Approved: March 15, 2005
Date

MINUTES OF THE SENATE FINANCIAL INSTITUTIONS AND INSURANCE COMMITTEE

The meeting was called to order by Chairman Ruth Teichman at 9:30 A.M. on February 16, 2005 in Room 234-N of the Capitol.

All members were present.

Committee staff present:
Melissa Calderwood, Kansas Legislative Research Department
Terri Weber, Kansas Legislative Research Department
Ken Wilke, Office of Revisor of Statutes
Sandy Yingling, Committee Secretary

Conferees appearing before the committee:
Jarrod Forbes, Kansas Insurance Department
Bud Burke, CFSA
Arthur Chartrand, Home Service Contractors Association of America
John Campbell, Kansas Insurance Department
Whitney Dameron, Kansas Pay Day Loan Association
Kevin Glendening, OSBC

Others attending:
See attached list.

Madam Chair opened the meeting by announcing that the Committee would hear **SB 176, SB 178** and **SB 223.**

Madam Chair opened the hearing on **SB 176.** Fiscal note (Attachment 1)

SB 176;- Insurance brokers, change of terminology to insurance producers. .

Jarrod Forbes, Kansas Insurance Department, offered testimony in support of **SB 176**. (Attachment 2) Jarrod stated that current law makes reference to a licensed "agent or broker," terms that are no longer appropriate for this area of the law. Therefore, the KID is proposing replacing those references with "producer." Ken Wilke stated that this does not change "broker" to "producer" throughout the code that this only does it for one Act and than questioned if that the intention? Mr. Forbes stated, that is correct. Senator Steineger asked why would that be? Mr. Forbes stated that to his understanding it deals with captive insurers. Senator Steineger asked Mr. Wilke if there is any other implication by not having this changed throughout the statutes? Mr. Wilke answered no, not really. The other major place this would be done would be in the Insurance Agent's or Broker's Licensing Act which was passed about two years ago. Mr. Wilke stated it was originally started with the term "producer" and there was an amendment to change it back to "agent." The way it is defined in that Act covers both terms, but the way **SB 176** is put together, it makes "producer" in this Act and cross links with the necessary definition in the Agent/Licensing Act. Mr. Wilke stated it is not a problem, he was simply clarifying that **SB 176** did not make the change throughout the insurance code. Chair Teichman asked Mr. Wilke if there would be any problem putting **SB 176** on the consent calendar? Mr. Wilke answered not to his knowledge. There were no other questions.

Madam Chair closed the hearings on SB 176.

Senator Barnett moved to put **SB 176** on the consent calendar. The motion was seconded by Senator Wilson. The motion carried.

Madam Chair opened the hearings on **SB 178**.. Fiscal note (Attachment 3).

SB 178 - Home service contract act.

Melissa Calderwood, Kansas Legislative Research Department, gave an overview defining Home Service Contract Act in the Contractor Agreement for service, repair, replacement or maintenance on all or any part of the structural component in compliance with utility system in any residential property. The Act would exempt warranties, maintenance agreements in service contracts including those agreements offered by public

utilities regulated by the Kansas Corporation Commission.

Bud Burke, in favor of **SB 178**, introduced Mr. Art Chartrand. Mr. Burke also announced that Mr. John Campbell from the Insurance Department was present to answer questions.

Art Chartrand, National Home Services Contractors Association of America, testified in favor of **SB 178**. (Attachment 4) Mr. Chartrand stated he represents the premier providers of home service contracts. Mr. Chartrand pointed out that these are not home warranties, but simply annual-based service contracts. Mr. Chartrand stated that Kansas does not have an existing law or definition on what this industry is or is not. Senator Wilson asked if registration would be through the Kansas Insurance Department. Mr. Chartrand stated that is correct. Senator Wilson asked what "financial assurance mechanism" means and what are you looking for? Mr. Chartrand stated there are three options under **SB 178**: 1) reserves; 2) provide service contract reimbursement coverage; and 3) filing proof to the state that you have substantial net worth. Senator Wilson asked if a business would go through an insurance company to reinsure so in the event they can perform the service in which they are contractually liable and if this insurance company would make it good with the homeowner? Mr. Chartrand stated that is one of the options, correct. Senator Brungardt asked if registration would be with the Insurance Department and regulated by the same? Mr. Chartrand stated yes, the insurance department would be an avenue for someone with a problem to resolve their complaint.

Ken Wilke asked how this would affect homeowner association where the association or the owner basically agrees to maintain the exterior of a living facility, could they potentially be covered? Mr. Chartrand answered he does not believe so, but had not had this suggested to him before. If someone built the project and was continuing to maintain it, they would be exempt, but if someone was a third party who was taking in the funds for future services to continued maintenance or repairs, yes they could be. Mr. Wilke stated that was exactly what he had discovered. Madam Chair instructed Mr. Chartrand to get the committee more information on this issue. John Campbell, Kansas Insurance Department, stated that he does not agree that the following are exempt from this act of the maintenance agreement see section 1(b)(2). Mr. Chartrand agreed that is absolutely correct that if the Homeowner's Association is only providing maintenance, unless they are getting into repair or replacement Senator Barnett stated the definition between maintenance or replace/repair seems like a very fine line because over time it will be repair/replacement. Mr. Chartrand stated that under SB 178 once one gets into repair and replacement they would be covered, absolutely. If they were strictly doing maintenance only, they would not be covered.

Senator Steineger stated that trying to regulate the construction industry is difficult at best. Especially the small repair type guys who got started in this country with a box of tools and a pick-up truck. It is difficult to say who can do what and who should be licensed and what constitutes repair vs. replacement and Senator Steineger personally has qualms about this bill. Senator Steineger suggested more studying needed to be done before a good bill could be made. Mr. Chartrand stated that **SB 178** was not to regulate the homebuilding industry, local contractors, re modelers or anyone else, but this is a third-party person who is taking in funds now and who is providing service repair and replacement on your household. It regulates the providers of the service contract industry, not the actual plumbers, electricians, etc. who are doing this work. Senator Steineger stated he understands, but it actually does affect them using Repairs Unlimited out of Kansas City as an example. Mr. Chartrand stated that this is simply the provider entities which are defined in this Act.

John Campbell, attorney with the Kansas Insurance Department, testified in support of **SB 178.** Mr. Campbell offered an amendment to expand the definition. (Attachment 5), Mr. Campbell stated the reason the KID likes' **SB 178** is because KID has been involved in other warranty type situations, who are now in the Cayman Islands laughing their heads off with all the money. Mr. Campbell stated their main thing was having financial surveillance and a pot of money that people can come to if the provider goes belly-up. Senator Barone asked with consumer protection laws in place, why do we need this? Mr. Campbell stated we have good consumer protection laws, but our main reason is so often that in a lot of these home repair things the homeowner gets a great judgment and it is too bad there is no money to go with it. This is to make sure there is some money in a pot for the consumer, but as far as enforcement, a consumer protection agency is great.

Senator Steineger asked if this proposed legislation became law, how would Mr. Campbell propose to go find these guys and get them licensed? Mr. Campbell stated first voluntary sign-ups and second KID would have

to go out and look for them. This undiscovered territory and apparently 17 other states have done it. Senator Steineger asked if our surrounding states, specifically Missouri, do they license, regulate or track this industry? Is there a mechanism, a data base, for the states to share their information? Mr. Campbell answered, they would not have an NAIC number and Missouri does not, they are doing theirs under the consumers' protection laws.

Madam Chair closed the hearings on SB 178.

Madam Chair opened the hearing on **SB 223**

SB 223 - Payday loans, changes affecting fees and military personnel.

