

SESSION OF 2020

**SUPPLEMENTAL NOTE ON SENATE SUBSTITUTE FOR
HOUSE BILL NO. 2619**

As Recommended by Senate Committee on
Financial Institutions and Insurance

Brief*

Senate Sub. for HB 2619 would enact law to establish the Kansas Economic Recovery Loan Deposit Program (Program); would amend law governing linked deposit programs and related investment procedures; would amend field-of-membership requirements placed on state-chartered credit unions to increase the permissible geographic area for a credit union's field of membership; and would permit national banking associations, state banks, trust companies, and savings and loan associations, for all taxable years commencing after December 31, 2021, to deduct from net income the net interest income received from qualified agricultural real estate loans and the net interest income received from single family residence loans to the extent such interest is included in the Kansas taxable income of a corporation.

The bill would also make technical changes.

Kansas Economic Recovery Loan Deposit Program (New Sections 1-7; Section 9)

Program Citation; Definitions (New Sections 1-2)

The bill would designate sections 1 through 7 of the bill as the Kansas Economic Recovery Loan Deposit Program

*Supplemental notes are prepared by the Legislative Research Department and do not express legislative intent. The supplemental note and fiscal note for this bill may be accessed on the Internet at <http://www.kslegislature.org>

and would further provide the Program shall be part of and supplemental to Article 42, Chapter 75 of the *Kansas Statutes Annotated*.

Definitions (New Section 2)

The bill would define terms including the following:

- “Economic recovery loan deposit” would mean an investment account placed by the Director of Investments under the provisions of Article 42, Chapter 75 of the *Kansas Statutes Annotated* with an eligible lending institution for the purpose of carrying out the intent of the Program;
- “Economic recovery loan deposit loan” or “loan” would mean a loan made by an eligible lending institution to an eligible borrower from the eligible lending institution’s economic recovery loan deposit as part of the Program;
- “Economic recovery loan deposit program” or “program” would mean a state-administered program in which eligible lenders are charged less than the market rate of interest and eligible borrowers receive a reduction in interest charged on a loan in the amount of the deposit;
- “Eligible borrower” would mean any individual or entity operating a business primarily for commercial or agricultural purposes and is not an individual obtaining a loan primarily for personal, family, or household purposes; and
- “Eligible lending institution” would mean a financial institution that is:
 - A bank, as defined in KSA 75-4201, that agrees to participate in the Program and is eligible to be a depository of state funds;

- A credit union, as defined in the State Credit Union Code, that agrees to participate in the Program and provides securities acceptable to the Pooled Money Investment Board (PMIB) pursuant to Article 42, Chapter 75 of the *Kansas Statutes Annotated*; or
- An institution of the Farm Credit System organized under the Federal Farm Credit Act of 1971, as amended, that agrees to participate in the Program and provides securities acceptable to the PMIB pursuant to Article 42, Chapter 75.

The bill would also define the terms “director of investments” and “economic recovery loan deposit loan package.”

Program Administration and Purpose (New Section 3)

The bill would authorize the State Treasurer to administer the Program and states the Program shall be for the purpose of providing incentives for the making of business loans. The bill would further specify the total aggregate amount of loans made under the Program must not exceed \$60.0 million of unencumbered funds pursuant to Article 42 of Chapter 75.

Rules and Regulations

The bill would require the State Treasurer to adopt all rules and regulations necessary to enact and administer the provisions of the Program. Such rules and regulations must be adopted no later than February 1, 2021.

Annual Report

The bill would also require the State Treasurer to submit an annual report to the Legislature and the Governor

identifying the eligible lending institutions participating in the Program and the eligible borrowers who have received an economic recovery loan deposit loan. The bill also would require the annual report to provide the aggregate amount of moneys loaned and the amount of moneys still available for loan, if any; the report would be due on or before January 1, 2022, and each January 1 thereafter.

Program Loan Package Requirements and Loan Information (New Section 4)

The bill would authorize the State Treasurer to disseminate information and to provide economic recovery loan deposit loan packages (loan packages) to the eligible lending institutions.

