

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 1, 2007 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
Bev Beam, Committee Secretary

Conferees appearing before the committee:

Doug Wareham, Kansas Bankers' Assn.
Matt Goddard, Heartland Community Bankers
John Fowler, First State Bank, Burlingame, for Community Bankers' Assn.

Others attending:

See attached list.

The Chair welcomed everyone and called the meeting to order.

Bill Introductions:

John Meetz, Kansas Insurance Department, said he would introduce two bills, first, a bill that would change the Commissioner's reserve evaluation method. The technical bill comes from the NAIC regarding the reserve evaluation method and the use of anticipated lapse rates. It is a very complicated issue. We will have our chief actuary testify. Second bill is a new prompt pay law for long-term care insurance. We originally tried to include long term care under the prompt pay bill we introduced previously, however, the nature of long term care will not fit into the category of accident and health insurance so we are proposing a new bill that would create prompt pay bill solely for long term care.

Senator Wysong moved introduction of the bills. Senator Wilson seconded. Motion carried.

Kerri Spielman, Kansas Association of Insurance Agents, requested two amendments to KSA 40-955. The first requires that Certificates of Insurance be filed with the Commissioner's office and approved prior to use and the Certificate would not be used to modify, alter or amend the insurance policies described and would establish violation having a fine up to \$1,000. The second amendment to the same statute would allow up to four worker's compensation loss cost multipliers per the insurers and also up to four dividend plans to be filed.

Senator Steineger moved introduction of the bill. Senator Wilson seconded. Motion passed.

The Chair opened the hearing on **SCR 1603** requesting the creation of a task force to study the design and implementation of an electronic motor vehicle financial security verification system for real time verification of compliance with the financial security requirements of the Kansas Automobile Injury Reparations Act.

John Meetz testified that in 2006 **SCR 1619** authorized the creation of an Auto Insurance Verification Task Force which was charged with finding a solution to the problem of uninsured motorists in Kansas. The Task Force met twice prior to the 2007 Legislative Session and explored a number of options.

The information gathered during the meetings was extremely valuable. Compilation of current information with new information from test programs in other states allowed the task force to present definitive solutions to the uninsured motorist problem. Members of the Task Force have agreed to urge the Kansas Legislature for a reauthorization of the Task Force with the hope that more information regarding experimental projects in other states and further exploration of the problems facing Kansas will manifest a solution to the uninsured motorist problem.

CONTINUATION SHEET

MINUTES OF THE Senate Financial Institutions and Insurance Committee at 9:30 A.M. on February 1, 2007 in Room 234-N of the Capitol.

Senator Brungardt moved continuation of the Task Force. Senator Barone seconded. Motion passed. Senator Wysong moved to amend Senator Brungardt's motion with a substitute motion to put SCR 1603 on the consent calendar. Senator Steineger seconded. Motion carried.

Hearing on:

SB 137 - would enact new law to prohibit banks from establishing a branch bank on the premises or property where an affiliate of the bank is engaged in commercial activity.

Melissa Calderwood gave the following overview: She said the bill is requested by the Kansas Bankers' Association and will have no fiscal affect on the operations of the banking department. The issues that have been raised are that industrial loan companies or industrial banks are FDIC supervised financial institutions. They can be owned by commercial firms that are not regulated by a federal banking agency. There was a moratorium put in place six months ago that was extended January 31 for another year by the FDIC Board of Directors and specifically for those institutions that have deposit insurance.

Doug Wareham, on behalf of Kansas Bankers Association, testified that Kansas Bankers Association membership includes 352 Kansas banks, which operate more than 1,300 banking facilities in 440 towns and cities across the state. Kansas banks currently employ nearly 15,000 Kansans. Concerns over the potential negative impact of commercial firms forming a Utah state-chartered industrial bank reached a boiling point recently with Wal-Mart, Inc. and Home Depot, Inc. Both filing applications for an industrial loan company charter in Utah and simultaneously applying for Federal Deposit Insurance Corporation Insurance.

Adoption of **SB 137** prohibits banks from establishing or maintaining a branch in Kansas on the premises or property of an affiliate if the affiliate engages in commercial activities and will require branches of all banks, regardless of charter, to compete stand-alone-branch to stand-alone branch. This proposal is in the best interests of consumers, small business, and the banking industry. Adoption of this bill sends a clear message to Congress that maintaining a clear dividing line between banking and commerce is the standard in Kansas. (Attachment 1)

Matt Goddard, Heartland Community Bankers Association testified that Community financial institutions have a number of concerns with ILC expansion, primarily as it relates to commercial ownership. The primary objection for HCBA is the mixing of banking and commerce. While there are those who object to the mixing of banking and commerce on safety and soundness grounds, the main objection is the exploitation of the ILC loophole in the federal Gramm-Leach-Bliley Act. Prior to the passage of this Act in 1999, a commercial firm was allowed to own a savings and loan through a unitary thrift holding company. This Act was supposed to have finally put the issue of mixing banking and commerce to rest; however, commercial firms who wanted to get into banking merely shifted their sights from the unitary thrift holding company to the industrial loan company charter. They are now exploiting the banking and commerce loophole that exists because Congress did not foresee the ILC issue when it was crafting the 1999 legislation. **SB 137** would preserve the original intent of Gramm-Leach-Bliley in Kansas. (Attachment 2)