Bud Burke, appearing on behalf of Community Financial Services Association of America, in support of **SB 223** (Attachment 6). First, it would change the complicated declining rate structure of the current law which you can see on page 1, line 21 and concluding on line 32. The effect would be the establishment of a fixed 15% for all amounts lent up to the statutory limit of $500. Mr. Burke offered a 2003 survey of Payday Advance Customer's Alternatives for Short Term Credit (Attachment 7). Chair Teichman asked for clarification on the 15% or 10% plus a $5.00 fee? Mr. Burke stated he meant 15% because if you add the 10% plus the $5.00 fee it is 15%. Senator Steineger asked what kind of study, if any, have been performed that show why people use Payday Loans, why are they in such desperate straights? Mr. Burke stated there have been independent studies done on why people utilize these loans. They utilize them because it is the best alternative for a short term small loan. Mike Waters, QC Holdings Company stated in answer to Senator Steineger's questions because they cannot go to a bank and get their loan. Senator Steineger's questions asked again why are they in such financial problems that they need to borrow $100.00? Speakers unanimously stated that they could not answer that question, poverty and other problems. Chair Teichman stated she could tell why the person in her town borrows $100 every other month, his income does not cover every expense.

Whitney Dameron, Kansas Payday Loan Association, testified in favor of **SB 223** (Attachment 8). Current rates $15.00 for the first $100 lent; $19.00 for $200; and $22.50 for a loan of $250 actually discourage a lender from lending more than $100. Mr. Dameron was also encouraging the legislature to look at a flat rate instead of a stair step loan structure. The fees change on the first, second and third amounts. Chair Teichman asked if basically the only change would be the flat rate? Mr. Dameron pointed out that there is language toward the back of the bill in regard to good practices act recovering funds from deployed military personnel. Chair Teichman asked if that was a new language? Mr. Dameron stated it is a new section.

Senator Wysong stated he was missing something. That on the first page of **SB 223** it states such cash advance . . . less than $500, so lets say $500 and than go down to line 32 which 15% was struck to read 10%. It would be 15% on $100 but if you do 10% on $500 plus add the $5.00 fee it does not stay 15%, you are down to 11%. They are ascending amounts. Senator Wysong suggested they say 15% and take out the $5.00 fee.

Senator Wysong made a motion to amend **SB 223** to read 15% strike the $5.00 fee. Senator Schmidt seconded the motion. All in favor unanimous. Madam Chair stated SB 223 would now read an amount equal to 15% of the amount of the cash advance.

Kevin Glendening, KID Deputy Commissioner for the Consumer & Mortgage Lending Department, offered neutral testimony and information to **SB 223** (Attachment 9). Mr. Glendening attachments included a letter dated January 1, 2005, to Attorney General Kline (Attachment 10). Mr. Glendening's testimony offered a chart of amounts and fees. Mr. Glendening stated the Payday Loan business in Kansas is very profitable. Mr. Glendening offered two amendments to SB 223: 1) page 1, line 34 change 7 days to read 14 days; and 2) deals with subsection 10 of the statute which would further clarify that a bank agency or broker relationship cannot be used and the end result is more fees or other charges than are otherwise allowed. Senator Wysong asked for an example. Senator Wilson stated, that based upon the testimony of Mr. Glendening that there is a place for this kind of lending and asked if Mr. Glendening was sure that only 2% of these outstanding loans are in jeopardy, is it higher? Senator Wilson stated there is a need for this type of loan with a descent interest rate. Mr. Glendening stated 2% figure stemmed from their examinations of Payday lenders last year. Madam Chair offered that a lot of the banks will not lend just $100.

MINUTES OF THE Senate Financial Institutions and Insurance Committee at 9:30 A.M. on February 16, 2005 in Room 234-N of the Capitol.

El Centro, Inc., provided written testimony in opposition of **SB 223** (Attachment 11).

Madam Chair stated further study needed to be done on **SB 223.**

Meeting adjourned 10:30 a.m.

FINANCIAL INSTITUTIONS & INSURANCE COMMITTEE GUEST LIST
DATE: Wed, Feb. 16, 2005

NAME	REPRESENTING
Brad Burke	NHSCA / Q.C. Financial
Alex Kotoyantz	PIA
Art Chantrand	NHSCA
Kathy Olsen	KCBA
Richard Thomas	KDOL WC
Dick Cook	KS Ins. Dept.
[illegible]	KID
Whitney Damron	KS Payday Loan Assn.
Chael Austin	KHA
[illegible]	Quik Cash
[illegible]	KMHA
Danny J. Voglewede	Office of the State Bank Comm.
Sonya Allen	"
Ruth Glendening	"

KANSAS

DIVISION OF THE BUDGET
DUANE A. GOOSSEN, DIRECTOR

KATHLEEN SEBELIUS, GOVERNOR

February 9, 2005

The Honorable Ruth Teichman, Chairperson
Senate Committee on Financial Institutions and Insurance
Statehouse, Room 521-S
Topeka, Kansas 66612

Dear Senator Teichman:

SUBJECT: Fiscal Note for SB 176 by Senate Committee on Financial Institutions and Insurance

In accordance with KSA 75-3715a, the following fiscal note concerning SB 176 is respectfully submitted to your committee.

SB 176 would change references to the term "agent or broker" to "producer" in statutes concerning insurance. The bill would also amend KSA 40-37a02 to include a definition for the term "captive insurer," which means an insurance company owned by another organization whose only purpose is to insure risks of the parent organization and affiliated companies.

The Kansas Insurance Department indicates that the passage of SB 176 would have no fiscal effect.

Sincerely,

Duane A. Goossen

Duane A. Goossen
Director of the Budget

cc: Jarrod Forbes, Insurance Department

Attachment 1
2/16/05
FII

LANDON STATE OFFICE BUILDING, 900 SW JACKSON, SUITE 504, TOPEKA, KS 66612
Voice 785-296-2436 Fax 785-296-0231 http://da.state.ks.us/budget

Kansas
Insurance
Department

Sandy Praeger COMMISSIONER OF INSURANCE

COMMENTS
ON
SB 176—RELATING TO NEW TERMINOLOGY FOR INSURANCE BROKERS
SENATE COMMITTEE ON FINANCIAL INSTITUTIONS AND INSURANCE
February 16, 2005

Madam Chair and Members of the Committee:

Thank you for the opportunity to visit with you on behalf of the Kansas Insurance Department.

Senate Bill 176 is a technical style change. This bill deals with a captive insurer writing business for a controlling company. Current law makes reference to a licensed "agent or broker", terms that are no longer appropriate for this area of the law. Therefore, we are proposing replacing those references with "producer".

This change would bring the law into compliance with the uniform insurance agent licensing act. We do believe this bill to be a technical clean up and would urge you to support Senate Bill 176.

With that Madam Chair I would be happy to stand for any questions the committee may have.

Jarrod Forbes
Assistant Director
Government Affairs

Attachment 2
2/16/05
FII

420 SW 9TH STREET
TOPEKA, KANSAS 66612-1678

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CONSUMER HOTLINE
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WEBSITE
www.ksinsurance.org

February 14, 2005

The Honorable Ruth Teichman, Chairperson
Senate Committee on Financial Institutions and Insurance
Statehouse, Room 521-S
Topeka, Kansas 66612

Dear Senator Teichman:

SUBJECT: Fiscal Note for SB 178 by Senate Committee on Financial Institutions and Insurance

In accordance with KSA 75-3715a, the following fiscal note concerning SB 178 is respectfully submitted to your committee.

SB 178 would create the Home Service Contract Act. Home service contracts would be considered contracts or agreements to repair, replace, or maintain all or any part of any structural component, appliance, or utility system of residential property. The bill specifically exempts warranties, service contracts, or maintenance agreements offered by public utilities on transmission devices, if the utility is regulated by the Kansas Corporation Commission. The bill would require certain contract provisions, identify provider responsibilities, and require the providers to register with the Insurance Commissioner. SB 178 would also authorize the Insurance Commissioner to conduct audits of providers, administrators, insurers, or other persons to enforce the Home Service Contract Act.