Eligible Borrowers, Applications, Loan Limitations

The bill would provide the following requirements and other criteria for participation in the Program:

- The loan package must be completed by the eligible borrower before being forwarded to the lending institution for consideration;
- An eligible lending institution that agrees to receive an economic recovery loan deposit must accept and review applications for loans from eligible borrowers;
- The lending institution must apply all usual lending standards to determine the credit worthiness of eligible borrowers;
- No single economic recovery loan deposit loan can exceed \$250,000;

- Only one economic recovery loan deposit loan can be made and be outstanding at any one time to any eligible borrower; and
- No loan may be amortized for a period of more than ten years.

Certification and Loan Approval

The bill would require an eligible borrower to certify on the loan application that the reduced rate loan will be used exclusively for the expenses involved in operating the borrower's business. The eligible lending institution would be permitted to approve or reject a loan package based on the institution's evaluation of the eligible borrowers included in the package, the amount of the individual loan in the package, and other appropriate considerations. The eligible lending institution would be required to forward to the State Treasurer an approved loan package in the prescribed form and manner. The bill would require the package to include a certification by the applicant that such applicant is an eligible borrower.

Evaluation of the Economic Recovery Loan Deposit Loan Package; Interest and Market Rates; Loan Agreement (New Section 5)

The bill would permit the State Treasurer to either accept or reject the loan package based on the State Treasurer's evaluation of whether the loan meets the Program requirements. The bill would further provide, if sufficient funds are not available for a loan deposit, then the applications may be considered in the order received when funds are once again available, subject to a review by the lending institution.

Upon acceptance of a loan package, the State Treasurer would be required to certify to the Director of Investments (Director) the required amount for the package and the

Director would be required to place an economic recovery loan deposit in the amount certified with the eligible lending institution at an interest rate that is 2.0 percent below the market rate provided in KSA 75-4237 (a floating rate). The bill would require such rate to be recalculated on the first business day of January each year using the market rate then in effect. The bill would further specify the minimum interest rate (or floor) would be 0.25 percent if the market rate is below 2.25 percent. When necessary, the bill would permit the State Treasurer to request the Director place an economic recovery loan deposit with the eligible lending institution prior to acceptance of a loan package.

An eligible lending institution would be required to enter into an economic recovery loan deposit agreement with the State Treasurer. Such agreement would include requirements necessary to implement the purposes of the Program. The bill would specify requirements must include an agreement by the eligible lending institution to lend an amount equal to the loan deposit to eligible borrowers at an interest rate that is not more than 3.0 percent greater than the interest rate made available to the lending institution (interest rate spread is effectively capped at 3.0 percent). The borrower's rate must be recalculated on an annual basis. The bill would provide the loan agreement would also include provisions for the loan deposit to be placed for an annually renewable one-year maturity up to a period of ten years. The bill also would require the agreement to include provisions for the reduction of the loan deposit in an amount equal to any payment of loan principal by the eligible borrower.

Funding of the Loan by the Lending Institution (New Section 6)

The bill would require, upon placement of a loan deposit with an eligible lending institution, the institution to fund the loan to each approved eligible borrower listed in the loan package in accordance with the agreement between the institution and the State Treasurer. The bill would require the

loan to be at the rate established in the agreement and established pursuant to requirements of this bill.

Liability for Default or Delay in Payments (New Section 7)

The bill would also state the State and the State Treasurer shall not be liable to any eligible lending institution in any manner for payment of the principal or interest on any economic recovery loan deposit loan to an eligible borrower. The bill would also state any delay in payments or default on the part of the eligible borrower does not in any manner affect the economic recovery loan deposit agreement between the eligible lending institution and the State Treasurer.

Amendments to Linked Deposit Loan Program Law (Section 9)

The bill would amend law governing the investment of state moneys, which also includes previously authorized linked deposit programs, to add those loan deposits made under the Program and applicable interest rates established by the bill.