John Fowler, Community Bankers Association of Kansas, testified that one of the fundamental ideals of our country is the separation of banking and commerce. This separation has been the strength of our economy for decades during the prosperous history of the United States. The federal safety and soundness provisions of banking law are deeply rooted in the belief that combining banking and commerce has the potential for conflicts of interest and dangerous operational relationships. Community Bankers Association of Kansas is cognizant of the detrimental concentration of power that could occur by mixing banking and commerce as proposed by the Wal-Mart application. This fosters an environment of unprecedented risk for conflict of interest with little or no oversight authority in place by either the FDIC or state banking regulators **SB 137** will protect community banks in Kansas and send a message to Wal-Mart and the federal government. Kansas citizens do not want Wal-Mart banks. (Attachment 3)

The Chair closed the hearing on **SB 137**.

The meeting adjourned at 10:30 a.m.



Date: February 1, 2007
To: Senate Financial Institutions & Insurance Committee
From: Doug Wareham, Senior Vice President-Government Relations
Re: Senate Bill 137

Madam Chairman and members of the Committee, I am Doug Wareham appearing on behalf of the Kansas Bankers Association (KBA). KBA's membership includes 352 Kansas banks, which operate more than 1,300 banking facilities in 440 towns and cities across the state. Kansas banks currently employ nearly 15,000 Kansans. KBA appreciates the opportunity to appear in support of Senate Bill 137.

Adoption of S.B. 137 will help ensure the prohibition on the mixing of banking and commerce remains in place in the State of Kansas. This bill prohibits banks from establishing or maintaining a branch in Kansas on the premises or property of an affiliate if the affiliate engages in commercial activities.

BANKING AND COMMERCE SHOULD NOT MIX

Federal policy separating banking and commercial activity was first codified in provisions of the National Banking Act of 1933. That dividing line, which has been revisited on numerous occasions by Congress over the past three-quarters of a century, has stood the test of time and traditional banks are still prohibited from engaging in non-financial commercial activities. Unfortunately, the wall separating banking and commerce is now being threatened by relaxed standards in the State of Utah, which allows commercial entities to form Industrial Loan Companies (ILC) or the more common term used today - Industrial Banks.

While the ability for commercial firms to engage in limited financial activities has existed since the early 1900's, the growth of the Industrial Bank sector has been dramatic during the past 20 years with Industrial Bank assets growing from just \$3.8 billion in 1987 to over \$140 billion in 2004. Concerns over the potential negative impact of commercial firms forming a Utah state-chartered industrial bank reached a boiling point recently with Wal-Mart, Inc. and Home Depot, Inc. both filing applications for an industrial loan company (ILC) charter in Utah and simultaneously applying for Federal Deposit Insurance Corporation (FDIC) insurance.

COMPETITIVE UNFAIRNESS/ CONFLICT OF INTEREST

A firm such as Wal-Mart, the world's largest commercial entity, could easily use its size to establish a pricing structure for financial services that drives competing banks out of business, only to raise prices to a profitable level once competing banks have been forced to close. Imagine the scenario where other local small businesses, competitors of Wal-Mart, are forced to seek financing outside of their

local community because the local Wal-Mart lender is the only game in town. Furthermore, the prohibition on the mixing of banking and commerce is in place for a good reason: to prevent conflicts of interest. Allowing large commercial enterprises to operate banking operations within their retail businesses creates a conflict of interest for the commercially owned bank and establishes an environment ripe for collusion between the bank and the retailer. Simply put, the use of financial services should not be used by retailers to entice their customers to purchase products.

SAFETY AND SOUNDNESS CONCERNS

It is also important to note that ILCs are not subject to the same regulatory environment as banks. A recent Government Accountability Office report noted that the FDIC, which would serve as a regulator for Wal-Mart and Home Depot, if their applications are approved, does not have the same powers to oversee an ILC's holding company operations as does the Federal Reserve who regulates bank holding companies. For example, the Federal Reserve establishes consolidated capital requirements to ensure that owners are a source of financial strength for a subsidiary bank. Corporate parents of industrial loan companies are not subject to these capital requirements.