SB 178 would place additional registration and auditing duties on the Kansas Insurance Department. However, the agency states that it is unknown whether the bill could be implemented within currently approved staffing and operating expenditure levels.

Sincerely,

Duane A. Goossen

Duane A. Goossen
Director of the Budget

cc: Jarrod Forbes, Insurance Department
Tom Day, Corporation Commission

Attachment 3
2/16/05
FII

February 16, 2005

In support of Senate Bill 178

The case for Kansas to adopt an NAIC style model position on Home Service Contracts.

By: Arthur J. Chartrand, JD. 913-768-4700 www.chartlaw.com

My name is Arthur J. Chartrand of Olathe, Kansas. I work exclusively in the insurance and regulatory arenas. I have visited every state and had the privilege of testifying before many state legislative bodies. I spent my early career as counsel to the National Association of Insurance Commissioners (NAIC). I authored many of the NAIC's position papers and served as counsel to the committees in the 1980's which examined the service contract industry.

I represent the National Home Service Contract Association (NHSCA). **NHSCA** is a non profit **Kansas Corporation** dedicated to industry and consumer information about the use and benefits of annual based, home service contracts. Home service, repair and replacement on your household appliances, heating, air-conditioning and major electrical and mechanical systems that fail due to normal wear and tear. Pure and simple. They do not desire or project any measure of being "in the business of insurance." Home service contracts do not provide any typical insurance protection whether it be for fire, windstorm, collision, theft or liability.

Kansas has no existing definition, law or authoritative interpretation on the business of home service contracts. Confusion in other states between the fundamental differences of service contracts and that of insurance suggest a proactive approach is indicated. Equally, Kansas has no minimum standards or fundamental protection or regulation of entities in the rapidly growing home service contract industry. We believe acting now to endorse the NAIC minimum standards model approach will best serve Kansas consumers. Waiting until some controversy arises is never a good climate in which to debate and address a balanced approach to a growing industry.

"Service contracts," as now defined and recognized by the National Association of Insurance Commissioners (NAIC) since 1995, do not constitute the "business of insurance." Regulation should be left to the general state consumer protection laws or a simple registration and financial assurance law administered by the insurance department.

Attachment 4
2/16/05
FII

This bill endorses limited registration with the Kansas Insurance Department, financial assurance mechanisms, consumer disclosures and clear power to the Commissioner to act in the event of a problem. It is limited, it is balanced, it is proactive, it is endorsed by the NAIC and is proven to work effectively.

<u>This bill does NOT address:</u>

- The automobile service contract industry which perhaps demands its own attention and potential other regulation.
- The home builder industry or deficient home construction—an issue for which we have significant consumer empathy as our industry tends to inherit home construction deficiencies.
- *Retail extended warranty* agreements on new goods or manufacturer warranties.
- Simple maintenance only plans offered by many heating, air conditioning and plumbing firms.

Many states in the last five years have been simply declared by statute that home service contracts are not insurance. We believe a limited registration and financial assurance law as recommended by the NAIC adds one additional measure of protection and balance.

While some states have considered or are placing home service contract registration with a state consumer services bureau or the attorney general, insurance departments often oversee non insurance providers simply because of the registration resources and familiarity the insurance department already possesses with such services. We support registration and responsiveness to either the insurance commissioner, attorney general or both.

<u>Home Service Providers</u>

Home service contract providers offer a contract to service, repair or replace certain listed household systems or appliances for a period of one year, which may fail due to normal wear and tear. Retailers offer similar programs on a single product point of purchase basis, or telemarket contracts covering one or a group of products regardless of purchase. Retail sales most often are a hybrid only offering an "extended warranty" on new products after the expiration of the manufacturers warranty. Home service contracts provide immediate service and repair on existing or "used" home appliances and systems.

Home service contracts in some states provide limited, coverage to repair leaky roofs due to normal wear and tear. However, few, if any, home service companies are in the business of providing an actual "home warranty" on housing structures. Contracts covering actual structures or "new home builder warranties," may or may not warrant other regulatory consideration or retention under the insurance code. States that enacted pre-1990 "home warranty acts" clearly were intended to primarily address that unique Existing laws on automobile plans and retail product warranties have been left largely intact.

What is critical to recognize is that no matter the provider or product covered, home service contracts provide no insurance coverage. Home service contracts repair or replace items due to predictable normal wear and tear for a set budgeted fee. They are the exact inverse of insurance in that they only cover what no insurance policy ever does—*normal wear and tear*. They do not cover nor afford protection from sudden and fortuitous events from unpredictable perils, which may never occur, such as fire, windstorm, hail or collision. Insurance contracts pay dollars for all financial losses from covered perils except that which are specifically excluded. The latter functional characteristics are what truly define the business of insurance.

Failure and wear rates of appliances are actually quite predictable. Consumers are simply paying a budgeted annual fee to maintain them by local plumbers and electricians, which have been qualified to do the work. Service contracts help level certain household expenses. They do not eliminate them. With the growth of the senior population and two working parents, the public has demanded the growth in this industry to economically and conveniently meet their daily household needs.

Providers of home service contracts may offer their services at the time of a house resale or at any time a consumer wishes to add the convenience on one or a group of appliances/household systems. Home service companies provide service and repair only (not economic loss indemnification) on specifically listed products and failures.

The generic term "home warranty" is still heavily utilized by the real estate community to describe what are in reality, home service contracts. In the coming years, most companies will be redefining their product to more clearly distinguish themselves as *home service contract* providers. We believe this bill

will encourage the real estate industry to embrace the *home service contract* terminology as well.

NAIC History on Service Contracts

From 1978 until 1995, the NAIC debated the concept and definition of service contracts. In the 1970's, the NAIC contemplated that there were three emerging industries—one covering "automobile mechanical repair;" one covering " non-automotive consumer products;" and one covering "home warranty" contracts. The NAIC next researched potential insurance regulation for "warranty and service contract administrators." The NAIC decided not to impose insurance treatment. [See *NAIC Proceedings* 1980 Vol. I, p. 847.] Until 1995, the NAIC decided to leave the service contract industry alone and concede consumer protection to the attorneys general and the state consumer protection laws.

In 1995, after several years of renewed hearings and debates, the NAIC resolved that a distinct "service contract" industry had emerged. The NAIC observed that regulation of this totally non-homogeneous business did not lend itself to the definition of insurance nor regulation under the insurance codes. The industry was simply too large and diverse and had permeated virtually every aspect of both consumer and commercial goods. In public meetings, the NAIC concluded, "service contracts" as it now defined them, "are not insurance." Mike Bownes, General Counsel for the State of Alabama and principal author of the NAIC model, directed the NAIC to state that conclusion for the record. [See *Proceedings of the NAIC* Vol II, December 4, 1995, page 1027; minutes of the *Service Contracts Model Act Subgroup of the Special Insurance Issues (E) Committee.*]

The insurance commissioners testified repeatedly in open hearings that they did not wish to regulate the service contract industry as the business of insurance. A minority reached a consensus that if there ever was a need to act upon a consumer complaint or potential insolvency of a service contract provider, the commissioners might be empowered with some limited level of authority. The NAIC Service Contracts Model Act was adopted in 1995 to meet that limited and balanced goal. This bill was crafted based upon that model.

We encourage Kansas to support Senate Bill 178 and its limited registration, financial assurance and consumer disclosure requirements for home service contract providers. Thank You.

Session of 2005

SENATE BILL No. 178

By Committee on Financial Institutions and Insurance

AN ACT concerning home service contracts; enacting the home service contract act; registration with the insurance commissioner.

Committee amendments; February 16, 2005

Suggested by Kansas Department of Insurance
Concurrence by NHSCA

Section 2
Line 43 page 1 to Line 2 page 2

(g) "Provider" means a person who administers, issues, makes, provides, sells or offers to sell a service contract, or is contractually obligated to the home service contract holder under the terms of the home service contract but shall not include individuals or other persons who simply act as employees or agents on behalf of a registered provider.