Field of Membership—Credit Unions (Section 8)

The bill would amend one of three criteria (occupation, association, and geographic) associated with defining field of membership for state-chartered credit unions in the State Credit Union Code (Code). Continuing law requires credit union members to be linked by one of three fields of membership.

Under current law, a geographic area is permitted to include a single political jurisdiction or multiple contiguous political jurisdictions, until the aggregate total of the population of the geographic area reaches 500,000. The law further provides, however, if the headquarters of the credit union is located within a metropolitan statistical area (MSA) of

more than one county, a different maximum population limit would apply. That limit is determined by a formula:

- Multiply the population of the most populous MSA within Kansas (*i.e.*, the population of the Kansas City MSA counties within Kansas) by the fraction having 1.0 million as the numerator and 750,000 as the denominator. [*Note:* Current population numbers are those of the adjusted federal census information presented to the Legislature by the Secretary of State.]

The bill would modify the above criteria to:

- Permit a single political jurisdiction (continuing law);
- Increase the permitted maximum for multiple contiguous political jurisdictions for an aggregate of the total population from 500,000 to 2.5 million, as determined by official state population figures, or any portion thereof, which are identical to the decennial census data from the enumeration conducted by the U.S. Census Bureau (language attributable to the Census data is located in the definition of “population data” in the current field of membership requirements); and
- Remove language that separately applied to credit unions with headquarters located within an MSA of more than one county (allowed for a different maximum population limit).

The bill would also modify a requirement that provides, from and after July 1, 2008, no geographic area shall consist of any congressional district or the entire state of Kansas to instead state no geographic area shall consist of the entire state of Kansas.

The bill would remove definitions within the Code for “MSA,” “population data,” and “overt act.” Some of the requirements within the definitions had been specific to operations of credit unions, including branch locations, construction of new buildings, and membership of occupation or association groups on or before either February 1, 2008, or June 30, 2008.

***Kansas Financial Institutions Privilege Tax—Definitions
(Section 10)***

The bill would permit a deduction from net income for financial institutions subject to the Kansas Financial Institutions Privilege Tax (privilege tax). It would create definitions for the terms “interest,” “qualified agricultural real estate,” and “single family residence” and would also create a calculation methodology for “net interest income received from qualified agricultural real estate loans” and for “net interest income from single family residence loans” as follows:

- “Interest” would mean interest on indebtedness attributed to Kansas and incurred in the ordinary course of the active conduct of any business and interest on indebtedness incurred that is secured by a single family residence;
- “Qualified agricultural real estate” would mean real property which is substantially used for the production of one or more agricultural products;
- “Net interest income received from qualified agricultural real estate loans attributed to Kansas” would mean the product of the ratio of the interest income earned on qualified agricultural real estate loans over total interest income earned, in relation to the net income of the national banking association, state bank, trust company, or savings

and loan association without regard to this deduction;

- “Net interest income received from single family residence loans attributed to Kansas” would mean the product of the ratio of the interest income earned on single family residence loans over total interest income earned, in relation to the net income of the national banking association, state bank, trust company, or savings and loan association without regard to this deduction; and
- “Single family residence” would mean a residence that is:
 - The principal residence of its occupant;
 - Located in Kansas, in a rural area as defined by the U.S. Department of Agriculture that is not within a MSA and has a population of 2,500 or less as determined by the most recent census for which data is available; and
 - Purchased or improved with the proceeds of the loan.

Background

HB 2619, as it passed the House, would have changed the frequency of the actuarial experience and cost study that is performed by the Board of Trustees of the Kansas Public Employees Retirement System from once every three years to once every four years. The Senate Committee on Financial Institutions and Insurance (Senate Committee) recommended a substitute bill that incorporates the provisions of Senate Sub. for HB 2054 (field of membership and privilege tax) and adds new language pertaining to a linked deposit program for economic recovery. Prior to the creation of Senate Sub. for HB 2619, the Senate Committee modified the privilege tax provisions to:

- Change the applicable tax year from the year commencing after December 31, 2019, to the year commencing after December 31, 2021;
- Modify one of the two permitted deductions from net interest income from business loans to net interest from agricultural real estate loans; and
- Update definitions and modify the related calculation methodology to conform with changes to one of the permitted deductions.

