEMBERS OF THE
HOUSE FINANCIAL INSTITUTIONS COMMITTEE

FROM: PAUL DAVIS, KBA LEGISLATIVE COUNSEL

Mr. Chairman and Members of the Committee:

Those of you who were here last session will recall that the legislature passed a new prudent investor act during the 2000 legislative session. This act replaced the Kansas act that was drafted by members of the Kansas Bar Association and Kansas Bankers Association in 1993 with a uniform act that was promulgated by the American Law Institute in its Restatement (Third) of Trusts (1992). The prudent investor rule, that is currently found at K.S.A. 17-5004 et seq., basically sets out guidelines for fiduciaries who manage and invest the assets of a trust.

Last year, the Kansas Bar Association originally opposed the enactment of the uniform prudent investor act because we felt that it would take away many of the Kansas-specific provisions that were written into the law in 1993. The Kansas Bankers Association and Kansas Trial Lawyers Association shared our concerns. Together, we were able to remedy this situation by proposing several amendments in this committee and in the Senate Financial Institutions and Insurance Committee that preserved several provisions of the law that was written in 1993. Our feeling was that these provisions were designed specifically to meet the

needs of Kansas trustees and beneficiaries, and therefore should be preserved in the prudent investor rule.

However, we failed to propose amendment of one section that was in the prior law. We are requesting in House Bill 2465 that this section be added to the current law. The language, which is found on page 7 of the bill, lines 8-17, is identical to the language that was in the prior law. This language contains an important protection for trustees who are following the written instructions of a grantor. It expressly clarifies the ability of a trustee to follow the written directions of the grantor with respect to self-directed investments. This is an important practical step because many grantors often want to make a direction regarding certain trust assets that have been accepted by the trustee. The new law allows the act to be “expanded, restricted, or otherwise altered by the provisions of a trust” but does not appear to be broad enough to include the ability to use a separate written direction given to the trustee by a grantor.

The bill also moves the prudent investor rule to Chapter 58 of the Kansas Statutes Annotated. We believe that this is a more appropriate location for these statutes.

I thank you for the opportunity to present this testimony and on behalf of the Kansas Bar Association I request your favorable consideration of House Bill 2465.

Testimony of Melissa Walker, President
Kansas Association of Mortgage Brokers

Submitted to
House Financial Institutions Committee

Regarding
House Bill 2481 - The Kansas Mortgage Business Act

Wednesday, February 14, 2001



Kansas Association of Mortgage Brokers

The Kansas Association of Mortgage Brokers is the State Trade Association that represents mortgage brokers throughout the State of Kansas. The Association consists of two Chapters (Greater Kansas City Chapter and the South Central Chapter) with approximately 200 members. The Association's purpose is to advance the knowledge and understanding of the mortgage profession and the valuable services we provide through the education of professionals of the mortgage industry and the public.

It is the position of the Kansas Association of Mortgage Brokers that the revised Kansas Mortgage Business Act (HB 2481) would be crucial to the mortgage industry. We believe that it is very important for mortgage representatives that have dealings with the general public to be not only licensed but also have required continuing education. This not only increases professionalism throughout our industry but also insures that all parties to the transaction, especially the general public, are dealing with a qualified originator. The purchase of a home is the single most important and largest transaction that a family will encounter in their lifetime. All parties involved, from the Realtor to the home inspector, must be licensed, with the exception of the mortgage originator. It is our hope that you will take this information into consideration when reviewing this bill.

BILL GRAVES
GOVERNOR



Franklin W. Nelson
Bank Commissioner

Sonya L. Allen
General Counsel

Judi M. Stork
Deputy Bank Commissioner

Kevin C. Glendening
*Deputy Commissioner
Consumer and Mortgage*

OFFICE OF THE
STATE BANK COMMISSIONER

House Committee on Financial Institutions

February 19, 2001

Testimony on HB 2481

Kevin Glendening
Deputy Commissioner
Consumer and Mortgage Lending
Office of the State Bank Commissioner