Reason: the Kansas Department of Insurance desires a broader definition of provider more similar to the NAIC model. There is no intent to include Realtors or any sales representatives who simply are selling or acting as administrative agents on behalf of a licensed provider, There are no requirements for mere sales representatives to be registered under the act as long as they are acting on behalf of a registered provider.

Section 3
Line 12 page 3 to Line 2 page 3

(1) Insure all home service contracts under a reimbursement insurance policy issued by an insurer ~~authorized~~ licensed to transact insurance in this state or issued pursuant to K.S.A. 40-4101 et seq., and amendments thereto;

Reason: The Kansas Department of Insurance desires that only Kansas *licensed* insurers and not merely risk retention groups, captives, surplus lines insurers or other effectively *authorized* insurers provide this coverage.

Attachment 5
2/16/05
FII

ISSUES MANAGEMENT GROUP, INC.

TESTIMONY

SB 223 – Payday loans
Tuesday, February 15, 2005
Senate Financial Institutions and Insurance Committee

Good morning Madam Chair and Members of the Committee. My name is Bud Burke and I appear before you this morning on behalf of the Community Financial Services Association of America, CFSA, in support of SB 223.

Before we start, as I have mentioned to most of you, we propose an amendment in line 32 that would strike 15% and insert 10%. I apologize for the drafting mistake. I gave the wrong number to the Revisor.

This bill proposes to accomplish two things. First of all, it would change the complicated declining rate structure of the current law which you can see on page 1 of the bill beginning on line 21 and concluding on line 32.

The effect would be the establishment of a fixed 15% for all amounts loaned up to the statutory limit of $500. This change, in many cases, would codify the actual practice that occurs today. Because the profit, under current law today, declines for each $100 loaned over $100, payday loan companies are reluctant to loan more than $100 to any one customer and while $100 was a lot more money when the law went into effect, today $100 rarely gets an individual to an amount they need to get past a short term need. This causes the individual to go down the street to another source to get the next $100 and repeat the process until they get the amount they need.

Attachment 6
2/16/05
FII

2009 Camelback Drive
Lawrence, Kansas 66047
(785) 749-5822 *fax* (785) 749-1502

800 SW Jackson, Suite 808
Topeka, Kansas 66612
(785) 232-2320 *fax* (785) 232-2868

In order to qualify for a payday loan an individual must have a job, must have a checking account and must pass a credit check. They are not the unemployed, homeless individuals that some people try to portray as the borrowers. You will note on page one of the bill beginning on line 34 and continuing on pages 2 and 3, that current law imposes significant restrictions on the lender. You may have heard that payday loans contribute to the ever deeper spiral of debt, yet unlike some open ended loans, Section 1, subsection (3) specifically prohibits the lender from having more than two loans to the same borrower at any one time nor more than three loans to any one borrower within a 30 day period.

We all understand that there are times when people may need a small, short term loan and these loans are not typically made by our banking industry. Where else would they go to get these loans which carry a high APR but in fact are competitive with many of the alternatives. Please take a look at the CFSA handout and particularly at the summary page at the end of the handout.

We do not intend to criticize the rates charged by others on this page but would observe that these small, uncollateralized, sometimes hard to collect loans are expensive to make and require higher rates to recover the higher costs.

New Section 2 contains language, suggested by CFSA, that provides additional consumer protection to active duty members of our Armed forces and like many provisions of the current law, are provisions taken from the CFSA best practices program which is intended to set a high standard for the industry to follow.

Thank you for the opportunity to appear before you today.

Bud Burke

6-2

Payday Advance:

A Cost Effective Alternative

A 2003 Industry Survey
of
Payday Advance Customers' Alternatives
for
Short-Term Credit

Community Financial Services Association of America
February 2003

Attachment 7
2/16/05
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NSF Fees*- National

Bank NSF Fees	
High	$50
Average	$26
Low	$4

*An industry survey conducted in 2003 of 2,243 banks in 858 cities.

Merchant Fees	
High	$60
Average	$25
Low	$5

*An industry survey conducted in 2003 of 2,282 major merchants in 814 cities.

Late Fees- National

Late Fees- Credit Card*	
High	$38
Average	$27
Low	$10

Late Fees- Auto Finance**	
High	$200
Average	$20
Low	$3

Late Fees- Apartments, Rental Property***	
High	$125
Average	$33
Low	$5

* *Credit Card fees are national, Consumer Action News, "Annual Credit Card Survey 2003" www.consumer-action.org.*

** *A survey conducted by national payday advance companies in 2003. 1,052 auto lenders were surveyed across 543 cities. Of the companies surveyed, 306 charge an average 6% in late fees in lieu of a flat fee.*

*** *A survey conducted by national payday advance companies in 2003. 1,131 landlords were surveyed across 603 cities. Of these, 138 companies charge an average 9% in late fees in lieu of a flat fee and 272 charge an average $5 per day in late fees.*

Late Fees- Utility Companies*

Late Fees	
High	$75
Average	$11
Low	25¢

Reconnect Fees	
High	$325
Average	$39
Low	45¢

Late Fees plus Reconnect Fees	
High	$400
Average	$50
Low	70¢

* *A survey conducted by national payday advance companies in 2003. 1,110 utility company locations were surveyed across 537 cities. Of the companies surveyed, 622 charge an average 4% in late fees in lieu of a flat fee.*

Annual Percentage Rates

14-Day Term	
$100 payday advance with $15 fee[1]	391%
$100 check with $35 overdraft privilege fee[2]	913%
$100 credit card balance with $27 late fee[3]	704%
$100 check with $26 NSF & $25 merchant fee[4]	1,329%
$100 utility bill with $50 late/reconnect fees[4]	1,303%
1-Day Term	
$100 ATM withdrawal with $1.49 fee[5]	544%

[1] *Typical payday advance fee.*

[2] *Alex Berenson, New York Times, "Banks Encourage Overdrafts, Reaping Profit," January 22, 2003.*

[3] *Credit Card fees are national, Consumer Action News, "Annual Credit Card Survey 2003" www.consumer-action.org.*

[4] *Average fees according to an industry survey conducted in 2003 of 2,243 banks in 858 cities and 2,282 major merchants in 814 cities. 1,110 utility company locations were surveyed across 537 cities. Of the utilities surveyed, 622 charge an average 4% in late fees in lieu of a flat fee.*

[5] *Bankrate.com, "Checking Study, Spring 2003", posted March 27, 2003, www.bankrate.com*

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TESTIMONY

TO: The Honorable Ruth Teichman
And Members Of The
Senate Committee on Financial Institutions and Insurance

FROM: Whitney Damron
One Behalf Of The
Kansas Payday Loan Association

RE: SB 223 - An Act concerning payday loans; relating to fees; relating to collection from deployed military.

DATE: February 16, 2005

Good morning Madam Chair Teichman and Members of the Senate Committee on Financial Institutions and Insurance. I am Whitney Damron and I appear before you today on behalf of the Kansas Payday Loan Association in support of SB 223 that sets a flat rate for payday loans and adopts a best practices act for collection of any payday loan-related outstanding loans or fees from deployed military personnel.

By way of information, the Kansas Payday Loan Association (KPLA) has been in existence for approximately 5 years and serves as a clearing house for dissemination of information to payday loan store licensees in our state. Members of our association compose about ¼ of the licensees in Kansas, but our efforts to inform are not limited to only our members. We typically undertake 2-3 mailings per year to all payday licensees to inform the industry about matters of interest to them occurring in Topeka and legislative changes regardless of membership. We also frequently solicit input from the Office of the State Bank Commission for our mailings.

I believe the KPLA has a good working relationship with the Office of the State Bank Commission. We have been straight forward with our legislative initiatives over the past few years and have met with Mr. Glendening and his staff on numerous occasions to discuss matters of interest, legislation proposed by the State Bank Commission and legislation sought by the payday loan industry. We have found their advice and counsel both helpful and well-received by the payday loan industry in our state.