STATES RIGHTS

I believe it is important to note Congress has been grappling with the commercially-owned bank issue since 2004, and is presently considering federal legislation that would prohibit commercial companies from acquiring insured depositories, including industrial banks. Congress will ultimately need to address the fact that commercial firms are utilizing the industrial loan company charter to avoid the long-standing separation of banking and commerce. While Congress continues to debate this issue, I believe it is important to note that Congress, through the Riegle, Neal Interstate Banking & Branching Efficiency Act of 1994 granted states the authority to determine how banks branch into individual states. Several states have already adopted legislation either prohibiting the ability of banks to branch into an affiliated retail business or they have adopted outright prohibitions of ILC branches from entering their state. Some of those states that have already adopted restrictions include Missouri, Oklahoma, Maryland, Iowa, Michigan, and Pennsylvania. Several others states, including Nebraska, Colorado, North Dakota, Texas, Maine, Virginia, and Massachusetts are presently considering legislation to maintain a dividing line between commerce and banking.

CONCLUSION

In conclusion, the adoption of S.B. 137 will establish parameters in Kansas that will prohibit the mixing of banking and commerce on the commercial premises of an affiliate and require branches of all banks, regardless of charter, to compete stand-alone-branch to stand-alone branch. We believe this proposal is in the best interests of consumers, small-business, and the banking industry. We also believe adoption of this bill sends a clear message to Congress that maintaining a clear dividing line between banking and commerce is the standard in Kansas.

Thank you for the opportunity to appear in support of S.B. 137. We encourage this committee to act favorably on this bill and I would be happy to stand for questions.

February 1, 2007

Senate Financial Institutions and Insurance Committee

Senate Bill 137

Dear Chairman Teichman,

Today I appear before you on behalf of the member bankers of the Community Bankers Association of Kansas. I am honored to present concerns to you regarding Senate Bill 137, an attempt to hold back a further intrusion of Wal-Mart into our communities.

A great deal of Kansas is rural. We depend on each other to work for the common good and maintain our strong sense of community no matter what the circumstances. Community banks are distraught with the destabilizing effect that Wal-Mart has already imposed on our communities – driving local shops out of business with their predatory business practices and placing a strain on the tax base. Now Wal-Mart proposes to take this demise of communities to the next level by mixing banking and commerce by virtue of their efforts to obtain federal deposit insurance.

One of the fundamental ideals of our country is the separation of banking and commerce. We believe that this separation has been the strength of our economy for decades during the prosperous history of the United States. The federal safety and soundness provisions of banking law are deeply rooted in the belief that combining banking and commerce has the potential for conflicts of interest and dangerous operational relationships. The unintended consequence of allowing such a ‘mega’ retailer to operate an in-house banking operation is unthinkable. It is crucial to our economic well-being to identify for the public the co-mingling of Wal-Mart, the retailer, and Wal-Mart Industrial Loan Company (ILC), the industrial bank, posing the inevitable detrimental effects of risk exposure to the federal safety net of deposit insurance.

Wal-Mart’s track record is one of disingenuous dialogue followed by actions that are not consistent with such claims. Wal-Mart has applied to Utah for an ILC charter and the FDIC, for federal deposit insurance. Wal-Mart proposes to use an ILC designation to process debit and credit card transactions made in its retail stores. However, Wal-Mart’s track record shows attempts on three separate occasions to enter the banking business. Each time Wal-Mart was prevented by Congress, by regulators or by a state legislature. In addition, Wal-Mart executives have publicly stated that they have identified financial services as the company’s next major growth area. Even though Wal-Mart’s filed business plan for an ILC suggests limited activity, it would be possible for them to amend the business plan and expand Wal-Mart ILC activity with branch banks outside of Utah into more than 20 states which currently have reciprocal agreements with Utah. We do not believe they have the best interests of communities at the heart of these business endeavors.

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Attachment 3

About twenty years ago when Congress authorized Industrial Loan Companies (ILCs) an exemption in regulatory supervision, ILCs were mostly small locally owned institutions that had only limited deposit-taking and lending power. That climate has since changed significantly presenting the potential for this exemption to undermine the Congressional intent of policies for the banking system. The total assets held by ILCs have grown by more than 3,500 percent between 1987 and now. In the words of the former Chairman of the Federal Reserve, Alan Greenspan, "The character, power and ownership of ILCs have changed materially since Congress first enacted the ILC exemption." It is now time to admit that ILCs have outgrown their original minimal regulatory oversight envisioned in legislative intent.

The Community Bankers Association of Kansas thanks you for hearing SB 137 today and for the opportunity to voice these concerns. We are cognizant of the detrimental concentration of power that could occur by mixing banking and commerce as proposed by the Wal-Mart application. This fosters an environment of unprecedented risk for conflict of interest with little or no oversight authority in place by either the FDIC or state banking regulators. Likewise, large commercial banks may then seek to acquire retail companies, thus creating a similar systemic risk to the federal deposit insurance fund. Our focus remains on safety and solvency. Senate Bill 137, like legislation in other states, will protect community banks in Kansas and send a message to Wal-Mart and the federal government: Kansas citizens do not want Wal-Mart banks.

Thank you for the opportunity to appear before you and I offer CBA members as a resource for any questions you may have regarding SB 137.

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