Mr. Chairman and members of the committee, the amendments contained in House Bill 2481 represents somewhat of a shift in the way we propose to license mortgage lenders and brokers, and I think also continues the movement, since the Mortgage Business Act's enactment in 1996, to broaden its focus to areas relating to how this kind of business is conducted in our state. Three issues are central to these amendments. First, the large number of companies engaged in this business and relatively low start-up cost equate to a sizable range in ability and experience levels of those participants. Consumers have a right and expectation that the individuals handling their mortgage transaction have at least a minimum level of expertise. The amendments beginning on page 8, line 28 of the bill would authorize our agency to establish continuing education and testing requirements for individuals engaged in mortgage brokering. Education has been strongly supported by the Kansas Association of Mortgage Brokers, and we intend to seek their continued input in developing the specific criteria in this area. The second issue pertains to our proposed changes to the current bonding alternatives contained in the law. Some elements of the existing bonding alternatives for in-state companies, have proven to be cumbersome and difficult, if not impossible to enforce. Therefore, we have proposed a simplified arrangement applied to all in-state companies. While several different alternatives were considered, I believe the proposed \$50,000 bond for in-state companies accomplishes our objective of requiring a financial stake by the company that will assist in enforcement activities and is at the same time easily identifiable. The third issue addressed by the amendments pertains to the establishment of what could be described as a laundry list of prohibited business practices, as well as some additional clarification on

advertising and related matters. Most of these are probably self-explanatory and generally deal with possible deceptive and/or predatory types of activities. We have also proposed to extend the existing criminal penalties to the entire act and thus make those prohibited activities subject to criminal as well as administrative action.

In summary, I believe the bill will enhance the protections afforded consumers and be beneficial from the perspective of enforcement, without creating unnecessary burden for the industry. Mr. Chairman, I will be happy to answer any questions from the committee.

Remarks of Dr. Bruce B. Morgan, Member, Kansas State Banking Board, at House Financial Institutions Committee, on February 19, 2001.

Mr. Chairman and Members of the Committee, on behalf of the State Banking Board, I would like to thank you for allowing us to offer our comments on the House Bill 2482 related to the transfer of certain powers from the State Banking Board to the State Bank Commissioner.

My name is Bruce B. Morgan, and I am a banker and member of the State Banking Board. Joining me today are State Banking Board members Bill New, a banker, and Jane Bateman, a public member and we are representing the views of the Board.

We last came before your Committee in March, 1999, regarding the House Substitute for Senate Bill No. 260. A copy of my testimony is attached for reference on the issues of concern to the State Banking Board at that time. Since that time, legislation was passed making the State Bank Commissioner at full time position and adding the Consumer Affairs division. This Committee tabled consideration of Senate Bill No. 260 and we thanked you for that action.

In the 2000 Legislature, Senate Bill No. 439 was introduced and it was almost verbatim to Senate Bill No. 260. In the State Banking Board meeting of January, 2000, the Board unanimously adopted a motion to oppose the bill on the same grounds as in 1999. The Senate Financial Institutions Committee did not work the bill last year, but requested that the State Bank Commissioner report to the Legislature proposed changes in banking legislation. Since this bill affected the State Banking Board, the Commissioner requested input from the Board regarding proposals to be made to you.

The State Banking Board worked throughout 2000 in reviewing the proposed changes in legislation contained today in House Bill No. 2482. The Board adopted a mission statement and reviewed all the laws relating to duties of the State Banking Board against this mission statement.

House Bill No. 2482 is the culmination of that effort.

The State Banking Board supports House Bill No. 2482 and recommends its passage by this Committee.

The Banking Department's General Counsel and the Legislative Research Department are both better equipped to summarize the intricacies of the Kansas Statutes this bill amends and/or repeals.

In the opinion of the State Banking Board, House Bill No. 2482 shifts a number of duties to the State Banking Commissioner that are administrative in nature and not involved in policy decisions that require the review by the nine member State Banking Board (e.g. name changes, reduction of capital stock, relieving the appointment of a special deputy). These changes will improve the efficiency of the Office of State Bank Commissioner and streamline the regulatory process of the State Banking Department making administrative decisions on an expedited basis similar to national banks regulated by the Comptroller of Currency.

In addition, House Bill No. 2482 provides a more stream-lined review and approval process for new branches and relocations of well-capitalized banks that are not subject to regulatory action by allowing the State Bank Commissioner to approve such applications. This change will bring Kansas Banking laws more in line with national banking laws improving the parity of Kansas chartered banks with national banks. The decision approving or disapproving an application by the State Bank Commissioner on new branches or relocations can be appealed to the State Banking Board by the applicant or any adversely affect person.

Finally, House Bill No. 2482 repeals two areas of banking law related to interest rates and reserve ratios which the State Banking Board and State Bank Commissioner no longer influence.