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Those of you who have been on the committee prior to 2005 may recall HB 2685 from the 2004 legislative session that implemented a number of changes to the payday loan industry in our state, including:

- Limit the number of loans to an individual to 3 during a 30 day period.
- Cap the maximum loan amount at $500.00 (down from $860.00).
- Require contact information for loan recipients to be collected.
- Require specific cancellation on the back of checks.
- Allow for a 24 hour right of rescission.
- Strengthen consumer protections in the statute.
- Define and codify agency limitations.

The payday loan industry supported that bill and as a matter of fact, most of those changes were included in language proposed to the State Bank Commission prior to their bill introduction by the industry that also included an amendment to the rate structure for payday loans.

Specifically, the payday loan industry is supportive of a flat rate for payday loans in our state, rather the current stair-step rate structure that exists.

Current rates of $15.00 for the first $100.00 loaned; $19.00 for $200; and $22.50 for a loan of $250.00 actually discourage a lender from loaning more than $100.00.

As the law is written now, a lender can receive $15.00 for loaning $100.000, but only an additional $4.00 for loaning an additional $100.00. As a result, most payday lenders limit loans to $100.00. Loaning an additional $100.00 for only $4.00 is not cost effective for an industry that has high loss ratios, limited access to civil remedies and a debt that is not enforceable as a bad check in criminal courts.

Tiered rates encourage loan splitting by unscrupulous lenders who manipulate the customer by making multiple loans to the same customer over a period of days or direct customers to other stores they own within the same market area. Such business practices are illegal, but difficult to enforce. In essence, consumers who need more than $100.00 are forced to seek loans from multiple lenders, whether affiliated with each other or not, and as a result, end up paying a higher rate because they obtain two $100.00 loans under separate transactions.

Existing payday loan rates have been in effect for a number of years and traditional loan rates date back to a time when $100.00 would go a little further than it will today. Payday loans still address a need in our society for those who need access to a smaller amount of money for a short period of time where no other lender is available to them. Caps on the maximum loan amount insure that the loans do not rise to the level of other forms of credit that if repayment is ignored or delayed, can become highly significant obligations for the borrower.

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Finally, payday loans are allowed in a majority of states and rates vary from a few as low as those found in Kansas to unlimited fees. Many states offer both higher rates and "roll overs". Our four neighboring states all have fees higher than those found in Kansas, as follows*:

Colorado	20% on first $300.00 7.5% on amounts in excess of $300.00.
Missouri	Maximum fee collected is 75% of amount loaned. Up to 6 rollovers.
Nebraska	$15.00 per $100.00.
Oklahoma	$15.00 per $100.00 up to first $300 loaned. $10.00 per $100.00 for amounts in excess of $300.00 Consumer can pay off old loan with new loan, but not called a rollover.

**Information from the Community Financial Services Association (CFSA), a national trade organization for payday lenders, effective July 1, 2004.*

With consumer protections included in the current act, including limitations on the number of loans within a 30 day period, the fact that a consumer cannot "roll over" their loan and a 24 hour right of rescission, we believe the payday loan industry has responsibly extended credit to those who need it.

Adopting a flat rate for payday loans in Kansas will help those who most need it: The consumers of payday loans.

As for the language in the bill dealing with deployed military personnel, we believe most responsible payday lenders already adhere to such practices, but we do not object to this language being placed in statute.

On behalf of the Kansas Payday Loan Association, I thank you for your time this morning and I would be pleased to stand for questions at the appropriate time.

WBD.

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KANSAS

OFFICE OF THE STATE BANK COMMISSIONER
CLARENCE W. NORRIS, Bank Commissioner

KATHLEEN SEBELIUS, GOVERNOR

February 16, 2005

Senate Financial Institutions and Insurance Committee

Re: Senate Bill 223

Madame Chairman and Members of the Committee:

I am Kevin Glendening, Deputy Commissioner for the Consumer and Mortgage Lending Division of the Office of the State Bank Commissioner, and Administrator of the Kansas Consumer Credit Code. I am offering neutral testimony and information, as well as two proposed amendments with regard to SB 223. Section 1 of the bill proposes to replace the current payday loan rate structure with a flat rate of 15% of the amount of the cash advance, plus a $5 administrative fee. I have attached a chart prepared by our staff which compares the current fee structure to that proposed in SB 223, in terms of actual dollar cost to the borrower. The chart also sets out some other options for comparison, including a flat 15% without a $5.00 administrative fee, and a flat 10% with a $5.00 administrative fee.

I have stated to this committee in the past, and continue to believe, that the payday loan business in Kansas is very profitable with relatively low risk. Information gathered by our field examiners at Kansas payday lender examinations has shown the average losses for our payday lenders is less than 2% of their outstanding loans. I suspect this fact is probably why both the number of licensees and number of locations has continued to grow. In short, I guess balancing the interest of those consumers who feel they must use this type of credit and the issue of fees for these loans comes down to the subjective question of how much profit is enough.

New Section 2 of the bill purports to place various restrictions on loans to military personnel. While the concepts are admirable, based on the way the bill is written, I believe it will be improbable, if not impossible to enforce many of these provisions. For example, subsection (a) (2) of section 2 in the bill (beginning on page 3, line 42) requires that the lender defer collection activity against a military borrower who has been deployed to a combat or combat support posting for the duration of the posting. However, it is unclear to me how the lender would know that the soldier has been deployed in order to defer collection, or how our examiners would know such information to determine whether the lender is violating that provision of the law. Similarly, subsection (a) (5) of Section 2 (page 4 of the bill, beginning on line 9), the lender is prohibited from making loans to a military borrower whenever the military base commander has declared such person's place of business off limits to military personnel. However, the bill does not indicate how the lender or our examiners would be aware of this information, nor how our examiners would be able to determine which military personnel are on the base and subject to the "off limits" declaration.

Finally, as I mentioned at the beginning of my testimony, if the committee chooses to move this bill forward, we would like to offer the following proposed amendments:

Amendment 1: The amendment we propose would be to lengthen the minimum term of the loan to 14 days. The current law sets a minimum term of 7 days. The purpose for extending the minimum term would simply be to allow the borrower use of the money for a longer time period and more time to repay the loan and the proposed increased fee.

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Amendment 2: The amendments we propose to subsection 10 would further clarify that a bank agency or broker relationship cannot be used if the end result is that the borrower pays more in fees or other charges than would otherwise be allowed under Kansas law. In 2004, a bill brought forth by our agency was passed by the legislature to address the issue and prevent the use of bank agent, rent-a-charter, broker, and other devices which attempt to circumvent state laws and result in consumers paying higher fees and charges than they would otherwise pay under state law. While we continue to believe the 2004 amendments referenced above did address this issue, recently a group of payday lenders who desire to utilize the rent-a-charter device have sought an interpretation of the 2004 amendments from the Kansas Attorney General. Although no opinion has been issued to date, our agency believes it is prudent to add the proposed language to further clarify legislative intent to prevent the use of agency, rent-a-charter, broker, or any other device which would result in a consumer incurring greater cost to obtain a payday loan than that expressly permitted under Kansas law.

Respectfully,

Kevin Glendening
Deputy Commissioner
Consumer and Mortgage Lending

Payday Loan Amount	Current Statute Finance Charge	SB 223 - 15% plus $5 administrative fee	Flat 15%	10% plus $5 administrative fee
$100.00	$15.00	$20.00	$15.00	$15.00
200.00	19.00	35.00	30.00	25.00
300.00	23.00	50.00	45.00	35.00
400.00	29.00	65.00	60.00	45.00
500.00	35.00	80.00	75.00	55.00

KansasCity.com

Posted on Thu, Jan. 20, 2005

Payday loans draw scrutiny in Missouri

By PAUL WENSKE
The Kansas City Star

The payday loan industry in Missouri had a great year, but that does not please consumer advocates who bristle at the high interest rates the lenders charge.