During the May 15, 2020, Senate Committee meeting at which the substitute bill was recommended, the Committee received testimony supporting an economic recovery initiative (revisor proposed bill draft 20rs3403). Proponents of the initiative appearing before the Committee included representatives of the Kansas Bankers Association (KBA); the Office of the State Treasurer; Heartland Credit Union Association (HCUA); the Kansas Chamber; the Kansas Grain and Feed Association, the Kansas Agribusiness Retailers Association, and Renew Kansas Biofuels Association; the Kansas Restaurant and Hospitality Association; the National Federation of Independent Business; and United Bank & Trust. Written-only proponent testimony was submitted by the Kansas Livestock Association. Conferees generally addressed the economic impacts created by the COVID-19 pandemic and supported providing low-cost credit for small businesses affected by the pandemic. Testimony from the Office of the State Treasurer also outlined prior law and program requirements established for another linked deposit program, the Kansas Agricultural Production Loan Deposit Program, which began operating in 2000.

Senate Sub. for HB 2054 (Field of Membership; Privilege Tax)

HB 2054, as it passed the House, would have amended several health insurance provisions in the Insurance Code

related to the regulation of association health plans and small employer plans. The bill also would have designated certain statutes as the Small Employer Health Insurance Availability Act. Its contents were included in the Conference Committee Report for HB 2209 (2019 law). The Senate Committee recommended a substitute bill, which incorporates the provisions of Sub. for SB 238. Prior to inserting the provisions into Senate Sub. for HB 2054, the Senate Committee amended the provisions pertaining to the privilege tax to modify the definition of “business” by removing loans made for commercial purposes. [Note: Senate Sub. for HB 2054 does not retain health insurance provisions.]

*Sub. for SB 238 (Field of Membership for Credit Unions;
Privilege Tax)*

Privilege tax legislation introduced in 2019 (SB 238 and SB 239) was one of several topics assigned to the interim Special Committee on Financial Institutions and Insurance. The Special Committee held a combined hearing on the two bills and received testimony from the interested parties. This committee made no recommendation on SB 238, which also would have created a similar deduction to that in SB 259, as introduced, and did not recommend SB 239, which would have imposed a privilege tax on certain credit unions.

The Senate Committee recommended a substitute bill, which removes the contents of SB 238 as introduced by the Senate Committee on Assessment and Taxation (privilege tax) and inserts provisions of SB 259 (financial institutions, privilege tax and field of membership), as amended by the Senate Committee, with technical amendments suggested by the Office of Revisor of Statutes.

*SB 259 – Financial Institutions, Privilege Tax and Field of
Membership Requirements*

SB 259 was introduced by the Senate Committee at the request of the KBA.

In the Senate Committee hearing on January 21-22, 2020, proponents included representatives of the KBA and Community Bankers Association; officials from Farmers & Drovers Bank, First Bank Kansas, Heartland Tri-State Bank, and Kaw Valley Bank; and the owner of a ranch partnership. Written-only proponent testimony was provided by officials with Alden State Bank, City State Bank, Community State Bank, Denison State Bank, Fidelity State Bank & Trust, First National Bank & Trust, First State Bank, Stanley Bank, The Bank, TriCentury Bank, and Vision Bank. Proponents generally commented on the issue of fairness for banks, especially as it applies to the current privilege tax, with the KBA representative stating the bill would help “level the playing field” between lenders. Several conferees indicated the bill would help revitalize rural communities, benefit borrowers with lower rates, and sustain local access to credit.

Opponents appearing before the Senate Committee included representatives of the HCUA; officials from Envista Credit Union, Farmway Credit Union, Frontier Community Credit Union, Mainstreet Credit Union, McPherson Co-Op Credit Union, and Skyward Credit Union; and the Kansas Cooperative Council. Written-only opponent testimony was provided by officials with Azura Credit Union, Catholic Family Credit Union, and Credit Union of America. Opponents generally commented on the credit unions as non-profit cooperatives with a different corporate structure, with the HCUA representative stating taxation of financial institutions is determined by the corporate structure the financial institution chooses. Conferees also highlighted structural rules and differences between credit unions and other financial institutions or lenders, including a federal cap on certain business lending, field-of-membership laws, and a state prohibition on the deposit of public funds.