In summary, the State Banking Board recommends the adoption of House Bill No. 2482. We believe this bill will strengthen the Office of State Bank Commissioner, preserves the policy and advisory role of the State Bank Board on issues of importance, and is in the public's interest. I would like to thank the Committee for allowing us to present these views and would welcome any questions.

MISSION STATEMENT

"The mission of the Kansas State Banking Board is to prudently, equitably, ethically, and efficiently administer all of its statutorily delegated powers and duties so as to promote the competitiveness, financial stability, safe and sound banking practices, protection of Kansas consumers, and public confidence in the state chartered banking industry."

State Banking Performance Summary FDIC-Insured Institutions

<i>(dollar figures in millions)</i>	Commercial Banks Kansas September 30, 2000			Commercial Banks Kansas September 30, 1999			Commercial Banks Kansas September 30, 1998		
	All Institutions	Assets less than \$100 million	Assets greater than \$100 million	All Institutions	Assets less than \$100 million	Assets greater than \$100 million	All Institutions	Assets less than \$100 million	Assets greater than \$100 million
Number of institutions reporting	376	305	71	389	323	66	398	333	65
Total employees (full-time equivalent)	13,662	4,848	8,814	13,225	5,204	8,021	13,252	5,347	7,905
AGGREGATE CONDITION AND INCOME DATA									
Net income (year-to-date)	383	110	273	307	108	199	314	114	200
Total assets	36,569	11,483	25,086	33,878	12,010	21,869	32,554	11,957	20,597
Earning assets	34,025	10,671	23,353	31,390	11,157	20,233	30,243	11,144	19,099
Total loans & leases	23,407	7,041	16,365	21,293	7,147	14,146	19,671	7,122	12,549
Other real estate owned	26	13	13	30	12	18	32	12	20
Total deposits	29,850	9,704	20,146	28,309	10,186	18,123	27,465	10,221	17,244
Equity capital	3,645	1,218	2,427	3,288	1,257	2,031	3,268	1,308	1,960
PERFORMANCE RATIOS (YTD, %)									
Yield on earning assets	8.40	8.23	8.48	7.92	7.80	7.99	8.30	8.11	8.42
Cost of funding earning assets	3.90	3.87	3.91	3.56	3.57	3.56	3.86	3.76	3.91
Net interest margin	4.50	4.36	4.56	4.35	4.22	4.43	4.45	4.35	4.51
Noninterest income to avg. earning assets	1.23	1.07	1.30	1.18	1.02	1.26	1.18	1.06	1.25
Noninterest expense to avg. earning assets	3.23	3.50	3.11	3.23	3.44	3.12	3.30	3.44	3.22
Net charge-offs to loans & leases	0.33	0.11	0.43	0.45	0.13	0.61	0.35	0.10	0.50
Credit-loss provision to net charge-offs	122.09	221.37	111.03	116.32	166.60	110.78	130.05	218.55	120.08
Net operating income to average assets	1.44	1.32	1.50	1.27	1.21	1.30	1.30	1.27	1.31
Retained earnings to average equity	7.36	5.93	8.09	5.88	4.78	6.56	7.39	5.51	8.66
Return on assets	1.42	1.30	1.48	1.22	1.22	1.22	1.31	1.28	1.32
Return on equity	14.68	12.50	15.79	12.61	11.58	13.24	13.35	12.01	14.24
Percent of unprofitable institutions	2.93	3.61		2.83	2.79	3.03	1.76	2.10	
Percent of institutions with earning gains	71.28	70.49	74.65	48.84	45.51	65.15	61.56	59.46	72.31
CONDITION RATIOS (%)									
Net loans and leases to assets	63.02	60.39	64.22	61.84	58.59	63.63	59.42	58.62	59.89
Loss allowance to:									
Loans and leases	1.54	1.51	1.55	1.60	1.54	1.63	1.66	1.58	1.71
Noncurrent loans and leases	193.88	164.43	209.62	188.38	145.28	219.38	200.17	163.81	226.50
Noncurrent loans & leases to									
total loans & leases	0.79	0.92	0.74	0.85	1.06	0.74	0.83	0.96	0.75
Nonperforming assets to assets	0.58	0.68	0.53	0.62	0.73	0.56	0.60	0.68	0.56
Core deposits to total liabilities	78.52	80.06	77.82	81.55	81.63	81.50	82.93	83.62	82.54
Equity capital to total assets	9.97	10.61	9.67	9.70	10.47	9.29	10.04	10.94	9.52
Core capital (leverage) ratio	9.67	10.55	9.27	9.43	10.36	8.91	9.38	10.43	8.77
Total capital to risk-weighted assets	14.65	17.07	13.65	14.75	17.26	13.51	15.35	17.62	14.11
Gross 1-4 family mortgages to gross assets	12.12	14.46	11.05	12.46	13.44	11.91	12.83	13.37	12.52
Gross real estate assets to gross assets	38.40	33.99	40.41	37.54	33.30	39.86	34.16	32.14	35.34