Missouri issued 1,198 new licenses to payday lenders last year, a 37.5 percent increase from January 2003, according to the Missouri Division of Finance. Payday lenders made 2.6 million loans to consumers last year, a 30 percent increase from two years ago.

The average payday loan was $241.11, a $20 increase from two years ago.

The average loan fee, calculated on an annualized basis, compares with an interest rate of 408 percent, according to the survey report, required by a 2002 law.

Though the Division of Finance offered its latest report on the industry without opinion, Missouri Attorney General Jay Nixon seized on the survey to push for legislation that would grant him more authority over the industry.

"The payday loan industry in Missouri is thriving, but it is doing so at the expense of cash-strapped Missourians who have run out of options to pay their rent, utilities or purchase food," Nixon said. "We need reform of this industry in Missouri, and we need it now."

Industry officials say payday loan fees can help strapped people avoid even higher fees for a bounced check or a late credit card payment. They say calculating loan fees as annualized interest rates is misleading.

"We don't charge interest, we charge fees," said Steven Schlein, a spokesman for the Community Financial Services Association, a payday lending trade group.

Nixon said he wanted new authority to issue cease-and-desist orders to stem payday lending violations and to sue for injunctions, restitution and revocation of loan contracts. Payday lenders currently are regulated by the Division of Finance. The attorney general can act against lenders only if the division refers cases to Nixon's office.

Missouri Finance Commissioner Eric McClure declined to comment on Nixon's statement. "We want to hold back on anything from our office about our opinion of the industry," McClure said.

Still, he said, people are often borrowing over their heads. "It's pretty easy to imagine they are ... over their eyeballs," McClure said. "But was it legal for them to get in that situation? Probably."

Payday loans have filled a niche in Missouri and other states for consumers who cannot or do not want to apply for traditional bank loans. In many cases, people resort to payday lenders for short-term loans to cover bills between paychecks.

They have done particularly well in Missouri, where the laws are slightly more lenient than in some surrounding states, according to state comparisons. Missouri has almost three times as many payday lenders as Kansas, officials said.

Two years ago Missouri consumer groups lobbied heavily to rein in payday lenders, resulting in a law that limited to six the number of times a consumer could refinance, or renew, a payday loan. In comparison, Kansas, Arkansas, Iowa and Nebraska forbid renewals.

Grass-roots groups that pushed for the tougher laws two years ago say more regulation is needed and say they support giving the attorney general more authority.

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"The law helped, but it needs to be strengthened," said Bob Rastorfer, president of the Kansas City Church Community Organization and the Christ the King Church Community Organization, two groups that worked with area legislators to get the 2002 law enacted.

"We have people who now owe $1,000 who started with a base loan amount of $200," he said. "What happens is they keep rolling it over, and every time they do they add another $15 fee.

"These are working people working payday to payday."

Missouri payday lenders can charge a $15 fee for each $100 lent, payable over two weeks. The $15 per $100 loan fee complies with a restriction that a payday loan cannot at any one time exceed an interest rate of 75 percent.

But consumer advocates say that annualized over one year, a $15 fee amounts to a more than 400 percent interest rate. Some rates are even higher. The loan becomes more onerous, they say, when it is rolled over or renewed multiple times.

State statistics show that the average consumer renews a loan two to three times.

Schlein, the Community Financial Services Association spokesman, said calculating the fees as annualized interest rates was done only to comply with national banking laws. He said referring to payday loan fees as annualized interest rates was like calling a $35 insufficient check charge a 931 percent interest loan.

Schlein contended that most people, in fact, turn to payday loans to avoid paying higher fees for late-check charges, over-the-limit credit card fees and late payment fees on their utilities. "They are very informed consumers," he said. "They know a $35 fee on a bounced check is not as desirable as a $15 fee on a payday loan."

Even so, the report states that in the past year, the Missouri Division of Finance received 350 complaints about payday loans or lenders.

The report states: "Most of these were from citizens who, after taking out the loan, saw the triple digit APR and believed the rate to be unlawful. In such cases, we explained the law and closed the file."

Other consumers had complaints about being unable to pay the interest rates, collection tactics and crediting of payments. Most complaints were resolved.

The payday loan report was sent to the General Assembly, which is considering several proposals that deal with the payday loan industry.

Nixon said he backed a bill, House Bill 164, sponsored by state Rep. John Burnett, a Kansas City Democrat.

Among other things, the bill would further restrict renewals and would limit interest and fees to 1.5 times the highest interest rate credit card companies can charge.

"Consumers who take out payday loans can easily get themselves in a hole they can never dig out of, and our lack of laws to protect consumers makes the situation worse," Nixon said.

To reach Paul Wenske, call

(816) 234-4454 or send e-mail to *pwenske@kcstar.com.*

First glance

- *The numbers of payday lenders and payday loans were up in Missouri last year.*
- *The average payday loan was $241.11, up $20 from two years ago.*

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Session of 2005

SENATE BILL No. 223

By Committee on Financial Institutions and Insurance

2-8

AN ACT concerning payday loans; relating to fees; relating to collection from deployed military personnel; amending K.S.A. 2004 Supp. 16a-2-404 and repealing the existing section.

Be it enacted by the Legislature of the State of Kansas:

Section 1. K.S.A. 2004 Supp. 16a-2-404 is hereby amended to read as follows: 16a-2-404. (1) On consumer loan transactions in which cash is advanced:

(a) With a short term,

(b) a single payment repayment is anticipated, and

(c) such cash advance is equal to or less than $500, a licensed or supervised lender may charge ~~in lieu of the loan finance charges specified in K.S.A. 16a-2-401, and amendments thereto, the following amounts:~~

~~(i) On any amount up to and including $50, a charge of $5.50 may be added;~~

~~(ii) on amounts in excess of $50, but not more than $100, a charge may be added equal to 10% of the loan proceeds plus a $5 administrative fee;~~

~~(iii) on amounts in excess of $100, but not more than $250 a charge may be added equal to 7% of the loan proceeds with a minimum of $10 plus a $5 administrative fee;~~

~~(iv) for amounts in excess of $250 and not greater than the maximum defined in this section, a charge may be added equal to 6% of the loan proceeds with a minimum of $17.50~~ *an amount equal to 15% of the amount of the cash advance* plus a $5 administrative fee.

(2) The minimum term of any loan under this section shall be ~~7~~ days and the maximum term of any loan made under this section shall be 30 days.

(3) A lender and related interest shall not have more than two loans made under this section outstanding to the same borrower at any one time and shall not make more than three loans to any one borrower within a 30 calendar day period. Each lender shall maintain a journal of loan transactions for each borrower which shall include at least the following information:

(a) Name, address and telephone number of each borrower; and

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(b) date made and due date of each loan.

(4) Each loan agreement made under this section shall contain the following notice in at least 10 point bold face type: NOTICE TO BORROWER: KANSAS LAW PROHIBITS THIS LENDER AND THEIR RELATED INTEREST FROM HAVING MORE THAN TWO LOANS OUTSTANDING TO YOU AT ANY ONE TIME. A LENDER CANNOT DIVIDE THE AMOUNT YOU WANT TO BORROW INTO MULTIPLE LOANS IN ORDER TO INCREASE THE FEES YOU PAY.

(5) The contract rate of any loan made under this section shall not be more than 3% per month of the loan proceeds after the maturity date. No insurance charges or any other charges of any nature whatsoever shall be permitted, except as stated in subsection (7), including any charges for cashing the loan proceeds if they are given in check form.

(6) Any loan made under this section shall not be repaid by proceeds of another loan made under this section by the same lender or related interest. The proceeds from any loan made under this section shall not be applied to any other loan from the same lender or related interest.