The Senate Committee amended the bill to limit business and residential loans subject to the permissible deduction from the privilege tax created by the bill to those in Kansas and add provisions that would modify field-of-membership requirements placed on credit unions.

Fiscal Information – Senate Sub. for HB 2619

Following Senate Committee action on May 15, 2020, its Chairperson requested a fiscal note. The fiscal note, published on May 19, 2020, addresses components of the bill and associated estimates.

Privilege Tax – Interest Income Deduction

The Department of Revenue (Department) estimates the substitute bill would decrease State General Fund (SGF) revenues by \$2.0 million in FY 2022, \$3.9 million in FY 2023, and \$3.9 million in FY 2024. The Department indicates that, to formulate these estimates, the Department reviewed data on state-chartered banks from the KBA. These data indicate there are 223 state-chartered banks in Kansas and 16.4 percent of total interest income for banks is attributed to interest income from agricultural loans (*i.e.*, farmland/real estate loans and agricultural real estate loans). Data provided also indicate 53.4 percent of total agricultural loans is attributed to real estate loans.

Under current law, the State is estimated to receive approximately \$44.0 million in financial institutions privilege taxes in FY 2022. Applying these ratios, the bill would reduce this estimate by approximately \$3.9 million each year. The financial institutions privilege tax estimate for FY 2022 indicates the first half of tax year 2022 tax liability. For FY 2023, the estimate includes the last half of tax year 2022 tax liability and the first half of tax year 2023 tax liability. Any fiscal effect regarding interest income from single family residence loans in rural areas is not accounted for in the fiscal effect of this bill because the Department does not have data on this specific income source.

The Department further indicates the bill would require \$48,078 from the SGF in FY 2022 to implement the bill and to modify the automated tax system. The required programming would be performed by existing Department staff.

Linked Deposit Program

The State Treasurer would be required to administer the new Program using the same processes and procedures in place for the current Agricultural Production Loan Deposit Program. The security of idle fund balances deposited at eligible lending institutions would be maintained by requiring that the lending institution underwrite the business loans and requiring the state deposits are collateralized to offset any default risk. The fiscal note indicates State Treasurer costs to create forms and instructions, update the agency's internal software program, and process paperwork would be negligible and could be absorbed within existing resources and staff levels.

The bill would require the PMIB, at the direction of the State Treasurer, to make deposits of up to \$60.0 million of idle funds at eligible financial institutions to fund the Program. The PMIB, the fiscal note states, is authorized to make investments in U.S. Treasury and federal agency securities, highly rated commercial paper and corporate bonds, and repurchase agreements and certificates of deposit at Kansas banks. Declining balances have required the PMIB to maintain a highly liquid portfolio, which reduces the amount of return available to the pool. The fiscal note indicates the PMIB maintains a significant portion of its investments in overnight repurchasing agreements and rates that it could earn in that market fell to near zero after the recent actions from the Federal Reserve. Recalculating the rate on the State's deposits one time each year has the potential to lock in a lower or higher interest rate that can be earned in the market; however, the note continues, without knowing the timing of future interest rate changes, it is not possible to estimate the bill's impact on interest earnings to other investments the PMIB might make.

The PMIB and the State Treasurer indicate sufficient idle fund cash balances exist to fully fund this new program. The PMIB indicates that the costs to administer the deposit of idle funds at eligible lending institutions would be negligible and

could be absorbed within existing resources and staff levels. The Office of the State Bank Commissioner and the Department of Credit Unions both state enactment of the bill would not have a fiscal effect on agency operating expenditures.

Any fiscal effect associated with Senate Sub. for HB 2619 is not reflected in *The FY 2021 Governor's Budget Report*.