Source: Call Report and Thrift Financial Report:
Prepared by the FDIC-Division of Research and Statistics

Remarks of Dr. Bruce B. Morgan, Chairman, Kansas State Banking Board, at House Financial Institutions Committee, on March 17, 1999.

Mr. Chairman and Members of the Committee, on behalf of the State Banking Board, I would like to thank you for allowing us to offer our comments on the House Substitute for Senate Bill No. 260 related to the State Banking Board and proposal to transfer certain powers to the State Bank Commissioner.

My name is Bruce B. Morgan, and I am a banker appointed to the State Banking Board and this year serve as its Chairman. Bill E. New is also a member of the State Banking Board and joins me here today representing the views of the Board.

The State Banking Board is comprised of nine members appointed by the Governor and confirmed by the Senate. At the present time, the State Banking Board performs several duties assigned to it by the Kansas legislature in conjunction with the activities of the State Banking Department and the Office of State Bank Commissioner. The Board is made up of six bankers and three public members appointed from different political parties and different congressional districts to insure all areas of the state are fairly represented. Board members are appointed after due diligence by the Governor's office, are subjected to Senate confirmation hearings, and an extensive KBI background check.

The State Banking Board received copies of the proposed Senate Bill No. 260 at our February, 1999, meeting, and discussed it in our March, 1999, meeting. The State Banking Board unanimously adopted a motion to express to you our concerns about this bill prior to your working the bill, recommendation to the house, and your final vote.

The State Banking Board has a deep concern, as expressed by the vote of its members, that Senate Bill No. 260 transfers too much power to one person, the State Bank Commissioner, without supervision of an oversight board.

In the past two years, a great deal of discussion has taken place regarding the duties of the State Bank Commissioner and in fact this House has passed legislation regarding notice under the so-called "wild card" statute so you would be better informed about the activities of this office. The State Banking Board has strong reservations about Senate Bill No. 260 without further study and deliberation on your part.

The proposed Senate Bill No. 260 changes, amends, and repeals 41 laws affecting state banking. The bill contains over 60 provisions shifting duties from the State Banking Board to the State Banking Commissioner. The State Banking Board believes the bill is transferring excessive power to the State Banking Commissioner with little to no oversight.

In Attachment A, an exhibit given to members of the Legislature on the Duties of the State Banking Board, I have tried to "map" the specific KSA laws being changed, the bill's page number, and specific policy issues for your consideration.

The State Banking Board has no objection to seven of the proposed 27 shifts in duties from the Banking Board to the State Bank Commissioner.

The State Banking Board objections to Senate Bill No. 260 can be summarized in six policy areas:

1. Community and public input on new charter and branch applications;
2. Bank capital issues;
3. Appeal of State Bank Commissioner decisions;
4. Review of Proposed Rules and Regulations;
5. Establishment of securities subsidiaries;
6. Authority of State Banking Board to perform their duties.

Briefly, I will discuss each of these in the context of Attachment A.

Community and public input on new charter and branch applications: Present law allows for a public hearing to be held in the community if objections are filed on branch bank applications. The bill eliminates this process and only provides for input in Topeka before an application is finally approved or disapproved. Our representative democracy is founded on the principal that citizens can make their voice heard. The State Banking Board feels the public hearing provision should not be eliminated and is a useful tool to elicit public input on applications. (See Attachment A, items 1, 2, 3, 12)

Bank Capital Issues: A number of changes proposed relate to the State Banking Board review of changes in a bank's capital structure. Banking is a "public confidence" business. A bank's equity capital is to protect the "uninsured" depositor in the event of a banking crisis. It has been the experience of several present and prior State Banking Board members that we have advocated higher bank capital standards than staff. We feel these sections of Kansas banking law should not be changed. (See Attachment A, items 5, 6, 7, 11)

Appeal of State Bank Commissioner Decisions: Several provisions in the bill (items 21-25 in Attachment A) now provide for appeals of decisions of the State Bank Commissioner be made to the State Banking Board. The bill changes this procedure so that decisions of the State Bank Commissioner are "appealed to the Commissioner". How can an aggrieved party get a fair and impartial review of the decision by the person that made the decision?