(7) On a consumer loan transaction in which cash is advanced in exchange for a personal check, one return check charge may be charged if the check is deemed insufficient as defined in paragraph (e) of subsection (1) of K.S.A. 16a-2-501, and amendments thereto. Upon receipt of the check from the consumer, the lender shall immediately stamp the back of the check with an endorsement that states: "Negotiated as part of a loan made under K.S.A. 16a-2-404. Holder takes subject to claims and defenses of maker. No criminal prosecution."

(8) In determining whether a consumer loan transaction made under the provisions of this section is unconscionable conduct under K.S.A. 16a-5-108, and amendments thereto, consideration shall be given, among other factors, to:

(a) The ability of the borrower to repay within the terms of the loan made under this section; or

(b) the original request of the borrower for amount and term of the loan are within the limitations under this section.

(9) A consumer may rescind any consumer loan transaction made under the provisions of this section without cost not later than the end of the business day immediately following the day on which the loan transaction was made. To rescind the loan transaction:

(a) A consumer shall inform the lender that the consumer wants to rescind the loan transaction;

(b) the consumer shall return the cash amount of the principal of the loan transaction to the lender; and

(c) the lender shall return any fees that have been collected in asso-

ciation with the loan.

(10) A person shall not commit or cause to be committed any of the following acts or practices in connection with a consumer loan transaction subject to the provisions of this section:

(a) Use any device or agreement that would have the effect of charging or collecting more fees, charges or interest than allowed by the provisions of this section, including but not limited to: , or which results in more fees, charges or interest being paid by the consumer,

(i) Entering into a different type of transaction with the consumer;

(ii) entering into a sales/leaseback or rebate arrangement;

(iii) catalog sales; or

(iv) entering into any other transaction with the consumer or any other person that is designed to evade the applicability of this section;

(b) use, or threaten to use the criminal process in any state to collect on the loan;

(c) sell any other product of any kind in connection with the making or collecting of the loan;

(d) include any of the following provisions in a loan document:

(i) A hold harmless clause;

(ii) a confession of judgment clause;

(iii) a provision in which the consumer agrees not to assert a claim or defense arising out of the contract.

(11) As used in this section, "related interest" shall have the same meaning as "person related to" in K.S.A. 16a-1-301, and amendments thereto.

(12) Any person who facilitates, enables or acts as a conduit or agent for any third party who enters into a consumer loan transaction with the characteristics set out in paragraphs (a) and (b) of subsection (1) shall be required to obtain a supervised loan license pursuant to K.S.A. 16a-2-301, and amendments thereto, regardless of whether the third party may be exempt from licensure provisions of the Kansas uniform consumer credit code.

(13) Notwithstanding that a person may be exempted by virtue of federal law from the interest rate, finance charge and licensure provisions of the Kansas uniform consumer credit code, all other provisions of the code shall apply to both the person and the loan transaction.

(14) This section shall be supplemental to and a part of the uniform consumer credit code.

New Sec. 2. (a) Any person who makes a loan under the provisions of K.S.A. 16a-2-404, and amendments thereto, shall:

(1) Not garnish any wages or salary paid to a military borrower for service in the armed forces.

(2) Defer all collection activity against a military borrower who has been deployed to a combat or combat support posting for the duration

of such posting.

(3) Not contact any person in the military chain of command of a military borrower in an attempt to collect such loan.

(4) Honor all terms of any repayment agreement between the person making such loan and:

(A) The military borrower; or

(B) any military counselor or third party credit counselor negotiating on behalf of the military borrower.

(5) Not make any loan to any military borrower whenever the military base commander has declared such person's place of business off limits to military personnel.

(b) For the purposes of this section, "military borrower" means any of the following that have been called to active duty:

(1) Any member of the armed forces of the United states;

(2) any member of the national guard; or

(3) any member of the armed forces reserves.

(c) This section shall be supplemental to and a part of the uniform consumer credit code.

Sec. 3. K.S.A. 2004 Supp. 16a-2-404 is hereby repealed.

Sec. 4. This act shall take effect and be in force from and after its publication in the statute book.

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KANSAS

OFFICE OF THE STATE BANK COMMISSIONER
CLARENCE W. NORRIS, Bank Commissioner

KATHLEEN SEBELIUS, GOVERNOR

January 10, 2005

The Honorable Phill Kline
Kansas Attorney General
120 SW 10th Avenue, 2nd Floor
Topeka, Kansas 66612-1597

RE: OR 44-2004

Dear Attorney General Kline:

Thank you for allowing the Office of the State Bank Commissioner to present comments concerning Opinion Request 44-2004 ("OR 44-2004"), submitted by Senator John Vratil on December 3, 2004. As you know, OR 44-2004 concerns a provision in the Kansas Consumer Credit Code, K.S.A. 16a-1-101 et seq. The Administrator of the Code is the Deputy of Consumer and Mortgage Lending in the Office of the State Bank Commissioner. See, K.S.A. 16a-1-301 (2). The Administrator has read the letter submitted by Barkley Clark of Shook, Hardy and Bacon, L.L.P., on behalf of the entities requesting clarity on K.S.A. 16a-2-404, and disagrees with the proposed position set forth by Mr. Clark concerning how the provisions adopted by the Kansas legislature in 2004 House Bill 2685 ("HB 2685") should be interpreted. It is the Administrator's opinion that all three provisions in question – K.S.A. 16a-2-404 (10), (12) and (13) - can be harmonized and given effect as written. Further, as Mr. Clark indicates, the Administrator believes that subsection (10) of K.S.A. 16a-2-404 does prohibit the proposed activity described in both Mr. Clark's and Senator John Vratil's letter to you of December 3, 2004.

Introduction/background:

As background, the Administrator, with his staff, drafted and brought HB 2685 to the Kansas legislature for consideration. The contents of the bill as proposed represented, and continue to represent, as enacted, a desire by the Administrator to protect Kansas consumers from the cycle of debt often created by the use of such high rate credit options, through regulation of interest rates, terms and conditions of all payday loans made to Kansas consumers. However, the Administrator also recognizes that there are limitations on his ability to provide such protections when the loans are made by supervised financial organizations (insured depository institutions) who export interest rates to borrowers residing in other states from the institutions' home state. The Administrator recognizes that attempts to use state law to control the interest on such loans are preempted by Federal law, which gives out of state depository institutions the ability to export the interest rate of their home state [12. U.S.C. 85 for national banks, and 12 U.S.C. 1831d for state-chartered banks, federal savings associations and credit unions.] Therefore, when drafting HB 2685, it was the Administrator's intent to recognize the preemptive effect of federal law while putting provisions in place that would control all aspects of those loan transactions made by insured depository institutions that were not preempted, and also to assert control and require licensing for persons acting on behalf of those depository institutions. The Administrator's testimony before the House Committee on Financial Institutions on February 9, 2004 indicates as much. Following is an excerpt from the Administrator's testimony, describing the "prohibited activities and business restrictions provisions" – now subsections (10), (11), (12) and (13) of the statute. He stated the provisions were designed to:

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"[r]einforce the agency's existing position that attempting to utilize an alternative marketing device or other scheme does not circumvent the requirements and regulations governing payday lending in Kansas...Finally the bill would add a provision that addresses agency relationships, "rent-a-charter" schemes, or other business structures or devices that attempt to circumvent state law."

Analysis of the statutory sections in question:

Going through each provision in reverse order, subsection (13) speaks to loans made by supervised financial organizations exempt from licensing and who can import their interest rates into Kansas. The provision is designed to put those entities on notice that all provisions of the statute not preempted by Federal law are still applicable to the loan.