Review of Rules and Regulations: The State Banking Department and State Bank Commissioner promulgate various rules and regulations impacting Kansas state banks. The present legislation requires these rules and regulations be reviewed and approved by the State Banking Board. In Senate Bill No. 260, the State Bank Commissioner only is granted the power to approve the rules and regulations. This is an example of lack of oversight by a Board representing both the industry and public members and vesting that power in one person. (Attachment A, item 19)

Establishment of Securities Subsidiaries: This is similar to approving a new charter, branch or trust company. In Kansas banking history, we have received and reviewed only one application to establish a securities subsidiary. In the future, as the lines become more "blurred" in financial services, we probably will have future applications and feel they should be reviewed under the same standards as new charters and branches. (Attachment A, item 16)

Authority of State Banking Board to Perform Their Duties: At the present time, the State Banking Board annually elects one of its nine members to be Chairman and the State Bank Commissioner serves as Secretary. This has worked for a number of years. The proposed Senate Bill No. 260 makes the State Bank Commissioner "permanent" Chairman of the State Banking Board. Also, the bill removes the State Banking Board from having access to all of the records in office of State Bank Commissioner, removes their ability to call a meeting, and removes their oversight from matters pertaining to the "conduct and welfare of the banking department". In a democracy, we have checks and balances; in an autocracy, we do not. These changes do not advance the cause of democracy for the citizens of Kansas. (Attachment A, item 8 & 10)

We support Senate Bill No. 240, with your amendments, and believe the office of State Bank Commissioner will be strengthened with its passage. We offer no comment on Senate Bill No. 271 because it addresses an administrative consolidation of two departments of state government and there are others better able to speak about these matters.

It is our understanding, regarding the State Banking Department, that the concern and discussion expressed by members of the Kansas Legislature the past two years have dealt with the power, authority, and decisions of the State Bank Commissioner and need for reform in the office with a full time bank commissioner. We support these reform efforts. We have heard no expression of support from the citizens of Kansas, elected representatives, or banks that it is in the State of Kansas' best efforts to create a "regulatory czar" in the office of State Bank Commissioner.

I would like to thank the Committee for allowing us to present these views and would welcome any questions.

DUTIES OF THE STATE BANKING BOARD

KSA DUTY

NO OBJECTION BY BANKING BOARD

CURRENTLY

ATTACHMENT A

SB439
-SB260

AS PROPOSED UNDER SB260

PRIOR TO 1990

of Appls. last 3 years
DUTIES #1-7-9
REMOVES PU HEARING IN COMMUNITY FOR PUBLIC INPUT

DUTY	CURRENTLY	AS PROPOSED UNDER SB260
Approval of new bank and trust company charters	Banking Board	Banking Board
Approval of branch banks	Banking Board	Banking Board
Approval of relocation of a bank or trust company	Banking Board	Banking Board
Approval of change of bank or trust company name	Banking Board	Commissioner
Approval of the reduction of the capital stock of a bank	Banking Board	Commissioner
Approval of the issuance of preferred stock by a bank	Banking Board	Commissioner
Approval of the reduction of a bank's surplus account	Banking Board	Commissioner
Approval for a bank to continue to hold a life insurance policy for deferred employee compensation plans when no liability exists under the plan	Banking Board	Commissioner
Approval of the issuance of capital notes/debentures by a bank	Banking Board	Commissioner
Relieving a special deputy commissioner from their duties	Banking Board	Commissioner
Removal of bank officer	Banking Board	Commissioner
Issuance of Cease and Desist orders	Banking Board	Commissioner
Establishment of a bank service corporation	Banking Board and Commissioner	Commissioner
Determination of a bank's reserve ratio	Banking Board and Commissioner	Commissioner
Establishment of maximum rates of interest on deposits	Banking Board and Commissioner	Commissioner
Approval of rules and regulations	Banking Board and Commissioner	Commissioner
Appointment of a special deputy	Commissioner	Commissioner
Issuance of an order to cease the declaration or payment of dividends	Commissioner	Commissioner
Approval of acquisitions of Kansas banks by HCs	Commissioner	Commissioner
Approval of the change of control of a bank	Commissioner	Commissioner
Approval of contracting trustees; trust service desk; trust service offices; trust branch banks	Commissioner	Commissioner
ESTABLISHMENT OF BANK SERVICE CORP.	Banking Board & Commissioner	Commissioner

(26) The Banking Board makes the decision. The appeal is under the Act for Judicial Review and Civil Enforcement of Agency Actions (KJRA). *Appeal of the decision was to the banking board, is now to the Commissioner.

xHearing is PRIOR to the decision. Was with the banking board, is now to the Commissioner.

Office of the State Bank Commissioner 3-10-99

USURPS BOARD ABILITY TO PERFORM DUTIES

USURPS BOARD AUTHORITY

WHY?

OUTRES #21-#25
APPEAL OF COMMISSIONER'S DECISION TO COMMISSIONER NOT BANK BOARD

**STATE OF KANSAS
BILL GRAVES
GOVERNOR**

Franklin W. Nelson
Bank Commissioner

Judi M. Stork
Deputy Bank Commissioner



Sonya L. Allen
General Counsel

Kevin C. Glendening
*Deputy Commissioner
Consumer and Mortgage Lending*

**OFFICE OF THE
STATE BANK COMMISSIONER**

HOUSE COMMITTEE ON FINANCIAL INSTITUTIONS

Monday, February 19, 2001

Mr. Chairman and Members of the Committee:

My name is Franklin W. Nelson. I am the Bank Commissioner for the State of Kansas. I am here today to present testimony in support of House Bill 2482.

The banking board and our office followed the suggestion of the Senate Financial Institutions and Insurance Committee of last year that banking board powers be reviewed and statutes that are outdated or obsolete be repealed. Since that time, the board, with the aid of my office, has been reviewing statutes related to banking board powers. Banking board members were very thorough in their review, and the product contained in this bill is the culmination of 10-12 months of comprehensive discussions. I would like to compliment our nine member banking board for a job well done.

I strongly support House Bill 2482 and would request your favorable consideration of the bill.

HOUSE BILL No. 2243**Proposed Amendments****Delete provisions relating to Variable Products***Sec. 1 (K.S.A. 17-1252)*

- | | | | |
|----|-----------------|--------|---|
| 1. | page 1, line 25 | delete | other than subsection (e) of K.S.A. 17-1261, and amendments thereto |
| 2. | page 3, line 4 | delete | <i>nonvariable</i> |
| 3. | page 3, line 6 | delete | <i>a fixed sum of</i> |

Sec. 5 (K.S.A. 17-1261)

- | | | | |
|----|----------------------|-------------|---|
| 4. | page 15, lines 28-29 | undo strike | (restore original language) when such securities are sold by the issuer |
|----|----------------------|-------------|---|

Sec. 6 (K.S.A. 17-1263)

- | | | | |
|----|----------------------|--------|----------------------------------|
| 5. | page 17, lines 39-40 | delete | <i>other than subsection (e)</i> |
|----|----------------------|--------|----------------------------------|

Sec. 11 (K.S.A. 40-436)

- | | | | |
|----|------------------|--------|--|
| 6. | page 23, line 25 | delete | (delete entire section 11 and remove any reference to K.S.A. 40-436) |
|----|------------------|--------|--|

Other amendments*Sec. 10 (K.S.A. 17-1271)*

- | | | | |
|----|------------------|--------|--|
| 7. | page 22, line 28 | delete | <i>; under the provisions of K.S.A. 50-1001, et seq., and amendments thereto,</i> |
| 8. | page 22, line 29 | add | or (before “under” so that the lines 26 and 29 read “under the Kansas securities act or under the uniform land sales practices act, to the state treasurer”) |
| 9. | page 23, line 6 | add | (Revisor to draft language to require that the investor education fund be subject to sunset review in five years.) |

Shifting Annuities May Help Brokers More Than Investors

YOUR MONEY MATTERS

By JEFF D. OPDYKE

Staff Reporter of THE WALL STREET JOURNAL

The National Association of Securities Dealers has a new warning for variable-annuity investors: Beware the broker bearing a switch letter.