Subsection (12) states that a person who "*facilitates, enables or acts as a conduit or agent*" for any third party making payday loans must obtain a supervised loan license regardless of whether the third party is exempt from the licensing requirements. This provision was not intended to constitute any authorization or endorsement of rent-a charter arrangements. The fact is, however, that such arrangements existed in other states at the time of the legislative proposal, and the Administrator wanted to ensure that the OSBC had the statutory authority to exercise control over and license the non-supervised financial organization entity in that arrangement. Mr. Clark argues that if subsection (10) of the law is read to prohibit the licensee from receiving more compensation that is authorized under Kansas law, subsection (12) is rendered surplusage. He states, "as a practical matter, a UCCC licensee will elect to arrange/service a foreign bank's payday loans rather than make loans directly to consumers only if the UCCC licensee would realize greater revenue under the former business model." However, this argument overlooks the fact that greater revenue does not necessarily need to come from charging interest in excess of the statutory limits. Greater revenue could also come from being able to generate a larger *volume* of loans due to the out of state bank having more capital available to lend. Or, use of an out of state bank's computerized lending programs could result in greater efficiencies and require lower levels of staffing by the licensee, resulting in increased revenues for the licensee. The point being, there may be any number of reasons why someone may want to enter into such a business arrangement, and subsection (12) does not propose to address the rationale behind the arrangement, just the licensing requirements that would apply to them.

Finally subsection (10) is a "prohibited practices" section. The specific portion that is at the heart of OR 44-2004 is (10) (a) (iv); "A person shall not commit or cause to be committed any of the following acts or practices in connection with a consumer loan transaction subject to the provisions of this section:
(a) Use any device or agreement that would have the effect of charging or collecting more fees, charges or interest than allowed by the provisions of this section, including but not limited to:...

(iv) entering into any other transaction with the consumer that is designed to evade the applicability of this section."

The purpose of a prohibited practices section of the law is to get at those arrangements, known or yet to be contrived, that are designed to evade state law. Because, by its very language, subsection (10) is not intended to be all inclusive ("entering into any other transaction with the consumer that is designed to evade the applicability of this section"), the language should be read broadly to prohibit the proposed activity when its sole purpose is to evade the interest rate restrictions imposed by Kansas law. Simply stated, use of a rent-a-charter/agent arrangement by a licensee in order to increase profits, where such profits are derived from the higher interest rate being charged on the loan is a device or agreement that has the effect of charging or collecting more fees, charges or interest from the consumer than allowed by the statute. It is asserted that

this provision should not be applicable to the agent because they are not the one directly charging or collecting any fees, charges or interest. However, the statute should not be read to require direct charging or collection by the licensee. The language of the statute merely requires that that the agreement *have the effect* of charging or collecting more fees, charges or interest from the consumer. Certainly, the effect on the consumer, when the transaction is accomplished through entering into a rent-a-charter arrangement to charge higher interest rates than allowed by Kansas law, is that they pay more in fees and charges. Finally, from a practical standpoint, it does not make sense that either the Administrator, or the Kansas legislature would add a provision to a body of law designed to protect consumers (the Consumer Credit Code) that results in consumers receiving less protection from excessive rates and fees.

The Office of the Comptroller of the Currency ("OCC") has advised national banks on payday lending in OCC Advisory Letter 2000-10. In that guidance, the OCC specifically addresses the use of third parties to arrange, purchase or service loans made by the bank. In such circumstances, the OCC states, "Payday lenders entering into such arrangements with national banks should not assume that the benefits of a bank charter, particularly with respect to the application of state and local law, would be available to them." (AL 2000-10, p.1, par. 4 "Purpose"). Largely as a result of guidance provided by the OCC to its national banks, as well as additional examination scrutiny, there are now no national banks that are willing to rent their charter to third parties to assist them in evading state interest rate caps. Unfortunately, the Federal Deposit Insurance Corporation's guidance and practices have not reached the level of the OCC's, and therefore, a few state banks continue to rent their charters to third parties. Such activity, ultimately, is to the detriment of consumers, and we are hopeful that in the near future, such arrangements will be a thing of the past. Until that time, however, the OSBC will exercise statutory control over the actions of third parties entering into such arrangements to prohibit them from using that arrangement to evade state law. If, in the opinion of the Attorney General, we failed to adequately address the nature of the bank/agent relationship in HB 2685, we will seek further legislative changes this session to remedy any weaknesses in the law as it is currently stated. We look forward to your opinion on this issue. If you require any additional information from the OSBC, please feel free to contact our office.

Sincerely,

Sonya Allen

Sonya Allen
General Counsel

SLA:jps

El Centro, Inc.

The Center for Continuous Family Improvement

Administration and Computer Learning Center
650 Minnesota Avenue
Kansas City, KS 66101
913-677-0100
www.ElCentroInc.com

The Academy for Children
1330 S. 30th Street
Kansas City, KS 66106
913-677-1115
913-677-7090 fax

Academy for Children, Choo Choo Child Care
219 S. Mill Street
Kansas City, KS 66101
913-371-1744
913-371-1866 fax

Academy for Children, Donnelly College
608 North 18th Street
Kansas City, KS 66102
913-281-1700

Casa de Rosina Apartments
851 Barnett
Kansas City, KS 66101

ECI Development, Inc.
2100 Metropolitan Ave.
Kansas City, KS 66106
913-677-1120
913-677-0051 fax

El Centro, Inc. Argentine
1333 S. 27th Street.
Kansas City, KS 66106
913-677-0177
913-362-8520 fax

El Centro, Inc. Family Center, Johnson County
9525 Metcalf Avenue
Overland Park, KS 66212
913-381-2861
913-381-2914 fax

Macías-Flores Family Center
290 S. 10th Street
Kansas City, KS 66102
913-281-1186
913-281-1259 fax

Woodland Hills, Inc.
1012 Forest Court
Kansas City, KS 66103
913-362-8155
913-362-8203 fax

NeighborWorks® CHARTERED MEMBER NCLR

February 16, 2005

Chairwoman Ruth Teichman and Honorable Members of the Senate Financial Institutions and Insurance Committee,

El Centro, Inc. wishes to express our opposition to SB223, which would, in part, raise the allowable fees charged for payday loans. While we certainly support the provisions of SB223 which restrict collection efforts in cases where borrowers are deployed military personnel, we feel that the fee increases, which at some loan amounts would be more than doubled, make this bill, on balance, a bad idea for Kansas consumers. Payday lending is a threat to the already-precarious financial security of low-income families and to the economic well being of many Kansas communities. Without significant protections, these loans quickly become predatory. High fees, in particular, increase the likelihood that borrowers cannot repay their loans on time and contribute to the cycle of debt in which many become trapped. We are particularly concerned by an attempt to increase these fees now, just as Kansans are beginning to exit the very difficult economic times in which they have been struggling to operate in recent years.

El Centro is not arguing that it should be impossible for these companies to operate. We simply believe that the Kansas Legislature's goals, in regards to payday lending, should be to strengthen regulations, protect consumers, and act as a check against usury practices. El Centro realizes that many payday loan customers are individuals who have difficulty accessing traditional credit, and we fully agree that companies should be allowed to protect their investments as the risk warrants. We personally have experience making small auto loans to low-income individuals as a part of our job-training program, and we realize that default rates on these loans are sometimes higher than the industry average. However, current law adequately accounts for that, allowing lenders to collect more than 10% in charges for smaller loans, plus administrative fees. Raising the fees as described in SB223 would allow payday lenders to charge fees in excess of 500% APR—many times higher than credit card companies and other underwriters of unsecured debt. While payday lenders inevitably counter that their loans are not intended to be kept for such long periods, the truth is that in many cases consumers have no choice but to take out subsequent loans, as they find themselves unable to come up with $535 in two weeks when they did not have $500 this week. Under SB223, this same consumer would now have to repay $580, instead of $535, in that same time period.

In recent years, the Kansas Legislature has responded appropriately to the payday lending industry, enacting sensible regulations that protect consumers while still allowing more than ample profit. We encourage you not to reverse this trend, for the economic health and well being of all of our families.

Sincerely,

Melinda K. Lewis

Melinda Lewis
Director of Policy Advocacy and Research
El Centro, Inc.

Attachment 11
2/16/05
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