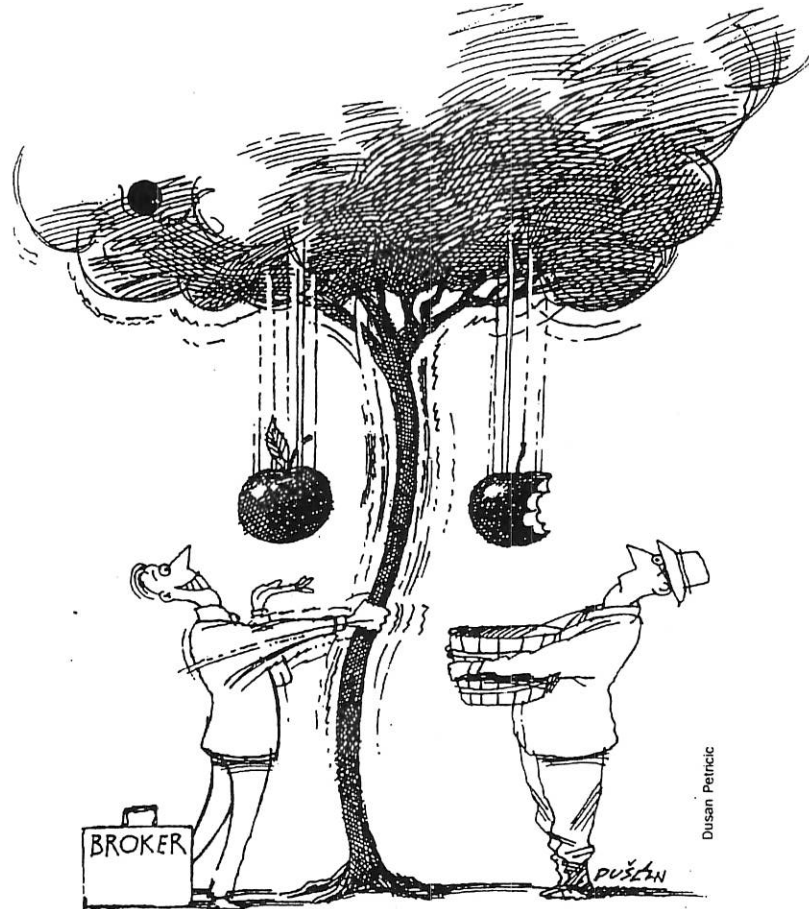
Investors "may be losing money—not gaining" if they exchange a current annuity for a new one, says an alert from the self-regulatory arm of the securities industry. It cautions, "Generally, the exchange or replacement of ... annuity contracts is not a good idea."

The concern is that many switches may be little more than "churning," the practice of excessive trading that typically generates a commission for the broker while providing little benefit for the investor. Churning is illegal under Securities and Exchange Commission and NASD rules.

The NASD warning was issued yesterday in connection with a series of enforcement actions against five firms and one individual, alleging improper marketing and sale of variable

annuities, including encouraging investors to switch from one annuity to another. The group was fined more than \$112,000 combined, including restitution.

Regulators elsewhere also are taking a close look at so-called 1035 exchanges, a name for the process used by brokers to switch investors between one annuity



and another. Paul F. Roye, director of the SEC's division of investor management, told members of the Practising Law Institute last month that the agency is "concerned about exchange programs because they create a high potential for sales-practice abuse."

The SEC late last year filed an action against a Florida broker for improper annuity switching, and state regulators are taking a hard look at the practice, as well. Among other things, annuity

switches can trigger "surrender" penalties under the old contract (such penalties are levied when investors cancel a contract early), while locking the investor into a new period in which withdrawals are subject to penalties.

Variable annuities—essentially mutual funds wrapped in an insurance contract—constitute one of the nation's largest stashes of investment cash, with assets just shy of \$1 trillion. New sales last year hit \$128.2 billion, according to Vards

Report, an industry publication. Investors allocate money among various funds, and the returns are tax-deferred until the cash is withdrawn. The insurance contract guarantees that when the investor dies, heirs receive no less than the amount originally invested, and some times earnings, even if the portfolio's total value has declined.

The SEC is finding that increasingly, "the motivation for some exchanges is principally to line the broker's pocket, and not in the best interest of the investor," Mr. Roye says. Variable annuities offer beefy commissions, as much as 8%. Sales agents typically receive between 50% and 90% of that. In general, the commissions are about twice those paid by the average mutual fund charging a "load."

No agency precisely tracks 1035 exchange volume, but Cerulli Associates, a Boston financial research and consulting firm, estimates that at least a quarter—and possibly as much as 40%—of all new variable-annuity sales stem from a 1035 exchange, or switch letter. To gauge this, the SEC is sweeping through selected brokerage firms, looking for high levels of exchange activity, Mr. Roye says. He won't detail the findings but says regulators "have a basis for selecting the firms we've looked at and are looking at."

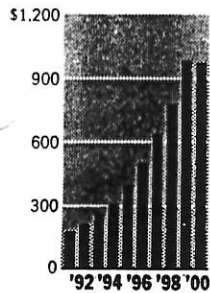
Firms sanctioned by the NASD yesterday included: **First Union Brokerage Services Inc.**, fined \$32,500; **Lutheran Brotherhood Securities Corp.**, fined \$25,000; **Allmerica Investments Inc.**, fined \$15,000; and **Prudential Securities Inc.**, fined \$10,000. Ralph C. Evans, a securities representative with **Morgan Stanley Dean Witter & Co.**, was censured, fined \$10,000 and ordered to pay \$20,130.61 in restitution. All settled the charges without admitting or denying the allegations.

The firms either declined to comment or said that the issues raised by the NASD were procedural in nature and that custom-

Please Turn to Page C8, Column 5

Accumulating Assets

A decade of variable annuity assets; in billions



Sources: the Vards Report

Switching Annuities May Not Pay

YOUR MONEY MATTERS

Continued From Page C1

ers weren't harmed. The NASD also began a disciplinary process against American United Life Insurance Co., but no sanctions have been imposed. A spokesman said the company believes "the proposed action is unwarranted" and it has "complied with all NASD regulations." The company is working with the NASD to resolve the issue, he added.

The SEC's first cease-and-desist order was filed last September in a case involving Raymond A. Parkins Jr., a Florida investment adviser. The agency alleges that between 1993 and 1996, he sent a total of 24 letters to eight clients recommending that they exchange variable annuities he had previously sold them for new ones. Often, he told clients that no fees would be incurred, or fees would be "nominal," according to the SEC. With each letter, the SEC notes, he included the appropriate forms to sign to effect the switch; all authorized the swap.

The exchanges ultimately cost the clients \$168,000 in fees and generated a total of \$210,000 in commissions for Mr. Parkins, according to the SEC's complaint. In one year alone, the SEC says, annuity exchanges accounted for half of the commission income at Orlando, Fla.'s Parkins Securities Corp., which closed in July 1999.

Mr. Parkins says his attorney has told him not to comment on the case. In a written response to the SEC, he said that "on every occasion, I attempted to comply fully with disclosure rules by providing" prospectuses and other information to clients. "If mistakes were made in disclosing specific percentages or amounts, they were inadvertent," he said.

The 1035 exchange itself, named for the section of the U.S. tax code that allows these swaps, is a relatively innocuous paperwork chore required by the Internal Revenue Service, since annuities are tax-advantaged investment accounts. In many cases, an investor legitimately wants to move money into a product with better benefits or investment options,

and the exchange permits the transaction without tax ramifications.

One concern of regulators: Investors may not even realize they are paying a commission. Unlike a stock transaction, in which a broker's commission is known and itemized on a trade-confirmation statement, annuity experts say commissions often aren't detailed in sales literature, the contract an investor receives or on confirmation statements. "While there has been lots of noise about better disclosure with mutual funds, investors really have no clue what they're paying their broker" when buying a variable annuity, says Todd Porter, a variable-annuity analyst at Morningstar, a Chicago market-research firm.

That stems from the annuity industry's decision not to disclose commissions as an asset-based sales charge. Instead, annuity commissions are embedded in insurance fees levied over the life of the contract as part of a basket of annual fees. Although those insurance fees usually are mentioned in the prospectus, the document often doesn't explain that they fund a commission, critics say. The average variable annuity currently charges about 2.3% of assets, according to Vards Report.

In the Parkins' case, the SEC said the adviser often didn't detail so-called surrender fees. These declining charges often start at between 7% and 12% of assets and can last for seven to 12 years or more. Surrender penalties docked one client's account \$13,000, another lost \$27,000, according to the SEC. In total, surrender charges trimmed Mr. Parkins's clients' accounts by nearly 5% on average, the SEC said.

Exchange activity also is coming under increasing scrutiny by state regulators. Last week, Deb Bortner, director of Washington state's Securities Division, met with her staff to discuss a new effort to patrol annuity sales because, she says, the agency "is starting to see problems with switches." David Brant, Kansas's securities commissioner, says complaints regarding annuity exchanges, in part, have prompted his current effort to put variable annuities under the purview of his agency; the investments are currently regulated by the insurance department. The NASD is considering backing that effort.